

SINOCOKING COAL & COKE CHEMICAL INDUSTRIES, INC.
Form 10-K
September 30, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-K

Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the fiscal year ended **June 30, 2013**
or

Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from _____ to _____

Commission File Number: **001-15931**

SINOCOKING COAL AND COKE CHEMICAL INDUSTRIES, Inc.
(Exact name of issuer as specified in its charter)

Florida
(State or other jurisdiction of incorporation or
organization)

98-0695811
(I.R.S. employer identification number)

Kuanggong Road and Tiyu Road 10th Floor 467000

Chengshi Xin Yong She, Tiyu Road

Xinhua District

Pingdingshan, Henan Province

People's Republic of China

(Address of principal executive offices)

(Zip Code)

Registrant's telephone number, including area code **+86-3752882999**

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

Title of each class	Name of each exchange on which registered
Common stock, \$0.001 par value	NASDAQ Capital Market

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes No

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every, Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Sec.232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act (Check one):

Large Accelerated Filer Accelerated Filer
Non-accelerated filer Smaller reporting company

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

As of December 31, 2012, the aggregate market value of the voting stock held by non-affiliates of the registrant was approximately \$17 million, based on a closing price of \$1.18 per share of common stock as reported on the NASDAQ Stock Market on such date.

As of September 19, 2013, the registrant had 21,121,372 shares of common stock outstanding.

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This annual report on Form 10-K (the “Report”) and other reports (collectively the “Filings”) filed by the registrant from time to time with the Securities and Exchange Commission (the “SEC”) contain or may contain forward looking statements and information that are based upon beliefs of, and information currently available to, the registrant’s management as well as estimates and assumptions made by the registrant’s management. When used in the filings the words “anticipate,” “believe,” “estimate,” “expect,” “future,” “intend,” “plan” or the negative of these terms and similar expressions as they relate to the registrant or the registrant’s management identify forward looking statements. Such statements reflect the current view of the registrant with respect to future events and are subject to risks, uncertainties, assumptions and other factors (including the risks contained in the section of this Report entitled “Risk Factors”) relating to the registrant’s industry, the registrant’s operations and results of operations and any businesses that may be acquired by the registrant. Should one or more of these risks or uncertainties materialize, or should the underlying assumptions prove incorrect, actual results may differ significantly from those anticipated, believed, estimated, expected, intended or planned.

Although the registrant believes that the expectations reflected in the forward looking statements are reasonable, the registrant cannot guarantee future results, levels of activity, performance or achievements. Except as required by applicable law, including the securities laws of the United States, the registrant does not intend to update any of the forward-looking statements to conform these statements to actual results. The following discussion should be read in conjunction with the registrant’s financial statements and the related notes thereto included in this Report.

In this Report, “we,” “our,” “us,” “SinoCoking” or the “Company” sometimes refers collectively to SinoCoking Coal and Coke Chemical Industries, Inc. and its subsidiaries and affiliated companies.

PART I

ITEM 1. BUSINESS.

General Overview

We are a vertically-integrated coal and coke producer based in Henan Province, People's Republic of China ("PRC" or "China"). Our products include raw coal, washed coal, "medium" or mid-coal, coal slurries, coke, coal tar and crude benzol. We also generate electricity from gas emitted during the coking process, which we use primarily to power our operations.

All of our business operations are conducted by Henan Province Pingdingshan Hongli Coal & Coke Co., Ltd. ("Hongli"), which we control through contractual arrangements that Hongli and its owners have entered into with Pingdingshan Hongyuan Energy Science and Technology Development Co., Ltd. ("Hongyuan"). These contractual arrangements provide for management and control rights, and in addition entitle us to receive the earnings and control the assets of Hongli. Hongyuan is wholly-owned by Top Favour Limited ("Top Favour"), of which we are the sole shareholder. Other than our interests in the contractual arrangements, we do not own any equity interests in Hongli.

Currently:

- Coking related operations are carried out by Hongli and its branch, Baofeng Coking Factory ("Baofeng Coking).

Coal related operations are under the following three subsidiaries of Hongli, although all mining activities are currently on hold pending the ongoing mining moratorium (see "*Our Products and Operations – Coal – Coal Mining Moratorium*" below):

- (1) Baofeng Hongchang Coal Co., Ltd. ("Hongchang Coal");
- (2) Baofeng Shuangrui Coal Mining Co., Ltd. ("Shuangrui Coal"), which is wholly owned by Hongchang Coal; and
- (3) Baofeng Xingsheng Coal Mining Co., Ltd. ("Xingsheng Coal").

Electricity generation is carried out by Baofeng Hongguang Environment Protection Electricity Generating Co., Ltd. ("Hongguang Power"), also a wholly owned subsidiary of Hongli.

It is our intention to transfer all coal related operations from Hongli's subsidiaries to a joint-venture established with Henan Province Coal Seam Gas Development and Utilization Co., Ltd. ("Henan Coal Seam Gas"), a state-owned

enterprise and qualified provincial-level coal mine consolidator. The joint-venture, Henan Hongyuan Coal Seam Gas Engineering Technology Co., Ltd. (“Hongyuan CSG”), has been established, although our planned transfer of coal related activities to Hongyuan CSG has not been carried out as of the date of this Report. Our interests in Hongyuan CSG are held by Henan Zhonghong Energy Investment Co., Ltd. (“Zhonghong”), which equity interests are presently held on Hongli’s behalf and for its benefit by three nominees pursuant to share entrustment agreements.

In addition, once we complete construction of our new coking plant, we intend to operate the plant through Baofeng Hongrun Coal Chemical Co., Ltd. (“Hongrun Coking”), a wholly-owned subsidiary of Hongli. As of the date of this Report, however, construction has not been completed (see “*Our Products and Operations – Coke – New Coking Facility*” below), and Hongrun Coking has not commenced operations.

As of June 30, 2013, our current liabilities exceeded our current assets by \$24,312,407. Our ability to continue as a going concern depends upon our expenditure requirements and repayments of our long-term loan facilities with Bairui Trust Co., Ltd. (“Bairui Trust”) as and when they fall due. See “*Risk Factors – Risks Related to Our Business – If we cannot continue as a going concern, you will lose your entire investment*” and “*If we do not raise additional capital or refinance our debt, we will not be able to achieve our objectives and we may need to curtail or even discontinue operations*”.

History and Corporate Structure

We were incorporated in Florida on September 30, 1996, originally under the name “J. B. Financial Services, Inc.” We changed our name to “Ableauctions.com, Inc.” on July 19, 1999.

On December 30, 2009, our shareholders approved a Plan and Agreement of Share Exchange, dated July 17, 2009, with Top Favour under which we agreed to acquire all of the outstanding capital stock of Top Favour in exchange for the issuance of 13,117,952 shares of our common stock to the shareholders of Top Favour (the “Share Exchange”). The Share Exchange was consummated on February 5, 2010.

On March 11, 2010, we completed two private placement financings, pursuant to exemptions under Regulation S and Regulation D, respectively, in which we sold and issued a total of 7,344,935 shares of common stock, and five-year warrants for the purchase of an additional 3,789,631 shares of common stock, resulting in aggregate proceeds of \$44 million.

Top Favour

Top Favour is a holding company incorporated in the British Virgin Islands on July 2, 2008. Top Favour was formed by the owners of Hongli as a special vehicle for raising capital outside of the PRC. Other than holding 100% of the equity interests in Hongyuan and facilitating loan transactions for Hongli and its subsidiaries, Top Favour has no operations of its own.

Hongyuan

Hongyuan is a limited liability company organized in the PRC with registered capital of \$3 million and is wholly-owned by Top Favour. Hongyuan was approved as a wholly foreign owned enterprise (“WFOE”) by the Henan government on February 26, 2009 and formally organized on March 18, 2009. Other than activities relating to its contractual arrangements with Hongli, Hongyuan has no separate operations of its own.

Hongli

Hongli is a limited liability company organized in the PRC on July 5, 1996, and held by four Chinese nationals (the “Owners”) initially as follows: 83.66% by Mr. Jianhua Lv, our Chairman and Chief Executive Officer, 6.44% by Ms. Xin Zheng, 4.95% by Mr. Wenqi Xu, and 4.95% by Mr. Guoxiang Song. In August 2010, the Pingdingshan government directed Hongli to increase its registered capital from 8,808,000 Renminbi (“RMB”) to RMB 28,080,000 in order to maintain its coal trading license. Accordingly, the Owners contributed the additional registered capital in full in August 2010, although not in proportion to their original ownership percentages: Mr. Lv and Ms. Zheng increased their holdings to 85.40% and 9.19%, respectively, while Mr. Xu and Mr. Song decreased their holdings to 3.99% and 1.42%, respectively. Registration of such additional contribution and change in ownership percentages with Pingdingshan’s Administration for Industry and Commerce (“AIC”) was completed in April 2011.

Currently, Hongli has a branch, six subsidiaries and a joint-venture as follows (each a “Hongli company,” and with Hongli collectively “Hongli Group”):

Branch:

Baofeng Coking was established on May 31, 2002 as a branch of Hongli.

Subsidiaries:

Hongchang Coal is a limited liability company formed in the PRC on July 19, 2007 with registered capital of RMB 3 million. Hongchang Coal is wholly-owned by Hongli and holds the rights to mine.

Hongguang Power is a limited liability company formed in the PRC on August 1, 2006 with registered capital of RMB 22 million. Hongguang Power is wholly owned by Hongli.

Hongrun Coking is a limited liability company formed in the PRC on May 17, 2011 with registered capital of RMB 30 million. Hongrun Coking is a wholly-owned subsidiary of Hongli.

Shuangrui Coal is a limited liability company formed in the PRC on March 17, 2009 with registered capital of RMB 4,029,960. Hongchang Coal currently holds 100% of the equity interests of Shuangrui Coal. Hongli initially acquired 60% of such interests on May 20, 2011, and subsequently acquired the remaining 40% on June 20, 2012. Hongli concurrently transferred all 100% of Shuangrui Coal to Hongchang Coal, which transfer has been registered with the Pingdingshan AIC. As of the date of this Report, Hongli has not yet paid any consideration for the 40% as negotiations with the seller remains ongoing, although we have accrued for such consideration based on its fair market value. Shuangrui Coal holds the rights to mine the Shuangrui coal mine. We intend to dissolve Shuangrui Coal in the future and consolidate its mine assets under Hongchang Coal.

Xingsheng Coal is a limited liability company formed in the PRC on December 6, 2007 with registered capital of RMB 3,634,600. Hongli currently holds 60% of the equity interests of Xingsheng Coal. Xingsheng Coal holds the rights to mine the Xingsheng coal mine.

Zhonghong is a limited liability company formed in the PRC on December 30, 2010 with registered capital of RMB 10,010,000, which was increased to RMB 20 million on April 14, 2011, and to RMB 51 million on July 12, 2011, of which RMB 30 million has been paid and the balance due by December 20, 2015. Zhonghong's equity interests are presently held on Hongli's behalf and for its benefit by three nominees pursuant to share entrustment agreements, namely, Messrs. Hui Zheng and Jiangong Fan, vice president of operations and a department manager at Hongli, respectively, and an unrelated party who also serves as Zhonghong's general manager. Zhonghong holds our interests in Hongyuan CSG, our joint-venture with Henan Coal Seam Gas.

Joint-Venture:

Hongyuan CSG is a joint-venture established in the PRC on April 28, 2011 by Zhonghong (49%) and Henan Coal Seam Gas (51%). Hongli's interests in the joint-venture are held by Zhonghong.

We also acquired 100% of Baofeng Shunli Coal Ming Co., Ltd. ("Shunli Coal") on May 20, 2011. On July 4, 2012, Shunli Coal was dissolved, and we are in the process of applying to transfer its mine assets to, and consolidating them under, Hongchang Coal, which we currently expect to complete by the end of fiscal 2014. Shunli Coal's mine assets consist of the rights to mine Shunli coal mine.

Contractual Arrangements with Hongli Group and the Owners

Our relationship with Hongli Group and the Owners are governed by a series of contractual arrangements, under which our subsidiary Hongyuan holds and exercises ownership and management rights over Hongli Group. While we do not own any equity interest in Hongli Group, the contractual arrangements are designed to provide us with rights equivalent in all material respects to those we would possess as its sole equity holder, including absolute control rights and the rights to assets, property and income. According to a legal opinion issued by our PRC counsel, the contractual arrangements constitute valid and binding obligations of the parties to such agreements, and are enforceable and valid in accordance with the laws of the PRC.

The contractual arrangements, entered into on March 18, 2009, consist of the following:

Consulting Services Agreement: Hongyuan provides each Hongli company with general consulting services relating to its business management and operations on an exclusive basis. Additionally, Hongyuan owns any intellectual property rights that are developed during the course of providing such services. Each Hongli company pays a quarterly consulting service fee in RMB equal to its net income for such quarter to Hongyuan. This agreement is in effect unless and until terminated by written notice of either party if: (a) the other party causes a material breach of the agreement, provided that if the breach does not relate to a financial obligation, the breaching party has 14 days to cure following the receipt of written notice; (b) the other party becomes bankrupt, insolvent, is the subject of proceedings or arrangements for liquidation or dissolution, ceases to carry on business, or becomes unable to pay its debts as they become due; (c) Hongyuan terminates its operations; (d) a Hongli Group business license or any other approval for its business operations is terminated, cancelled or revoked; or (e) circumstances arise which would materially and adversely affect the performance or the objectives of this agreement. Additionally, Hongyuan may terminate the agreement without cause.

*Operating Agreement**: Hongyuan provides guidance and instructions for each Hongli company's daily operations, financial management and employment issues. In addition, Hongyuan agrees to guarantee the performance of each Hongli company under any agreements or arrangements relating to its business arrangements with any third party. In return, the Owners must designate Hongyuan's designees as their representatives on each Hongli company's board of directors, and Hongyuan has the right to appoint senior executives of each Hongli company. Additionally, each Hongli company agrees to pledge its accounts receivable and all of its assets to Hongyuan. Moreover, each Hongli company agrees not to engage in any transactions that could materially affect its assets, liabilities, rights or operations without Hongyuan's prior consent, including without limitation, incurrence or assumption of any indebtedness, sale or purchase of any assets or rights, incurrence of any encumbrance on any of its assets or intellectual property rights in favor of a third party or transfer of any agreements relating to its business operation to any third party. The term of this agreement is the maximum period of time permitted by law unless sooner terminated by any other agreements reached by all parties or upon a 30-day written notice from Hongyuan. The term may be extended only upon Hongyuan's written confirmation prior to the expiration of the agreement, with the extended term to be mutually agreed upon by the parties. Under current applicable PRC law, there is no limitation on the maximum term permitted by law for this agreement.

*Equity Pledge Agreement**: The Owners pledged all of their equity interests in Hongli Group to Hongyuan to guarantee each Hongli company's performance of the consulting services agreement. If a Hongli company or the owners breach their respective contractual obligations, Hongyuan, as pledgee, will be entitled to certain rights, including, but not limited to, the right to vote with, control and sell the pledged equity interests. The Owners also agreed that upon occurrence of any event of default, Hongyuan shall be granted an exclusive, irrevocable power of attorney to take actions in the place and stead of the owners to carry out the security provisions of the equity pledge agreement, and take any action and execute any instrument as required by Hongyuan to accomplish the purposes of the agreement. The Owners agreed not to dispose of the pledged equity interests or take any actions that would prejudice Hongyuan's interest. This agreement will expire two years from the fulfillment of Hongli Group's obligations under the consulting services agreement.

*Option Agreement**: The Owners irrevocably granted Hongyuan an exclusive option to purchase, to the extent permitted under PRC law, all or part of their equity interests in Hongli Group at a price equal to their initial registered capital contributions or the minimum amount of consideration permitted under PRC law. Hongyuan has sole discretion to decide when to exercise the option, and whether in part or in full. The term of this agreement is ten years from January 1, 2006 and may be extended prior to its expiration by written agreement of the parties.

*Voting Rights Proxy Agreement**: The Owners irrevocably granted a Hongyuan designee the right to exercise all their voting rights in accordance with PRC laws and each Hongli company's governing charters. This agreement may not be terminated without the unanimous consent of all parties, except that Hongyuan may terminate the proxy agreement with or without cause upon 30-day written notice to the owners.

Re-executed on September 9, 2011, to reflect RMB 20 million of additional registered capital contributed by the *Owners in August 2010, and the resulting change in ownership percentages. We were made a party to the re-executed agreements to acknowledge them.

As a result of the foregoing contractual arrangements, we have the ability to effectively control Hongli Group's daily operations and financial affairs, appoint senior executives and decide on all matters requiring the Owners' approval. While the Owners continue to own 100% of equity interests, they have given us their rights attendant to such ownership through the contractual arrangements. Accordingly, we are considered the primary beneficiary of Hongli Group and each Hongli company is deemed our variable interest entity ("VIE").

However, control based on contractual arrangements may ultimately not be as effective as direct ownership, as we will need to enforce our rights through quasi-judicial proceeding in the event Hongli Group fails to perform its contractual obligations. In the event the outcome of such proceeding is unfavorable to us, we may effectively lose control over Hongli Group. See "*Risk Factors – Risks Related to Our Corporate Structure – Our contractual arrangements with Hongli and its owners as well as our ability to enforce our rights thereunder may not be as effective in providing control over Hongli as direct ownership.*" As of September 19, 2013, Mr. Lv held approximately 31.7% of our issued and outstanding common stock, and 85.40% of the equity interests of Hongli. As such, we believe that our interests remain aligned with the Owners. However, we cannot give assurance that such interests will always be aligned, or that we can effectively control Hongli Group if and when such interests are no longer aligned. See "*Risk Factors - Risks Related to Our Corporate Structure – Management members of Hongli have potential conflicts of interest with us, which may adversely affect our business and your ability for recourse.*"

Our Current Corporate Structure

The following diagram illustrates our current corporate structure:

Our Products and Operations

Overview

We are based in Henan Province in the central part of China, known as a coal-rich region. Our current operations are located in west Baofeng County, a part of Pingdingshan Prefecture south of Zhengzhou, the provincial capital. Our three principal products are coal, coke and electricity.

Coal

We sell coal, including raw (unprocessed) coal, washed coal, mid-coal and coal slurries (see “*Coal Washing*” below), and also use washed coal to make coke. We currently control four coal mines (see “*Property, Plant and Equipment*” below). Until June 2010, we largely extracted coal from Hongchang coal mine to meet our needs, although we also engaged in coal trading. As described under “*Coal Mining Moratorium*” below, however, we have been unable to extract coal since September 2011. We have instead been relying on coal purchased elsewhere, including from Shanxi, Qinghai and Inner Mongolia, to meet our requirements. Our coal purchases for the fiscal years ended June 30, 2012 and 2013 are as follows:

Fiscal Year	Annual Purchases* (metric tons)
2012	461,932
2013	384,515

* Including coal for washing, coking and trading.

Generally, if the coal that we purchase meets coking requirements, we will reserve it for that purpose. Occasionally, however, we sell the coal (also known as coal trading) when market conditions are favorable.

Coal Mining Moratorium

In December 2009, the Henan government issued a directive to consolidate coal mines with annual production capacity below 300,000 metric tons (each a “targeted mine” and collectively the “targeted mines”), spurred by the central government’s decision to consolidate China’s coal industry in order to improve production efficiency and reduce coal mine accidents. In March 2010, the Henan government directed all lower-level governments within the province to begin shutting down all targeted mines, and further designated six state-owned enterprises (“SOEs”) to consolidate the targeted mines. Once shut down, the targeted mines cannot resume operations until they are consolidated and their facilities satisfy certain safety requirements.

In February and April 2010, the Baofeng government and the Pingdingshan government designated Hongli to consolidate targeted mines within the county and municipality, respectively. Because the Henan government’s directive requires that safety responsibility at each targeted mine be borne by a designated SOE, we reached an arrangement with one of them, Henan Coal Seam Gas, to form a joint-venture that would allow us to comply with the

Henan government's directive while maintaining operational control over any targeted mine that we consolidate. Such joint-venture, Hongyuan CSG, was formed in April 2011.

In late June 2010, pursuant to the Henan government's directive, the Pingdingshan government imposed a mining moratorium on all targeted mines within Pingdingshan. Nevertheless, we continued to operate our only mine at that time, Hongchang coal mine, at approximately 50% capacity until September 2011, when we halted operation in order to complete certain engineering and safety upgrades. Operations at our other three mines (Shuangrui, Xingsheng and Shunli) were already halted when we acquired controlling interests in them in May 2011, and have not resumed since.

In August 2011, Henan Coal Seam Gas, as a designated SOE consolidator, determined that Hongchang and Xingsheng coal mines were safe to resume operations, and applied with the Henan government to confirm such determination and issue the necessary licenses and permits to resume operations at both mine sites. However, due to an accident in November 2011 at a mine owned by Yima Coal Group, another designated SOE consolidator, the Henan government ordered all targeted mines to undergo further safety inspections and upgrades. We have made approximately \$3.2 million in prepayments for works to increase our mining capacity at Hongchang coal mine to 450,000 metric tons, as well as to upgrade the monitoring system (by installing additional detectors), automatic control system (including power controls and ventilation), and escape system (with additional refuge compartments) at Hongchang and Xingsheng coal mines. Although such works have not commenced, we have submitted the related engineering plans to Henan Coal Seam Gas for its approval and submission to the Henan government. Accordingly, the applications to resume operations at these two mines remain pending as of the date of this Report. As we are also in the process of consolidating Shunli coal mine under Hongchang Coal (see "*History and Corporate Structure – Hongli*" above), the application approval for Hongchang coal mine may be subject to additional delay.

Henan Coal Seam Gas has not yet made a determination as to the safety at Shuangrui and Shunli coal mines, and we do not know when such determination will be made, if at all. In addition, our objective in acquiring Shuangrui Coal, Xingsheng Coal and Shunli Coal is their mining rights, and their sellers were required to dispose of all other assets and liabilities before the transfer of equity interests to us is complete, and to assume all rights and obligations to such assets and liabilities until their disposal, which rights and obligations we would disclaim should any such asset or liability remains in the company after the transfer of equity interests to us is complete. Although equity interests have been transferred to us, the assets and liabilities that the sellers agreed to dispose of remain intact as of the date of this Report. In accordance with our agreements with them, the sellers are in the process of disposing all such assets and liabilities, and on September 2, 2011, we entered into a supplemental agreement with them to memorialize such agreements, which were not previously reduced to writing. Aside from the mining moratorium, we expect such disposals to be completed prior to any resumption of mining operations.

Assuming all four mines can resume operations, it is our present intention to transfer our interests in them to, and to operate them through, Hongyuan CSG. Such transfer, if carried out, would reduce any future revenue we may receive from these mines by 31%, or pro rata to the 49% of the joint-venture that we control. Nevertheless, we believe that such transfer would be in our best interests by reducing any risk of loss from potential future policy changes by the central and provincial governments through the presence and influence of Henan Coal Seam Gas, our joint-venture partner.

Coal Washing

At the Baofeng plant (see “Coke” below), we operate a coal-washing facility that is capable of processing up to 750,000 metric tons of coal per year. Under current Chinese coking industry standards, raw coal with no more than 1% sulfur content is deemed suitable for coking, although other factors are also considered. In addition to low sulfur content, the industry preference is for lower ash content and volatile matters. While much of the coal from our mines and that we purchase is generally suitable for coking based on these parameters, the coal must nevertheless be washed before it is ready for the coking ovens, in order to reduce ash and sulfur content, and to increase thermal value. We use a water-based jig washing process, which is prevalent in China, and use both underground and recycled water. Sorting machines that can process up to 600 metric tons per hour sort the washed coal according to size. Washed coal is also typically blended with other coal in order to achieve the proper chemical composition and thermal value for coking.

Approximately 1.33 - 1.38 metric tons of raw coal yield 1 metric ton of washed coal. The bulk of the washed coal we produce is intended for our coking needs, although we sell if the pricing is favorable. In addition to washed coal, the coal-washing process produces two byproducts:

“Medium” coal (or “mid-coal”), a PRC coal industry classification, is coal that does not have sufficient thermal value for coking, and is mixed with raw coal and even coal slurries, then sold for electricity generation, and domestic and industrial

4,152,083

See Notes to Schedule of Investments.

WESTERN ASSET MUNICIPAL HIGH INCOME FUND INC.**Schedule of investments (unaudited) (cont d)****July 31, 2016**

SECURITY	RATE	MATURITY DATE	FACE AMOUNT	VALUE
Indiana - 1.6%				
Indiana State Finance Authority Revenue, Private Activity Ohio River Bridges East End Crossing Project	5.000%	7/1/48	\$ 2,000,000	\$ 2,294,980 ^(e)
Valparaiso, IN, Exempt Facilities Revenue, Pratt Paper LLC Project	7.000%	1/1/44	500,000	632,760 ^(e)
<i>Total Indiana</i>				2,927,740
Kentucky - 1.3%				
Owen County, KY, Waterworks System Revenue, Kentucky American Water Co. Project	6.250%	6/1/39	2,000,000	2,262,000
Louisiana - 0.0%				
Epps, LA, COP	8.000%	6/1/18	775,000	77,500 ^(f)
Maryland - 2.0%				
Maryland State Health & Higher EFA Revenue, Mercy Medical Center	6.250%	7/1/31	3,000,000	3,573,390
Massachusetts - 1.5%				
Massachusetts State DFA Revenue:				
Partners Healthcare System	5.000%	7/1/47	1,250,000	1,521,575
Tufts Medical Center Inc.	6.875%	1/1/41	1,000,000	1,210,480
<i>Total Massachusetts</i>				2,732,055
Michigan - 3.0%				
Michigan State Finance Authority Limited Obligation Revenue:				
Higher Education, Thomas M Cooley Law School Project	6.000%	7/1/24	310,000	337,395 ^(b)
Higher Education, Thomas M Cooley Law School Project	6.750%	7/1/44	430,000	468,102 ^(b)
Michigan State Finance Authority Revenue:				
Local Government Loan Program, Detroit Water & Sewer Department	5.000%	7/1/35	250,000	292,673
Senior Lien Detroit Water & Sewer	5.000%	7/1/33	260,000	304,353
Senior Lien Detroit Water & Sewer	5.000%	7/1/44	270,000	301,369
Michigan State Strategic Fund Limited Obligation Revenue:				
Evangelical Homes of Michigan	5.250%	6/1/32	500,000	536,475
Evangelical Homes of Michigan	5.500%	6/1/47	750,000	799,095
Royal Oak, MI, Hospital Finance Authority Revenue, William Beaumont Hospital	8.250%	9/1/39	2,000,000	2,315,440 ^(e)
<i>Total Michigan</i>				5,354,902
Missouri - 3.0%				
Kansas City, MO, IDA, Senior Living Facilities Revenue, Kansas City United Methodist Retirement Home Inc.	6.000%	11/15/51	200,000	207,764 ^(b)
Missouri State HEFA Revenue:				
Lutheran Senior Services	6.000%	2/1/41	500,000	577,870
Lutheran Senior Services	5.000%	2/1/44	750,000	851,085
Refunding, St. Lukes Episcopal	5.000%	12/1/21	1,300,000	1,320,995
St. Louis County, MO, IDA, Senior Living Facilities Revenue, Friendship Village of Sunset Hills	5.875%	9/1/43	2,000,000	2,383,840

Total Missouri

5,341,554

See Notes to Schedule of Investments.

WESTERN ASSET MUNICIPAL HIGH INCOME FUND INC.**Schedule of investments (unaudited) (cont d)****July 31, 2016**

SECURITY	RATE	MATURITY DATE	FACE AMOUNT	VALUE
Nebraska - 2.1%				
Central Plains Energy Project, NE, Gas Project Revenue, Project #3	5.000%	9/1/42	\$ 3,340,000	\$ 3,755,930
Nevada - 0.5%				
Director of the State of Nevada Department of Business & Industry Revenue:				
Somerset Academy of Las Vegas	5.000%	12/15/35	300,000	319,368 ^(b)
Somerset Academy of Las Vegas	5.125%	12/15/45	500,000	525,205 ^(b)
<i>Total Nevada</i>				<i>844,573</i>
New Jersey - 6.6%				
Gloucester County, NJ, PCFA Revenue, Keystone Urban Renewal, Logan Generating	5.000%	12/1/24	450,000	519,813 ^(e)
New Jersey State EDA Revenue, Private Activity-The Goethals Bridge Replacement Project	5.375%	1/1/43	1,500,000	1,757,940 ^(e)
New Jersey State Higher Education Assistance Authority, Student Loan Revenue	5.000%	12/1/44	640,000	686,573 ^(e)
New Jersey State Transportation Trust Fund Authority Revenue, Transportation Program	5.250%	6/15/32	4,720,000	5,367,914
Salem County, NJ, PCFA Revenue, Chambers Project	5.000%	12/1/23	3,000,000	3,451,560 ^(e)
<i>Total New Jersey</i>				<i>11,783,800</i>
New York - 4.0%				
Brooklyn Arena, NY, Local Development Corp. Revenue, Barclays Center Project	6.250%	7/15/40	2,000,000	2,317,500 ^(c)
New York City, NY, TFA Revenue, Future Tax Secured	5.000%	5/1/36	600,000	742,452
New York State Liberty Development Corp., Liberty Revenue, 3 World Trade Center LLC Project	5.000%	11/15/44	1,205,000	1,384,352 ^(b)
New York State Transportation Development Corp., Special Facilities Revenue, Laguardia Airport Terminal B Redevelopment Project	4.000%	7/1/31	2,500,000	2,705,050 ^(e)
<i>Total New York</i>				<i>7,149,354</i>
Ohio - 1.3%				
Miami County, OH, Hospital Facilities Revenue, Refunding and Improvement Upper Valley Medical Center	5.250%	5/15/21	1,500,000	1,505,610
Ohio State Private Activity Revenue, Portsmouth Bypass Project	5.000%	6/30/53	700,000	800,478 ^(e)
<i>Total Ohio</i>				<i>2,306,088</i>
Oklahoma - 0.8%				
Payne County, OK, EDA Revenue, Epworth Living at The Ranch	6.250%	11/1/31	250,000	260,138
Tulsa County, OK, Industrial Authority, Senior Living Community Revenue, Montereau Inc. Project	7.125%	11/1/30	1,000,000	1,095,210
<i>Total Oklahoma</i>				<i>1,355,348</i>

Oregon - 0.4%

Yamhill County, OR, Hospital Authority Revenue, Friendsview Retirement Community	5.000%	11/15/51	725,000	791,461 ^(g)
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See Notes to Schedule of Investments.

WESTERN ASSET MUNICIPAL HIGH INCOME FUND INC.**Schedule of investments (unaudited) (cont d)****July 31, 2016**

SECURITY	RATE	MATURITY DATE	FACE AMOUNT	VALUE
Pennsylvania - 5.7%				
Cumberland County, PA, Municipal Authority Revenue, Diakon Lutheran Social Ministries Project	5.000%	1/1/28	\$ 350,000	\$ 419,520
Erie County, PA, Convention Center Authority Gtd. Hotel Revenue, County GTD	5.000%	1/15/36	750,000	884,505
Monroe County, PA, Hospital Authority Revenue, Pocono Medical Center	5.000%	1/1/27	1,000,000	1,017,910
Montgomery County, PA, IDA Revenue:				
Acts Retirement-Life Communities	5.000%	11/15/28	1,400,000	1,620,808
Acts Retirement-Life Communities	5.000%	11/15/29	1,350,000	1,558,143
Pennsylvania State Turnpike Commission Revenue	5.000%	12/1/46	3,170,000	3,693,621
Philadelphia, PA, Authority for IDR:				
Discovery Charter School Inc. Project	6.250%	4/1/37	500,000	502,070
Performing Arts Charter School Project	6.000%	6/15/23	480,000	510,336 ^(b)
<i>Total Pennsylvania</i>				<i>10,206,913</i>
Tennessee - 1.4%				
Shelby County, TN, Health Educational & Housing Facilities Board Revenue, Trezevant Manor Project	5.750%	9/1/37	2,500,000	2,506,300
Texas - 22.4%				
Arlington, TX, Higher Education Finance Corp., Education Revenue:				
Uplift Education	5.000%	12/1/36	240,000	282,581
Uplift Education	5.000%	12/1/46	200,000	232,588
Brazos River, TX, Harbor Industrial Development Corp., Environmental Facilities Revenue, Dow Chemical Co.	5.900%	5/1/28	1,500,000	1,607,250 ^{(a)(e)(h)}
Central Texas Regional Mobility Authority Revenue	5.000%	1/1/42	2,000,000	2,279,200
Dallas-Fort Worth, TX, International Airport Revenue, Joint Improvement	5.000%	11/1/42	4,000,000	4,524,240 ^(e)
Grand Parkway Transportation Corp., TX, System Toll Revenue, Convertible CAB	0.000%	10/1/35	1,500,000	1,373,535 ^(a)
Gulf Coast, TX, IDA Revenue, Citgo Petroleum Corp. Project	4.875%	5/1/25	1,000,000	1,069,840 ^(e)
Harris County, TX, Cultural Education Facilities Finance Corp., Medical Facilities Revenue, Baylor College of Medicine	5.625%	11/15/32	2,000,000	2,227,060 ^(c)
Love Field Airport Modernization Corp., TX, Special Facilities Revenue, Southwest Airlines Co. Project	5.250%	11/1/40	6,000,000	6,836,700
New Hope Cultural Education Facilities Finance Corp., TX, Senior Living Revenue:				
Cardinal Bay Inc., Village on the Park Carriage Inn Project	5.000%	7/1/46	250,000	287,903
Cardinal Bay Inc., Village on the Park Carriage Inn Project	5.000%	7/1/51	150,000	175,272
New Hope Cultural Education Facilities Finance Corp., TX, Student Housing Revenue, Collegiate Housing Stephenville II LLC, Tarleton State University Project	5.000%	4/1/39	1,165,000	1,348,406
North Texas Tollway Authority Revenue	5.000%	1/1/39	175,000	211,157
North Texas Tollway Authority Revenue:				
System-First Tier	5.750%	1/1/40	2,190,000	2,348,227 ^(c)
System-First Tier	5.750%	1/1/40	310,000	331,486
Texas Midwest Public Facility Corp. Revenue, Secure Treatment Facility Project	9.000%	10/1/30	2,000,000	240,000 ^(f)

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Texas State Municipal Gas Acquisition & Supply Corp. I, Gas Supply Revenue	6.250%	12/15/26	1,000,000	1,272,310
Texas State Municipal Gas Acquisition & Supply Corp. III, Gas Supply Revenue	5.000%	12/15/28	1,500,000	1,745,310
Texas State Private Activity Bond Surface Transportation Corp. Revenue:				
LBJ Infrastructure Group LLC	7.000%	6/30/40	4,000,000	4,774,840
Senior Lien, Blueridge Transportation Group LLC	5.000%	12/31/40	1,000,000	1,170,950 ^(e)
Senior Lien, NTE Mobility Partners LLC	6.875%	12/31/39	2,000,000	2,375,240
Texas State Public Finance Authority, Charter School Finance Corp. Revenue:				
Cosmos Foundation Inc.	6.200%	2/15/40	1,000,000	1,187,370 ^(e)
Uplift Education	5.750%	12/1/27	1,500,000	1,602,405 ^(e)
Willacy County, TX, PFC Project Revenue, County Jail	7.500%	11/1/25	445,000	413,325
<i>Total Texas</i>				39,917,195

See Notes to Schedule of Investments.

WESTERN ASSET MUNICIPAL HIGH INCOME FUND INC.**Schedule of investments (unaudited) (cont d)****July 31, 2016**

SECURITY	RATE	MATURITY DATE	FACE AMOUNT	VALUE
U.S. Virgin Islands - 1.5%				
Virgin Islands Public Finance Authority Revenue, Matching Fund Loan	6.750%	10/1/37	\$ 2,500,000	\$ 2,643,500
Virginia - 2.0%				
Virginia State Small Business Financing Authority Revenue:				
Elizabeth River Crossings OpCo LLC Project	5.250%	1/1/32	1,000,000	1,166,970 ^(e)
Elizabeth River Crossings OpCo LLC Project	5.500%	1/1/42	2,000,000	2,345,760 ^(e)
<i>Total Virginia</i>				3,512,730
West Virginia - 1.4%				
Pleasants County, WV, PCR, Refunding, County Commission, Allegheny Energy Supply Co., LLC	5.250%	10/15/37	2,500,000	2,571,975
Wisconsin - 0.5%				
Public Finance Authority, WI, Exemption Facilities Revenue, Celanese Project	5.000%	12/1/25	550,000	645,744 ^(e)
Public Finance Authority, WI, Revenue, Church Home of Hartford Inc.	5.000%	9/1/38	250,000	268,890 ^(b)
<i>Total Wisconsin</i>				914,634
TOTAL INVESTMENTS BEFORE SHORT-TERM INVESTMENTS				
(Cost - \$158,814,143)				176,579,879
SHORT-TERM INVESTMENTS - 0.6%				
MUNICIPAL BONDS - 0.6%				
Illinois - 0.1%				
Illinois State Health Facilities Authority Revenue, Evanston Hospital Corp., SPA-Wells Fargo Bank N.A.	0.420%	6/1/35	200,000	200,000 ^{(f)(j)}
North Carolina - 0.5%				
North Carolina State Medical Care Commission, Health Care Facilities Revenue, Wakemed Obligated Group, LOC-Wells Fargo Bank N.A.	0.410%	10/1/38	800,000	800,000 ^{(f)(j)}
TOTAL MUNICIPAL BONDS				
(Cost - \$1,000,000)				1,000,000
SHARES				
MONEY MARKET FUNDS - 0.0%				
State Street Institutional U.S. Government Money Market Fund, Premier Class (Cost - \$54,898)	0.250%		54,898	54,898
TOTAL SHORT-TERM INVESTMENTS				
(Cost - \$1,054,898)				1,054,898

TOTAL INVESTMENTS - 99.6%

(Cost - \$159,869,041#)

177,634,777

Other Assets in Excess of Liabilities - 0.4%

738,296

TOTAL NET ASSETS - 100.0%

\$ 178,373,073

See Notes to Schedule of Investments.

WESTERN ASSET MUNICIPAL HIGH INCOME FUND INC.

Schedule of investments (unaudited) (cont d)

July 31, 2016

- * Non-income producing security.

- (a) Variable rate security. Interest rate disclosed is as of the most recent information available.

- (b) Security is exempt from registration under Rule 144A of the Securities Act of 1933. This security may be resold in transactions that are exempt from registration, normally to qualified institutional buyers. This security has been deemed liquid pursuant to guidelines approved by the Board of Directors, unless otherwise noted.

- (c) Pre-Refunded bonds are escrowed with U.S. government obligations and/or U.S. government agency securities and are considered by the manager to be triple-A rated even if issuer has not applied for new ratings.

- (d) All or a portion of this security is held at the broker as collateral for open futures contracts.

- (e) Income from this issue is considered a preference item for purposes of calculating the alternative minimum tax (AMT).

- (f) The coupon payment on these securities is currently in default as of July 31, 2016.

- (g) Security is purchased on a when-issued basis.

- (h) Maturity date shown represents the mandatory tender date.

- (i) Variable rate demand obligations have a demand feature under which the Fund can tender them back to the issuer or liquidity provider on no more than 7 days notice.

- (j) Maturity date shown is the final maturity date. The security may be sold back to the issuer before final maturity.

Aggregate cost for federal income tax purposes is substantially the same.

Abbreviations used in this schedule:

AGM	Assured Guaranty Municipal Corporation - Insured Bonds
CAB	Capital Appreciation Bonds
CDA	Communities Development Authority

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COP	Certificates of Participation
DFA	Development Finance Agency
EDA	Economic Development Authority
EFA	Educational Facilities Authority
GO	General Obligation
GTD	Guaranteed
HEFA	Health & Educational Facilities Authority
IDA	Industrial Development Authority
IDR	Industrial Development Revenue
LOC	Letter of Credit
PCFA	Pollution Control Financing Authority
PCR	Pollution Control Revenue
PFC	Public Facilities Corporation
SPA	Standby Bond Purchase Agreement - Insured Bonds
TFA	Transitional Finance Authority

This Schedule of Investments is unaudited and is intended to provide information about the Fund's portfolio holdings as of the date of the schedule. Other information regarding the Fund is available in the Fund's most recent annual or semi-annual shareholder report.

See Notes to Schedule of Investments.

Notes to Schedule of Investments (unaudited)**1. Organization and significant accounting policies**

Western Asset Municipal High Income Fund Inc. (the Fund) was incorporated in Maryland and is registered as a diversified, closed-end management investment company under the Investment Company Act of 1940, as amended (the 1940 Act). 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.

The following are significant accounting policies consistently followed by the Fund and are in conformity with U.S. generally accepted accounting principles (GAAP).

(a) Investment valuation. The valuations for fixed income securities (which may include, but are not limited to, corporate, government, municipal, mortgage-backed, collateralized mortgage obligations and asset-backed securities) and certain derivative instruments are typically the prices supplied by independent third party pricing services, which may use market prices or broker/dealer quotations or a variety of valuation techniques and methodologies. The independent third party pricing services use inputs that are observable such as issuer details, interest rates, yield curves, prepayment speeds, credit risks/spreads, default rates and quoted prices for similar securities. Short-term fixed income securities that will mature in 60 days or less are valued at amortized cost, unless it is determined that using this method would not reflect an investment's fair value. Investments in open-end funds are valued at the closing net asset value per share of each fund on the day of valuation. Futures contracts are valued daily at the settlement price established by the board of trade or exchange on which they are traded. If independent third party pricing services are unable to supply prices for a portfolio investment, or if the prices supplied are deemed by the manager to be unreliable, the market price may be determined by the manager using quotations from one or more broker/dealers or at the transaction price if the security has recently been purchased and no value has yet been obtained from a pricing service or pricing broker. When reliable prices are not readily available, such as when the value of a security has been significantly affected by events after the close of the exchange or market on which the security is principally traded, but before the Fund calculates its net asset value, the Fund values these securities as determined in accordance with procedures approved by the Fund's Board of Directors.

The Board of Directors is responsible for the valuation process and has delegated the supervision of the daily valuation process to the Legg Mason North Atlantic Fund Valuation Committee (the Valuation Committee). The Valuation Committee, pursuant to the policies adopted by the Board of Directors, is responsible for making fair value determinations, evaluating the effectiveness of the Fund's pricing policies, and reporting to the Board of Directors. When determining the reliability of third party pricing information for investments owned by the Fund, the Valuation Committee, among other things, conducts due diligence reviews of pricing vendors, monitors the daily change in prices and reviews transactions among market participants.

The Valuation Committee will consider pricing methodologies it deems relevant and appropriate when making fair value determinations. Examples of possible methodologies include, but are not limited to, multiple of earnings; discount from market of a similar freely traded security; discounted cash-flow analysis; book value or a multiple thereof; risk premium/yield analysis; yield to maturity; and/or fundamental investment analysis. The Valuation Committee will also consider factors it deems relevant and appropriate in light of the facts and circumstances. Examples of possible factors include, but are not limited to, the type of security; the issuer's financial statements; the purchase price of the security; the discount from market value of unrestricted securities of the same class at the time of purchase; analysts' research and observations from financial institutions; information regarding any transactions or offers with respect to the security; the existence of merger proposals or tender offers affecting the security; the price and extent of public trading in similar securities of the issuer or comparable companies; and the existence of a shelf registration for restricted securities.

For each portfolio security that has been fair valued pursuant to the policies adopted by the Board of Directors, the fair value price is compared against the last available and next available market quotations. The Valuation Committee reviews the results of such back testing monthly and fair valuation occurrences are reported to the Board of Directors quarterly.

The Fund uses valuation techniques to measure fair value that are consistent with the market approach and/or income approach, depending on the type of security and the particular circumstance. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable securities. The income approach uses valuation techniques to discount estimated future cash flows to present value.

Notes to Schedule of Investments (unaudited) (continued)

GAAP establishes a disclosure hierarchy that categorizes the inputs to valuation techniques used to value assets and liabilities at measurement date. These inputs are summarized in the three broad levels listed below:

Level 1 quoted prices in active markets for identical investments

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

Level 3 significant unobservable inputs (including the Fund's own assumptions in determining the fair value of investments)
The inputs or methodologies used to value securities are not necessarily an indication of the risk associated with investing in those securities.

The following is a summary of the inputs used in valuing the Fund's assets and liabilities carried at fair value:

DESCRIPTION	ASSETS			TOTAL
	QUOTED PRICES (LEVEL 1)	OTHER SIGNIFICANT OBSERVABLE INPUTS (LEVEL 2)	SIGNIFICANT UNOBSERVABLE INPUTS (LEVEL 3)	
Municipal Bonds		\$ 176,579,879		\$ 176,579,879
Short-Term Investments :				
Municipal Bonds		\$ 1,000,000		\$ 1,000,000
Money Market Funds	\$ 54,898			54,898
Total Short-Term Investments	\$ 54,898	\$ 1,000,000		\$ 1,054,898
Total Investments	\$ 54,898	\$ 177,579,879		\$ 177,634,777
DESCRIPTION	LIABILITIES			TOTAL
	QUOTED PRICES (LEVEL 1)	OTHER SIGNIFICANT OBSERVABLE INPUTS (LEVEL 2)	SIGNIFICANT UNOBSERVABLE INPUTS (LEVEL 3)	
Other Financial Instruments:				
Futures Contracts	\$ 114,109			\$ 114,109

See Schedule of Investments for additional detailed categorizations.

2. Investments

At July 31, 2016, the aggregate gross unrealized appreciation and depreciation of investments for federal income tax purposes were substantially as follows:

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Gross unrealized appreciation	\$ 21,047,077
Gross unrealized depreciation	(3,281,341)
Net unrealized appreciation	\$ 17,765,736

At July 31, 2016, the Fund had the following open futures contracts:

	Number of Contracts	Expiration Date	Basis Value	Market Value	Unrealized Depreciation
Contracts to Sell:					
U.S. Treasury Long-Term Bonds	19	9/16	\$ 3,200,204	\$ 3,314,313	\$ (114,109)

ITEM 2. CONTROLS AND PROCEDURES.

- (a) The registrant's principal executive officer and principal financial officer have concluded that the registrant's disclosure controls and procedures (as defined in Rule 30a-3(c) under the Investment Company Act of 1940, as amended (the "1940 Act")) are effective as of a date within 90 days of the filing date of this report that includes the disclosure required by this paragraph, based on their evaluation of the disclosure controls and procedures required by Rule 30a-3(b) under the 1940 Act and 15d-15(b) under the Securities Exchange Act of 1934.

- (b) There were no changes in the registrant's internal control over financial reporting (as defined in Rule 30a-3(d) under the 1940 Act) that occurred during the registrant's last fiscal quarter that have materially affected, or are likely to materially affect the registrant's internal control over financial reporting.

ITEM 3. EXHIBITS.

Certifications pursuant to Rule 30a-2(a) under the Investment Company Act of 1940, as amended, are attached hereto.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934 and the Investment Company Act of 1940, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Western Asset Municipal High Income Fund Inc.

By */s/ JANE TRUST*
Jane Trust
Chief Executive Officer

Date: September 21, 2016

Pursuant to the requirements of the Securities Exchange Act of 1934 and the Investment Company Act of 1940, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

By */s/ JANE TRUST*
Jane Trust
Chief Executive Officer

Date: September 21, 2016

By */s/ RICHARD F. SENNETT*
Richard F. Sennett
Principal Financial Officer

Date: September 21, 2016