

MUNICIPAL HIGH INCOME FUND INC
Form N-CSRS
July 07, 2006

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM N-CSR

CERTIFIED SHAREHOLDER REPORT OF REGISTERED MANAGEMENT INVESTMENT COMPANIES

Investment Company Act file number 811-5497

Municipal High Income Fund Inc.

(Exact name of registrant as specified in charter)

125 Broad Street, New York, NY 10004
(Address of principal executive offices) (Zip code)

Robert I. Frenkel, Esq.
Legg Mason & Co., LLC
300 First Stamford Place, 4th Fl.
Stamford, CT 06902
(Name and address of agent for service)

Registrant's telephone number, including area code: **(800) 451-2010**

Date of fiscal year end: **October 31**

Date of reporting period: **April 30, 2006**

ITEM 1. REPORT TO STOCKHOLDERS.

The **Semi-Annual** Report to Stockholders is filed herewith.

Municipal High Income
Fund Inc.

**SEMI-ANNUAL
REPORT**

April 30, 2006

INVESTMENT PRODUCTS: NOT FDIC INSURED NO BANK GUARANTEE MAY LOSE VALUE

Municipal High Income Fund Inc.

Semi-Annual Report April 30, 2006

What's Inside

Letter from the Chairman	I
Fund at a Glance	2
Schedule of Investments	3
Statement of Assets and Liabilities	14
Statement of Operations	15
Statements of Changes in Net Assets	16
Financial Highlights	17
Notes to Financial Statements	18
Financial Data	23
Additional Shareholder Information	24
Dividend Reinvestment Plan	25

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Letter from the Chairman

Dear Shareholder,

The U.S. economy was mixed during the six-month reporting period. After a 4.1% advance in the third quarter of 2005, fourth quarter gross domestic product (GDP) growth slipped to 1.7%. This marked the first quarter in which GDP growth did not surpass 3.0% since the first three months of 2003. However, as expected, the economy rebounded sharply in the first quarter of 2006, with GDP rising an estimated 5.3%. The economic turnaround was prompted by both strong consumer and business spending. In addition, the U.S. Labor Department reported that unemployment hit a five-year low in March.

R. JAY GERKEN, CFA
Chairman, President and
Chief Executive Officer

The Federal Reserve Board (Fed) continued to raise interest rates during the reporting period. Despite the changing of the guard from Fed Chairman Alan Greenspan to Ben Bernanke in early 2006, it was business as usual for the Fed, as it raised short-term interest rates four times during the reporting period. Since it began its tightening campaign in June 2004, the Fed has increased rates 15 consecutive times, bringing the federal funds rateⁱⁱⁱ from 1.00% to 4.75%. The Fed then raised rates to 5.00% on May 10th, after the end of the reporting period. Coinciding with this latest move, the Fed said that the extent and timing of further rate hikes would depend on future economic data.

Both short- and long term yields rose over the reporting period. During the six months ended April 30, 2006, two-year Treasury yields increased from 4.42% to 4.87%. Over the same period, 10-year Treasury yields moved from 4.58% to 5.07%. During part of the reporting period, the yield curve was inverted, with the yield on two-year Treasuries surpassing that of 10-year Treasuries. An inverted yield curve has historically foreshadowed an economic slowdown or recession. However, some experts, including new Chairman

Municipal High Income Fund Inc. I

Bernanke, believe the inverted yield curve was largely a function of strong foreign demand for longer-term bonds. Looking at the municipal market, yields of both short- and longer-term securities also rose over the reporting period. However, unlike the Treasury yield curve, the municipal bond curve retained a positive slope.

Performance Review

For the six months ended April 30, 2006, the Municipal High Income Fund Inc. returned 4.26%, based on its net asset value (NAV^v) and 6.31% based on its New York Stock Exchange (NYSE) market price per share. In comparison, the Fund's unmanaged benchmark, the Lehman Brothers Municipal Bond Index returned 1.56% for the same time frame. The Lipper High Yield Municipal Debt Closed-End Funds Category Average^{vi} increased 4.19%. Please note that Lipper performance returns are based on each fund's NAV per share.

Certain investors may be subject to the Federal Alternative Minimum Tax, and state and local taxes may apply. Capital gains, if any, are fully taxable. Please consult your personal tax or legal adviser.

During this six-month period, the Fund made distributions to shareholders totaling \$0.204 per share, (which may have included a return of capital). The performance table shows the Fund's six-month total return based on its NAV and market price as of April 30, 2006. **Past performance is no guarantee of future results.**

Performance Snapshot as of April 30, 2006 (unaudited)

Price Per Share	Six-Month Total Return
\$8.06 (NAV)	4.26%
\$7.34 (Market Price)	6.31%

All figures represent past performance and are not a guarantee of future results.

Total returns are based on changes in NAV or market price, respectively. Total returns assume the reinvestment of all distributions, including returns of capital, if any, in additional shares.

II Municipal High Income Fund Inc.

Special Shareholder Notices

On December 1, 2005, Citigroup Inc. (Citigroup) completed the sale of substantially all of its asset management business to Legg Mason, Inc. (Legg Mason). As a result, the Fund's investment manager (the Manager), previously an indirect wholly-owned subsidiary of Citigroup, has become a wholly-owned subsidiary of Legg Mason. Completion of the sale caused the Fund's then existing investment management contract to terminate. The Fund's shareholders previously approved a new investment management contract between the Fund and the Manager, which became effective on December 1, 2005.

Effective January 1, 2006, the Fund's Board of Directors has approved the appointment of Joseph P. Deane and David T. Fare as co-portfolio managers of the Fund. Messrs. Deane and Fare have been elected Vice Presidents and Investment Officers of the Fund.

Information About Your Fund

As you may be aware, several issues in the mutual fund industry have come under the scrutiny of federal and state regulators. The Manager and some of its affiliates have received requests for information from various government regulators regarding market timing, late trading, fees, and other mutual fund issues in connection with various investigations. The regulators appear to be examining, among other things, the open-ended funds response to market timing and shareholder exchange activity, including compliance with prospectus disclosure related to these subjects. The Fund has been informed that the Manager and its affiliates are responding to those information requests, but are not in a position to predict the outcome of these requests and investigations.

Important information concerning the Fund and its Manager with regard to recent regulatory developments is contained in the Notes to Financial Statements included in this report.

Looking for Additional Information?

The Fund is traded under the symbol MHF and its closing market price is available in most newspapers under the NYSE listings. The daily NAV is available on-line under symbol XMHFX. *Barron's* and *The Wall Street Journal's* Monday editions carry closed-end fund tables that will provide additional information. In addition, the Fund issues a quarterly press release that can be found on most major financial websites as well as www.leggmason.com/InvestorServices.

In a continuing effort to provide information concerning the Fund, shareholders may call 1-888-735-6507, Monday through Friday from 8:00 a.m. to 6:00 p.m. Eastern Time, for the Fund's current net asset value, market price and other information.

As always, thank you for your confidence in our stewardship of your assets. We look forward to helping you continue to meet your financial goals.

Sincerely,

R. Jay Gerken, CFA
Chairman, President and Chief Executive Officer

May 25, 2006

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The information provided is not intended to be a forecast of future events, a guarantee of future results or investment advice. Views expressed may differ from those of the firm as a whole.

RISKS: The Fund may use derivatives, such as options and futures, which can be illiquid, may disproportionately increase losses, and have a potentially large impact on fund performance. High yield bonds involve greater credit and liquidity risks than investment grade bonds. Certain investors may be subject to the Federal Alternative Minimum Tax (AMT), and state and local taxes may apply. Capital gains, if any, are fully taxable.

All index performance reflects no deduction for fees, expenses or taxes. Please note that an investor cannot invest directly in an index.

- i Gross domestic product is a market value of goods and services produced by labor and property in a given country.
- ii The Federal Reserve Board is responsible for the formulation of a policy designed to promote economic growth, full employment, stable prices, and a sustainable pattern of international trade and payments.
- iii The federal funds rate is the interest rate that banks with excess reserves at a Federal Reserve district bank charge other banks that need overnight loans.
- iv NAV is calculated by subtracting total liabilities and outstanding preferred stock from the closing value of all securities held by the Fund (plus all other assets) and dividing the result (total net assets) by the total number of the common shares outstanding. The NAV fluctuates with changes in the market prices of securities in which the Fund has invested. However, the price at which an investor may buy or sell shares of the Fund is at the Fund's market price as determined by supply of and demand for the Fund's shares.
- v The Lehman Brothers Municipal Bond Index is a broad measure of the municipal bond market with maturities of at least one year.
- vi Lipper, Inc. is a major independent mutual-fund tracking organization. Returns are based on the 6-month period ended April 30, 2006, including the reinvestment of distributions, including returns of capital, if any, calculated among the 15 funds in the Fund's Lipper category, and excluding sales charges.

Municipal High Income Fund Inc. V

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Take Advantage of the Fund's Dividend Reinvestment Plan	
As an investor in the Fund, you can participate in its Dividend Reinvestment Plan (Plan), a convenient, simple and efficient way to reinvest your dividends and capital gains, if any, in additional shares of the Fund. A more complete description of the Plan begins on page 25. Below is a short summary of how the Plan works.	
Plan Summary	
If you are a Plan participant who has not elected to receive your dividends in the form of a cash payment, then your dividend and capital gain distributions will be reinvested automatically in additional shares of the Fund.	
The number of shares in the Fund you will receive in lieu of a cash dividend is determined in the following manner. If the market price of the shares is equal to or higher than 98% of the net asset value (NAV) per share on the date of valuation, you will be issued shares for the equivalent of either 98% of the most recently determined NAV per share or 95% of the market price, whichever is greater.	
If 98% of the NAV per share at the time of valuation is greater than the market price of the common stock, the Fund will buy shares for your account in the open market or on the New York Stock Exchange.	
If the Fund begins to purchase additional shares in the open market and the market price of the shares subsequently rises above 98% of the NAV before the purchases are completed, the Fund will attempt to cancel any remaining orders and issue the remaining dividend or distribution in shares at 98% of the Fund's NAV per share. In that case, the number of Fund shares you receive will be based on the weighted average of prices paid for shares purchased in the open market and the price at which the Fund issues the remaining shares.	
To find out more detailed information about the Plan and about how you can participate, please call American Stock Transfer & Trust Company at 1 (877) 366-6441.	

Fund at a Glance (unaudited)

Investment Breakdown

As a Percent of Total Investments

Schedule of Investments (April 30, 2006) (unaudited)

MUNICIPAL HIGH INCOME FUND INC.

Face Amount	Rating	Security	Value
MUNICIPAL BONDS 90.3%			
Alabama 0.7%			
\$ 615,000	NR	Capstone Improvement District of Brookwood, AL, Series A, 7.700% due 8/15/23 (a)	\$ 86,100
1,000,000	AAA	West Jefferson, AL, Amusement & Public Park Authority Revenue, Visionland Project, Call 12/1/06 @102, 8.000% due 12/1/26 (b)	1,044,480
		Total Alabama	1,130,580