

WESTERN ASSET MUNICIPAL HIGH INCOME FUND INC.

Form N-CSRS

June 20, 2016

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 811-05497

Western Asset Municipal High Income Fund Inc.

(Exact name of registrant as specified in charter)

620 Eighth Avenue, 49th Floor, New York, NY 10018

(Address of principal executive offices) (Zip code)

Robert I. Frenkel, Esq.

Legg Mason & Co., LLC

100 First Stamford Place,

Stamford, CT 06902

(Name and address of agent for service)

Registrant's telephone number, including area code: (888) 777-0102

Date of fiscal year end: October 31

Date of reporting period: April 30, 2016

ITEM 1. REPORT TO STOCKHOLDERS.

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

Semi-Annual Report

April 30, 2016

WESTERN ASSET
MUNICIPAL HIGH
INCOME FUND INC.
(MHF)

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

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Fund objective

The Fund seeks high current income exempt from federal income taxes.

The Fund invests primarily in intermediate- and long-term municipal debt securities issued by state and local governments. However, the Fund may invest in municipal obligations of any maturity.

Letter from the chairman

Dear Shareholder,

We are pleased to provide the semi-annual report of Western Asset Municipal High Income Fund Inc. for the six-month reporting period ended April 30, 2016. Please read on for Fund performance information and a detailed look at prevailing economic and market conditions during the Fund's reporting period.

As always, we remain committed to providing you with excellent service and a full spectrum of investment choices. We also remain committed to supplementing the support you receive from your financial advisor. One way we accomplish this is through our website, www.lmcef.com. Here you can gain immediate access to market and investment information, including:

Fund prices and performance,

Market insights and commentaries from our portfolio managers, and

A host of educational resources.

We look forward to helping you meet your financial goals.

Sincerely,

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Jane Trust, CFA

Chairman, President and Chief Executive Officer

May 27, 2016

II Western Asset Municipal High Income Fund Inc.

Investment commentary

Economic review

The pace of U.S. economic activity moderated during the six months ended April 30, 2016 (the reporting period). Looking back, the U.S. Department of Commerce reported that third quarter 2015 U.S. gross domestic product (GDP) growth was 2.0%. The U.S. Department of Commerce then reported that fourth quarter 2015 GDP growth was 1.4%. Slower growth was attributed to downturns in nonresidential fixed investment and state and local government spending, along with a deceleration in personal consumption expenditures (PCE) and less export activity. The U.S. Department of Commerce's second reading for first quarter 2016 GDP growth released after the reporting period ended was 0.8%. This further slowdown was attributed to a number of factors, including a decrease in nonresidential fixed investment, a deceleration in PCE and a downturn in federal government spending.

Job growth in the U.S. was solid overall and was a tailwind for the economy during the reporting period. When the period ended in April 2016, unemployment was 5.0%, close to its lowest level since February 2008.

Investment commentary (cont d)

Market review

Q. How did the Federal Reserve Board (Fed) respond to the economic environment?

A. After an extended period of maintaining the federal funds rateⁱⁱⁱ at a historically low range between zero and 0.25%, the Fed increased the rate at its meeting on December 16, 2015. This marked the first rate hike since 2006. In particular, the U.S. central bank raised the federal funds rate to a range between 0.25% and 0.50%. In its official statement after the December 2015 meeting, the Fed said, "The stance of monetary policy remains accommodative after this increase, thereby supporting further improvement in labor market conditions and a return to 2 percent inflation." The Committee expects that economic conditions will evolve in a manner that will warrant only gradual increases in the federal funds rate; the federal funds rate is likely to remain, for some time, below levels that are expected to prevail in the longer run. At its meetings that concluded on January 27, 2016, March 16, 2016 and April 27, 2016, the Fed kept rates on hold.

Q. Did Treasury yields trend higher or lower during the six months ended April 30, 2016?

A. Short-term Treasury yields edged higher, whereas long-term Treasury yields declined during the reporting period. When the period began, the yield on the two-year Treasury note was 0.75%. Its low for the period was 0.64% on February 11, 2016, and it peaked at 1.09% on December 29, 2015. The yield on the two-year Treasury note ended the period at 0.77%. The yield on the ten-year Treasury note began the period at 2.16%. Its peak of 2.36% occurred on November 9, 2015, and its low of 1.63% was on February 11, 2016. The yield on the ten-year Treasury note ended the period at 1.83%.

Q. How did the municipal bond market perform versus the taxable bond market over the reporting period?

A. The municipal bond market outperformed its taxable bond counterpart during the six months ended April 30, 2016, as the Barclays Municipal Bond Index^{iv} and the Barclays U.S. Aggregate Index^v returned 3.55% and 2.82%, respectively. The municipal market was supported by overall positive investor demand and largely improving fundamentals.

Performance review

For the six months ended April 30, 2016, Western Asset Municipal High Income Fund Inc. returned 3.92% based on its net asset value (NAVⁱ) and 10.11% based on its New York Stock Exchange (NYSE) market price per share. The Fund's unmanaged benchmark, the Barclays Municipal Bond Index, returned 3.55% for the same period. The Lipper High Yield Municipal Debt Closed-End Funds Category Average^{vii} returned 5.31% over the same time frame. Please note that Lipper performance returns are based on each fund's NAV.

Certain investors may be subject to the federal alternative minimum tax, and state and local taxes will 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 \$0.17 per share. As of April 30, 2016, the Fund estimates that 98% of the distributions were sourced from net investment income

and 2% constitute 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, 2016. **Past performance is no guarantee of future results.**

Performance Snapshot as of April 30, 2016
(unaudited)

Price Per Share	6-Month Total Return**
\$8.11 (NAV)	3.92%
\$8.05 (Market Price)	10.11%

All figures represent past performance and are not a guarantee of future results. Performance figures for periods shorter than one year represent cumulative figures and are not annualized.

**** Total returns are based on changes in NAV or market price, respectively. Returns reflect the deduction of all Fund expenses, including management fees, operating expenses, and other Fund expenses. Returns do not reflect the deduction of brokerage commissions or taxes that investors may pay on distributions or the sale of shares.**

Total return assumes the reinvestment of all distributions, including returns of capital, if any, at NAV.

Total return assumes the reinvestment of all distributions, including returns of capital, if any, in additional shares in accordance with the Fund's Dividend Reinvestment Plan.

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 the symbol **XMHF** on most financial websites. *Barron's* and the *Wall Street Journal's* Monday edition both carry closed-end fund tables that 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.lmcef.com (click on the name of the Fund).

In a continuing effort to provide information concerning the Fund, shareholders may call 1-888-777-0102 (toll free), Monday through Friday from 8:00 a.m. to 5:30 p.m. Eastern Time, for the Fund's current NAV, market price and other information.

Thank you for your investment in Western Asset Municipal High Income Fund Inc. As always, we appreciate that you have chosen us to manage your assets and we remain focused on achieving the Fund's investment goals.

Sincerely,

Jane Trust, CFA

Chairman, President and Chief Executive Officer

May 27, 2016

***RISKS:** The Fund's investments are subject to credit risk, inflation risk and interest rate risk. High-yield bonds, known as junk bonds, involve greater credit and liquidity risks than investment grade bonds. As interest rates rise,*

*These estimates are not for tax purposes. The Fund will issue a Form 1099 with final composition of the distributions for tax purposes after year-end. A return of capital is not taxable and results in a reduction in the tax basis of a shareholder's investment. For more information about a distribution's composition, please refer to the Fund's distribution press release or, if applicable, the Section 19 notice located in the press release section of our

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website, www.lmcef.com (click on the name of the Fund).

Western Asset Municipal High Income Fund Inc.

V

Investment commentary (cont d)

bond prices fall, reducing the value of the Fund's holdings. Municipal securities purchased by the Fund may be adversely affected by changes in the financial condition of municipal issuers and insurers, regulatory and political developments, uncertainties and public perceptions, and other factors. 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.

All investments are subject to risk including the possible loss of principal. Past performance is no guarantee of future results. All index performance reflects no deduction for fees, expenses or taxes. Please note that an investor cannot invest directly in an index.

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.

ⁱ Gross domestic product (GDP) is the market value of all final goods and services produced within a country in a given period of time.

ⁱⁱ The Federal Reserve Board (Fed) is responsible for the formulation of U.S. policies 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 rate charged by one depository institution on an overnight sale of immediately available funds (balances at the Federal Reserve) to another depository institution; the rate may vary from depository institution to depository institution and from day to day.

^{iv} The Barclays Municipal Bond Index is a market value weighted index of investment grade municipal bonds with maturities of one year or more.

^v The Barclays U.S. Aggregate Index is a broad-based bond index comprised of government, corporate, mortgage- and asset-backed issues, rated investment grade or higher, and having at least one year to maturity.

^{vi} Net asset value (NAV) is calculated by subtracting total liabilities, including liabilities associated with financial leverage (if any), 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 the Fund's market price as determined by supply of and demand for the Fund's shares.

^{vii} Lipper, Inc., a wholly-owned subsidiary of Reuters, provides independent insight on global collective investments. Returns are based on the six-month period ended April 30, 2016, including the reinvestment of all distributions, including returns of capital, if any, calculated among the 11 funds in the Fund's Lipper category.

VI Western Asset Municipal High Income Fund Inc.

Fund at a glance (unaudited)

Investment breakdown (%) as a percent of total investments

The bar graph above represents the composition of the Fund's investments as of April 30, 2016 and October 31, 2015 and does not include derivatives, such as futures contracts. The Fund is actively managed. As a result, the composition of the Fund's investments is subject to change at any time.

Spread duration (unaudited)

Economic exposure April 30, 2016

Total Spread Duration

MHF 6.66 years

Benchmark 5.77 years

Spread duration measures the sensitivity to changes in spreads. The spread over Treasuries is the annual risk-premium demanded by investors to hold non-Treasury securities. Spread duration is quantified as the % change in price resulting from a 100 basis points change in spreads. For a security with positive spread duration, an increase in spreads would result in a price decline and a decline in spreads would result in a price increase. This chart highlights the market sector exposure of the Fund's sectors relative to the selected benchmark sectors as of the end of the reporting period.

Benchmark Barclays Municipal Bond Index

MHF Western Asset Municipal High Income Fund Inc.

Effective duration (unaudited)

Interest rate exposure April 30, 2016

Total Effective Duration

MHF 6.70 years

Benchmark 5.95 years

Effective duration measures the sensitivity to changes in relevant interest rates. Effective duration is quantified as the % change in price resulting from a 100 basis points change in interest rates. For a security with positive effective duration, an increase in interest rates would result in a price decline and a decline in interest rates would result in a price increase. This chart highlights the interest rate exposure of the Fund's sectors relative to the selected benchmark sectors as of the end of the reporting period.

Benchmark Barclays Municipal Bond Index

MHF Western Asset Municipal High Income Fund Inc.

Schedule of investments (unaudited)

April 30, 2016

Western Asset Municipal High Income Fund Inc.

Security	Rate	Maturity Date	Face Amount	Value
Municipal Bonds 96.2%				
<i>Alabama 5.4%</i>				
Jefferson County, AL, Sewer Revenue:				
AGM	5.500%	10/1/53	\$ 400,000	\$ 456,572 (a)
Convertible CAB, Subordinated Lien	0.000%	10/1/50	3,020,000	2,231,448 (b)
Subordinated Lien Warrants	6.000%	10/1/42	1,120,000	1,313,693
Subordinated Lien Warrants	6.500%	10/1/53	3,000,000	3,625,530
Lower Alabama Gas District, Gas Project Revenue	5.000%	9/1/46	1,500,000	1,911,705
<i>Total Alabama</i>				<i>9,538,948</i>
<i>Arizona 3.5%</i>				
La Paz County, AZ, IDA, Educational Facility Lease Revenue, Charter School Solutions, Harmony Public School Project	5.000%	2/15/36	1,000,000	1,096,330 (c)
Navajo Nation, AZ, Revenue	5.500%	12/1/30	190,000	214,740 (d)
Phoenix, AZ, IDA, Education Revenue:				
Basis School Inc.	5.000%	7/1/35	1,000,000	1,073,620 (d)
Great Hearts Academies	5.000%	7/1/41	1,200,000	1,324,116
Salt Verde, AZ, Financial Corp. Senior Gas Revenue	5.000%	12/1/37	1,500,000	1,872,690
University Medical Center Corp., AZ, Hospital Revenue	6.250%	7/1/29	500,000	581,740 (e)
<i>Total Arizona</i>				<i>6,163,236</i>
<i>California 9.9%</i>				
Anaheim, CA, Public Financing Authority Lease Revenue	5.000%	5/1/46	2,000,000	2,331,800
California State PCFA, Water Furnishing Revenue	5.000%	11/21/45	3,000,000	3,103,530 (d)
California State Public Works Board, Lease Revenue, Various Capital Project	5.125%	10/1/31	1,500,000	1,772,880
California Statewide CDA, Student Housing Revenue:				
Provident Group-Pomona Properties LLC	5.600%	1/15/36	505,000	539,487
Provident Group-Pomona Properties LLC	5.750%	1/15/45	360,000	384,030
Inland Valley, CA, Development Agency, Successor Agency Tax Allocation Revenue	5.000%	9/1/44	500,000	555,990
M-S-R Energy Authority, CA, Gas Revenue	7.000%	11/1/34	2,000,000	2,978,820
M-S-R Energy Authority, CA, Gas Revenue	6.500%	11/1/39	3,000,000	4,340,970
Redding, CA, Redevelopment Agency, Tax Allocation, Shastec Redevelopment Project	5.000%	9/1/29	600,000	600,366
River Islands, CA, Public Financing Authority Special Tax, Community Facilities District No. 2003-1	5.500%	9/1/45	620,000	676,029
<i>Total California</i>				<i>17,283,902</i>
<i>Colorado 4.5%</i>				
Colorado Educational & Cultural Facilities Authority Revenue:				
Cheyenne Mountain Charter Academy	5.250%	6/15/25	680,000	