AMES NATIONAL CORP
Form 10-Q
August 08, 2006

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

[Mark One]
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2006

¨ 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 0-32637

AMES NATIONAL CORPORATION
(Exact Name of Registrant as Specified in Its Charter)

IOWA	**42-1039071**
(State or Other Jurisdiction of Incorporation or Organization)	(I. R. S. Employer Identification Number)

405 FIFTH STREET
AMES, IOWA 50010
(Address of Principal Executive Offices)

Registrant's Telephone Number, Including Area Code: **(515) 232-6251**

NOT APPLICABLE
(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

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 x No ¨

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes x No ¨

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

COMMON STOCK, $2.00 PAR VALUE	**9,425,013**
(Class)	(Shares Outstanding at August 1, 2006)

AMES NATIONAL CORPORATION

INDEX

Index

AMES NATIONAL CORPORATION AND SUBSIDIARIES

Consolidated Balance Sheets
(unaudited)

ASSETS		**June 30, 2006**		**December 31, 2005**
Cash and due from banks	$	18,632,106	$	18,092,139
Federal funds sold		11,150,000		300,000
Interest bearing deposits in financial institutions		4,373,148		5,983,542
Securities available-for-sale		333,959,950		333,510,152
Loans receivable, net		429,548,140		440,317,685
Loans held for sale		1,380,669		981,280
Bank premises and equipment, net		11,557,644		11,030,840
Accrued income receivable		6,567,073		6,633,795
Deferred income taxes		1,882,303		343,989
Other assets		2,893,674		2,190,652
Total assets	$	821,944,707	$	819,384,074
LIABILITIES AND STOCKHOLDERS' EQUITY				
LIABILITIES				
Deposits				
Demand, noninterest bearing	$	72,020,426	$	74,155,477
NOW accounts		151,090,394		151,680,984
Savings and money market		166,285,257		160,998,014
Time, $100,000 and over		100,511,727		101,042,024
Other time		182,543,829		180,465,836
Total deposits		672,451,633		668,342,335
Federal funds purchased and securities sold under agreements to repurchase		35,987,930		34,659,983
Other short-term borrowings		29,957		2,861,130
Dividend payable		2,450,503		2,354,818
Accrued expenses and other liabilities		3,770,281		1,938,507
Total liabilities		714,690,304		710,156,773
STOCKHOLDERS' EQUITY				
Common stock, $2 par value, authorized 18,000,000 shares; 9,425,013 shares issued and outstanding June 30, 2006 and 9,419,271 shares issued and outstanding December 31, 2005		18,850,026		18,838,542
Additional paid-in capital		22,498,904		22,383,375
Retained earnings		65,491,202		64,713,530
Accumulated other comprehensive income, net unrealized gain on securities available-for-sale		414,271		3,291,854
Total stockholders' equity		107,254,403		109,227,301

Total liabilities and stockholders' equity	$	821,944,707	$	819,384,074

3

Index

AMES NATIONAL CORPORATION AND SUBSIDIARIES

Consolidated Statements of Income
(unaudited)

	Three Months Ended June 30, 2006	Three Months Ended June 30, 2005	Six Months Ended June 30, 2006	Six Months Ended June 30, 2005
Interest and dividend income:				
Loans	$ 7,357,897	$ 6,599,747	$ 14,559,841	$ 12,852,498
Securities				
Taxable	2,127,842	2,117,885	4,168,073	4,348,004
Tax-exempt	1,040,194	1,061,590	2,076,557	2,122,439
Federal funds sold	92,691	75,714	103,994	128,281
Dividends	359,005	372,138	698,779	719,589
Total interest income	10,977,629	10,227,074	21,607,244	20,170,811
Interest expense:				
Deposits	4,968,077	3,562,992	9,404,262	6,545,298
Other borrowed funds	257,605	299,135	600,224	665,728
Total interest expense	5,225,682	3,862,127	10,004,486	7,211,026
Net interest income	5,751,947	6,364,947	11,602,758	12,959,785
Provision (credit) for loan losses	(302,854)	74,882	(273,230)	128,607
Net interest income after provision (credit) for loan losses	6,054,801	6,290,065	11,875,988	12,831,178
Non-interest income:				
Trust department income	389,676	411,021	753,078	743,530
Service fees	497,729	450,489	905,051	870,645
Securities gains, net	270,830	232,844	515,308	367,783
Gain on sale of loans held for sale	172,521	168,196	283,987	282,021
Merchant and ATM fees	133,160	138,273	276,220	284,202
Gain on foreclosure of real estate	—	—	471,469	—
Other	134,651	112,605	286,193	240,841
Total non-interest income	1,598,567	1,513,428	3,491,306	2,789,022
Non-interest expense:				
Salaries and employee benefits	2,372,072	2,335,550	4,787,278	4,711,498
Data processing	582,175	568,690	1,082,277	1,045,404

Occupancy expenses		287,920		268,233		597,879		578,408
Other operating expenses		715,330		657,065		1,384,961		1,301,885
Total non-interest expense		3,957,497		3,829,538		7,852,395		7,637,195
Income before income taxes		3,695,871		3,973,955		7,514,899		7,983,005
Income tax expense		931,053		1,005,643		1,837,714		2,000,769
Net income	$	2,764,818	$	2,968,312	$	5,677,185	$	5,982,236
Basic and diluted earnings per share	$	0.29	$	0.32	$	0.60	$	0.64
Declared dividends per share	$	0.26	$	0.25	$	0.52	$	0.50
Comprehensive income	$	688,961	$	6,257,812	$	2,799,602	$	5,271,551

4

Index

AMES NATIONAL CORPORATION AND SUBSIDIARIES

Consolidated Statements of Cashflows
(unaudited)

	Six Months Ended June 30,	
	2006	**2005**
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 5,677,185	$ 5,982,236
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision (credit) for loan losses	(273,230)	128,607
Amortization and accretion	115,521	307,016
Depreciation	477,208	440,453
Provision for deferred taxes	151,694	8,020
Securities gains, net	(515,308)	(367,783)
Gain on foreclosure of real estate	(471,469)	-
Change in assets and liabilities:		
Increase in loans held for sale	(399,389)	(668,766)
Decrease in accrued income receivable	66,722	114,640
Decrease (increase) in other assets	(231,553)	132,169
Increase in accrued expenses and other liabilities	1,831,774	550,882
Net cash provided by operating activities	6,429,155	6,627,474
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of securities available-for-sale	(30,273,695)	(44,172,624)
Proceeds from sale of securities available-for-sale	3,765,005	18,597,058
Proceeds from maturities and calls of securities available-for-sale	21,891,088	35,498,182
Net decrease in interest bearing deposits in financial institutions	1,610,394	2,638,274
Net decrease (increase) in federal funds sold	(10,850,000)	19,835,000
Net decrease (increase) in loans	11,042,775	(19,415,633)
Purchase of bank premises and equipment	(1,004,012)	(386,515)
Net cash provided by (used in) investing activities	(3,818,445)	12,593,742
CASH FLOWS FROM FINANCING ACTIVITIES		
Increase (decrease) in deposits	4,109,298	(4,668,830)
Increase (decrease) in federal funds purchased and securities sold under agreements to repurchase	1,327,947	(2,737,752)
Decrease in other borrowings, net	(2,831,173)	-
Dividends paid	(4,803,828)	(3,889,962)
Proceeds from issuance of common stock	127,013	287,937
Net cash used in financing activities	(2,070,743)	(11,008,607)
Net increase in cash and cash equivalents	539,967	8,212,609
CASH AND DUE FROM BANKS		

Beginning		18,092,139		18,759,086
Ending	$	18,632,106	$	26,971,695
Cash payments for:				
Interest	$	9,230,172	$	7,047,829
Income taxes		1,867,780		2,127,665

5

Index

AMES NATIONAL CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Unaudited)

1. Significant Accounting Policies

The consolidated financial statements for the three and six month periods ended June 30, 2006 and 2005 are unaudited. In the opinion of the management of Ames National Corporation (the "Company"), these financial statements reflect all adjustments, consisting only of normal recurring accruals, necessary to present fairly these consolidated financial statements. The results of operations for the interim periods are not necessarily indicative of results which may be expected for an entire year. Certain information and footnote disclosures normally included in complete financial statements prepared in accordance with generally accepted accounting principles have been omitted in accordance with the requirements for interim financial statements. The interim financial statements and notes thereto should be read in conjunction with the year-end audited financial statements contained in the Company's 10-K. The consolidated condensed financial statements include the accounts of the Company and its wholly-owned banking subsidiaries (the “Banks”). All significant intercompany balances and transactions have been eliminated in consolidation.

2. Dividends

On May 10, 2006, the Company declared a cash dividend on its common stock, payable on August 15, 2006 to stockholders of record as of August 1, 2006, equal to $0.26 per share.

3. Earnings Per Share

Earnings per share amounts were calculated using the weighted average shares outstanding during the periods presented. The weighted average outstanding shares for the three months ended June 30, 2006 and 2005 were 9,420,218 and 9,412,530, respectively. The weighted average outstanding shares for the six months ended June 30, 2006 and 2005 were 9,419,747 and 9,411,867, respectively.

4. Off-Balance Sheet Arrangements

The Company is party to financial instruments with off-balance-sheet risk in the normal course of business. These financial instruments include commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the balance sheet. No material changes in the Company’s off-balance sheet arrangements have occurred since December 31, 2005.

5 Other Real Estate Owned

Real estate properties acquired through or in lieu of loan foreclosure are initially recorded at the fair value less estimated selling cost at the date of foreclosure. Any write-downs based on the asset’s fair value at the date of acquisition are charged to the allowance for loan losses. In the unusual case where the fair market value less selling costs exceeds the loan carrying amount, a gain is recorded. After foreclosure, valuations are periodically performed by management and property held for sale is carried at the lower of the new cost basis or fair value less cost to sell. Valuations are periodically performed by management, and any subsequent write-downs are recorded as a charge to operations, if necessary, to reduce the carrying value of a property to the lower of its cost or fair value less cost to sell.

Index

During the quarter ended March 31, 2006, the Company recorded a $471,000 gain on the foreclosure of a commercial real estate property where the fair market value determined by an independent appraisal exceeded the loan carrying amount.

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

Overview

Ames National Corporation is a bank holding company established in 1975 that owns and operates five bank subsidiaries in central Iowa. The following discussion is provided for the consolidated operations of the Company and its Banks, First National Bank, Ames, Iowa (First National), State Bank & Trust Co. (State Bank), Boone Bank & Trust Co. (Boone Bank), Randall-Story State Bank (Randall-Story Bank) and United Bank & Trust NA (United Bank). The purpose of this discussion is to focus on significant factors affecting the Company's financial condition and results of operations.

The Company does not engage in any material business activities apart from its ownership of the Banks. Products and services offered by the Banks are for commercial and consumer purposes including loans, deposits and trust services. The Banks also offer investment services through a third-party broker dealer. The Company employs eleven individuals to assist with financial reporting, human resources, audit, compliance, marketing, technology systems and the coordination of management activities, in addition to 171 full-time equivalent individuals employed by the Banks.

The Company's primary competitive strategy is to utilize seasoned and competent Bank management and local decision making authority to provide customers with faster response times and more flexibility in the products and services offered. This strategy is viewed as providing an opportunity to increase revenues through creating a competitive advantage over other financial institutions. The Company also strives to remain operationally efficient to provide better profitability while enabling the Company to offer more competitive loan and deposit rates.

The principal sources of Company revenues and cashflow are: (i) interest and fees earned on loans made by the Banks; (ii) securities gains and dividends on equity investments held by the Company and the Banks; (iii) service charges on deposit accounts maintained at the Banks; (iv) interest on fixed income investments held by the Banks; and (v) fees on trust services provided by those Banks exercising trust powers. The Company's principal expenses are: (i) interest expense on deposit accounts and other borrowings; (ii) salaries and employee benefits; (iii) data processing costs associated with maintaining the Bank's loan and deposit functions; and (iv) occupancy expenses for maintaining the Banks' facilities. The largest component contributing to the Company's net income is net interest income, which is the difference between interest earned on earning assets (primarily loans and investments) and interest paid on interest bearing liabilities (primarily deposits and other borrowings). One of management's principal functions is to manage the spread between interest earned on earning assets and interest paid on interest bearing liabilities in an effort to maximize net interest income while maintaining an appropriate level of interest rate risk.

The Company earned net income of $2,765,000, or $0.29 per share for the three months ended June 30, 2006, compared to net income of $2,968,000, or $0.32 per share, for the three months ended June 30, 2005, a decrease of 7%. Net interest income for the second quarter decreased $613,000, or 10%, from one year ago as the expense for attracting and retaining deposits rose more quickly than interest income on earning assets. A reduction in the specific reserve for a problem credit and declining loan demand allowed for the lowering of the allowance for loan losses by $303,000 in the second quarter of 2006 which offset nearly half of the decline in the net interest income.

For the six month period ending June 30, 2006, the Company earned net income of $5,677,000, or $0.60 per share, a 5% decrease from the net income of $5,982,000, or $0.64 per share, earned a year ago. As with the quarterly earnings results, the net interest income for the first half of 2006 decreased by $1,357,000, a decline of 10% compared to the first half of 2005. Reducing the level of the allowance for loan losses by $273,000 and a gain on the foreclosure of a real estate property of $471,000 partially offset the lower net interest income.

Index

The following management discussion and analysis will provide a summary review of important items relating to:

- Challenges
- Key Performance Indicators and Industry Results
- Income Statement Review
- Balance Sheet Review
- Asset Quality and Credit Risk Management
- Liquidity and Capital Resources
- Forward-Looking Statements and Business Risks

Challenges

Management has identified certain challenges that may negatively impact the Company's revenues in the future and is attempting to position the Company to best respond to those challenges.

- Short-term federal fund interest rates have risen 2.00% since June of last year. This rapid increase has negatively impacted the Company's net interest margin as interest expense on interest bearing liabilities increased more quickly than interest income on earning assets. Additional rapid increases in short term rates may create additional downward pressure on the Company's earnings. As a result of the short term rate increases and the competitive nature of the Company's markets, the net interest margin has fallen to 3.29% for the three months ended June 30, 2006 compared to 3.53% for the three months ended June 30, 2005. The Company's earning assets (primarily its loan and investment portfolio) have longer maturities than its interest bearing liabilities (primarily deposits and other borrowings); therefore, in a rising interest rate environment, interest expense will increase more quickly than interest income as the interest bearing liabilities reprice more quickly than earning assets. In response to this challenge, the Banks model quarterly the changes in income that would result from various changes in interest rates. Management believes Bank assets have the appropriate maturity and repricing characteristics to optimize earnings and the Banks' interest rate risk positions.

- The Company's market in central Iowa has numerous banks, credit unions, and investment and insurance companies competing for similar business opportunities. This competitive environment will continue to put downward pressure on the Banks' net interest margins and thus affect profitability. Strategic planning efforts at the Company and Banks continue to focus on capitalizing on the Banks' strengths in local markets while working to identify opportunities for improvement to gain competitive advantages.

- A potential challenge to the Company's earnings would be poor performance in the Company's equity portfolio, thereby reducing the historical level of realized security gains. The Company, on an unconsolidated basis, invests capital that may be utilized for future expansion in a portfolio of primarily financial and utility stocks totaling $22 million as of June 30, 2006. The Company focuses on stocks that have historically paid dividends that may lessen the negative effects of a bear market.

Index

Key Performance Indicators and Industry Results

Certain key performance indicators for the Company and the industry are presented in the following chart. The industry figures are compiled by the Federal Deposit Insurance Corporation (FDIC) and are derived from 8,790 commercial banks and savings institutions insured by the FDIC. Management reviews these indicators on a quarterly basis for purposes of comparing the Company's performance from quarter to quarter against the industry as a whole.

Selected Indicators for the Company and the Industry

	June 30, 2006		March 31, 2006		Years Ended December 31,			
	3 Months Ended	6 Months Ended	3 Months Ended		2005		2004	
	Company	Company	Company	Industry*	Company	Industry	Company	Industry
Return on assets	1.35%	1.39%	1.43%	1.35%	1.40%	1.28%	1.56%	1.29%
Return on equity	10.22%	10.44%	10.66%	13.07%	10.57%	12.46%	11.47%	13.28%
Net interest margin	3.29%	3.31%	3.34%	3.46%	3.56%	3.49%	3.97%	3.53%
Efficiency ratio	53.84%	52.02%	50.30%	56.92%	49.09%	57.24%	46.59%	58.03%
Capital ratio	13.20%	13.30%	13.40%	8.27%	13.21%	8.25%	13.62%	8.12%

*Latest available data

Key performances indicators include:

- Return on Assets

This ratio is calculated by dividing net income by average assets. It is used to measure how effectively the assets of the Company are being utilized in generating income. The Company's annualized return on average assets was 1.35% and 1.42%, respectively, for the three month periods ending June 30, 2006 and 2005. This ratio declined in 2006 from the previous year primarily as the result of lower net interest income.

- Return on Equity

This ratio is calculated by dividing net income by average equity. It is used to measure the net income or return the Company generated for the shareholders' equity investment in the Company. The Company's annualized return on equity ratio is below that of the industry primarily as a result of the higher level of capital the Company maintains for future growth and acquisitions. The Company's return on average equity was 10.22% and 10.89%, respectively for the three month periods ending June 30, 2006 and 2005.

Index

· Net Interest Margin

The net interest margin for the three months ended June 30, 2006 was 3.29% compared to 3.53% for the three months ended June 30, 2005. The ratio is calculated by dividing net interest income by average earning assets. Earning assets are primarily made up of loans and investments that earn interest. This ratio is used to measure how well the Company is able to maintain interest rates on earning assets above those of interest-bearing liabilities, which is the interest expense paid on deposits and other borrowings. The Company's net interest margin declined 24 basis points when compared to June 30, 2005 and is 12 basis points below the industry average as of March 31, 2006. Management expects the rising interest rate environment and the competitive nature of the Company's market environment to put downward pressure on the Company's margin for the remainder of 2006.

· Efficiency Ratio

This ratio is calculated by dividing noninterest expense by net interest income and noninterest income. The ratio is a measure of the Company's ability to manage noninterest expenses. The Company's efficiency ratio compares favorably to the industry's average and was 53.84% and 48.61% for the three months ended June 30, 2006 and 2005, respectively.

· Capital Ratio

The average capital ratio is calculated by dividing average total equity capital by average total assets. It measures the level of average assets that are funded by shareholders' equity. Given an equal level of risk in the financial condition of two companies, the higher the capital ratio, generally the more financially sound the company. The Company's capital ratio is significantly higher than the industry average. The capital ratio declined slightly for the latest quarter compared to the December 31, 2005 year end ratio.

Industry Results

Results at Large Banks Contribute to Record Earnings for the Industry

Increased income from trading and securitization activities helped insured commercial banks and savings institutions post record-high net income of $37.3 billion in the first quarter of 2006, eclipsing the previous record of $34.6 billion set in the third quarter of 2005. In addition to the improvement in noninterest income, earnings benefited from lower expenses for loan losses, especially among credit-card lenders, and from increased net interest income produced by strong loan growth. Earnings were $3.2 billion (9.5%) higher than in the first quarter of 2005, when noninterest revenues at large institutions were not as strong. Total noninterest income was up by $5.7 billion (10.3%). Income from trading activities was $1.4 billion (32.4%) higher than a year earlier, income from securitization activities was up by $1.1 billion (19.4%), and income from investment banking was $407 million (16.3%) higher. Net interest income was $5.0 billion (6.5%) above the level of a year ago. Loan-loss provisions were $234 million (3.8%) lower, in response to a sharp reduction in losses on consumer loans. The improvement in earnings was limited by lower gains on sales of securities and other assets, which were $174 million (20.6%) less than a year earlier, and by increased noninterest expenses, which were up by $6.8 billion (8.8%). Salary and benefit expenses rose by $3.7 billion (10.5%), led by increases at large banks that have had recent mergers. The average return on assets (ROA) was 1.35%, slightly above the 1.34% the industry registered in the first quarter of 2005. More than half of all institutions (52%) reported an ROA of 1% or higher for the quarter. A slightly higher proportion, 56.3% had higher quarterly earnings than a year earlier, but only 47.7% reported higher quarterly ROAs.

Index

Most Institutions See Margins Decline

The industry's average net interest margin declined by three basis points during the first quarter, to 3.46% from 3.49% in the fourth quarter of 2005. Almost two out of every three institutions (64.8%) saw their margins decline in the first quarter. A combination of rising short-term interest rates, a flat yield curve, and a growing dependence on volatile (interest-sensitive) liabilities for funding has caused average funding costs to rise more rapidly than average asset yields, narrowing the spread between the two. Smaller institutions have had more success in avoiding margin erosion. Higher proportions of core deposits in their funding have kept their funding costs from rising as rapidly as larger institutions. In contrast, larger institutions have seen their margins fall to 15-year lows. Both large and small institutions experienced margin erosion in the first quarter. Despite narrower margins, the industry has been able to grow its net interest income, thanks to strong growth in interest-earning assets. Earning assets increased by 9.2% during the 12 months ended March 31. During the first quarter, earning assets increased by 3.1%.

Income Statement Review

The following highlights a comparative discussion of the major components of net income and their impact for the three month periods ended June 30, 2006 and 2005:

Critical Accounting Policies

The discussion contained in this Item 2 and other disclosures included within this report are based, in part, on the Company's audited consolidated financial statements. These statements have been prepared in accordance with accounting principles generally accepted in the United States of America. The financial information contained in these statements is, for the most part, based on the financial effects of transactions and events that have already occurred. However, the preparation of these statements requires management to make certain estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses.

The Company's significant accounting policies are described in the "Notes to Consolidated Financial Statements" contained in the Company's 10-K. Based on its consideration of accounting policies that involve the most complex and subjective estimates and judgments, management has identified its most critical accounting policy to be that related to the allowance for loan losses.

The allowance for loan losses is established through a provision for loan losses that is treated as an expense and charged against earnings. Loans are charged against the allowance for loan losses when management believes that collectibility of the principal is unlikely. The Company has policies and procedures for evaluating the overall credit quality of its loan portfolio, including timely identification of potential problem loans. On a quarterly basis, management reviews the appropriate level for the allowance for loan losses incorporating a variety of risk considerations, both quantitative and qualitative. Quantitative factors include the Company's historical loss experience, delinquency and charge-off trends, collateral values, known information about individual loans and other factors. Qualitative factors include the general economic environment in the Company's market area. To the extent actual results differ from forecasts and management's judgment, the allowance for loan losses may be greater or lesser than future charge-offs.

Index

AVERAGE BALANCES AND INTEREST RATES

The following two tables are used to calculate the Company's net interest margin. The first table includes the Company's average assets and the related income to determine the average yield on earning assets. The second table includes the average liabilities and related expense to determine the average rate paid on interest bearing liabilities. The net interest margin is equal to the interest income less the interest expense divided by average earning assets.

AVERAGE BALANCE SHEETS AND INTEREST RATES

Three Months Ended June 30,

ASSETS (dollars in thousands)	2006 Average balance	2006 Revenue/ expense	2006 Yield/ rate	2005 Average balance	2005 Revenue/ expense	2005 Yield/ rate
Interest-earning assets						
Loans						
Commercial	$ 70,770	$ 1,346	7.61%	$ 66,989	$ 1,047	6.25%
Agricultural	33,197	685	8.25%	29,927	540	7.22%
Real estate	308,940	4,899	6.34%	311,208	4,639	5.96%
Installment and other	28,306	428	6.05%	27,226	374	5.49%
Total loans (including fees)	$ 441,213	$ 7,358	6.67%	$ 435,350	$ 6,600	6.06%
Investment securities						
Taxable	$ 209,964	$ 2,222	4.23%	$ 218,331	$ 2,189	4.01%
Tax-exempt	122,321	1,954	6.39%	128,364	2,002	6.24%
Total investment securities	$ 332,285	$ 4,176	5.03%	$ 346,695	$ 4,191	4.84%
Interest bearing deposits with banks	$ 2,538	$ 35	5.52%	$ 7,037	$ 40	2.27%
Federal funds sold	7,396	93	5.03%	10,182	76	2.99%
Total interest-earning assets	$ 783,432	$ 11,662	5.95%	$ 799,264	$ 10,907	5.46%
Non-interest-earning assets	36,184			36,588		
TOTAL ASSETS	$ 819,616			$ 835,852		

1 Average loan balances include nonaccrual loans, if any. Interest income on nonaccrual loans has been included.

Gerdau Trade Inc., Senior Notes	4.750%	4/15/23	1,860,000	1,174,125[(a)]
Severstal OAO Via Steel Capital SA, Senior Notes	4.450%	3/19/18	1,200,000	1,203,000[(b)]
Southern Copper Corp., Senior Notes	7.500%	7/27/35	100,000	95,310
Southern Copper Corp., Senior Notes	6.750%	4/16/40	2,880,000	2,547,844[(c)]
Southern Copper Corp., Senior Notes	5.250%	11/8/42	300,000	225,557
Vale Overseas Ltd., Senior Notes	4.375%	1/11/22	1,476,000	1,143,900
Vale Overseas Ltd., Senior Notes	6.875%	11/21/36	1,349,000	928,787[(c)]

Vedanta Resources PLC, Senior Bonds	8.250%	6/7/21	2,040,000	1,132,200[b][c]
Total Metals & Mining				*14,454,787*
Paper & Forest Products - 1.2%				
Celulosa Arauco y Constitucion SA, Senior Notes	7.250%	7/29/19	352,000	395,750
Celulosa Arauco y Constitucion SA, Senior Notes	4.750%	1/11/22	625,000	642,830[c]
Inversiones CMPC SA, Notes	4.375%	5/15/23	690,000	679,638[b][c]
Inversiones CMPC SA, Senior Notes	4.750%	1/19/18	1,020,000	1,049,720[b][c]
Inversiones CMPC SA, Senior Notes	4.500%	4/25/22	790,000	794,771[b][c]
Klabin Finance SA, Senior Notes	5.250%	7/16/24	640,000	569,600[b]
Total Paper & Forest Products				*4,132,309*
TOTAL MATERIALS				32,991,415
TELECOMMUNICATION SERVICES - 2.6%				
Diversified Telecommunication Services - 1.1%				
Bharti Airtel International Netherlands BV, Senior Bonds	5.350%	5/20/24	950,000	1,008,898[b]
Bharti Airtel Ltd., Senior Notes	4.375%	6/10/25	770,000	765,444[b]
Empresa Nacional de Telecomunicaciones SA, Senior Notes	4.875%	10/30/24	950,000	879,411[b][c]
Oi Brasil Holdings Cooperatief U.A., Senior Notes	5.750%	2/10/22	910,000	227,500[b]
Ooredoo International Finance Ltd., Senior Notes	4.750%	2/16/21	910,000	1,002,022[b]
Total Diversified Telecommunication Services				*3,883,275*

See Notes to Schedule of Investments.

WESTERN ASSET EMERGING MARKETS INCOME FUND INC.

Schedule of investments (unaudited) (cont d) **February 29, 2016**

SECURITY	RATE	MATURITY DATE	FACE AMOUNT	VALUE
Wireless Telecommunication Services - 1.5%				
VimpelCom Holdings BV, Senior Notes	5.950%	2/13/23	5,250,000	$ *4,998,000*[(a)]
Total Telecommunication Services				8,881,275
UTILITIES - 4.3%				
Electric Utilities - 1.8%				
Comision Federal de Electricidad, Senior Notes	4.875%	1/15/24	780,000	784,875[(b)]
Comision Federal de Electricidad, Senior Notes	6.125%	6/16/45	910,000	875,875[(b)]
Eskom Holdings SOC Ltd., Senior Notes	5.750%	1/26/21	1,090,000	955,908[(a)]
Majapahit Holding BV, Senior Notes	7.750%	1/20/20	1,970,000	2,246,549[(a)]
PT Perusahaan Listrik Negara, Senior Notes	5.500%	11/22/21	400,000	423,000[(a)]
State Grid Overseas Investment 2013 Ltd., Senior Bonds	3.125%	5/22/23	750,000	766,255[(b)(c)]
Total Electric Utilities				*6,052,462*
Gas Utilities - 0.6%				
Empresa de Energia de Bogota SA, Senior Notes	6.125%	11/10/21	860,000	882,575[(b)(c)]
Transportadora de Gas Internacional SA ESP, Senior Notes	5.700%	3/20/22	1,270,000	1,249,363[(b)(c)]
Total Gas Utilities				*2,131,938*
Independent Power and Renewable Electricity				
Producers - 1.6%				
AES Gener SA, Notes	5.250%	8/15/21	1,000,000	1,007,113[(b)(c)]
Empresa Nacional de Electricidad SA, Senior Notes	4.250%	4/15/24	500,000	507,729
First Gen Corp., Senior Notes	6.500%	10/9/23	830,000	888,100[(a)]
Korea East-West Power Co., Ltd., Senior Notes	2.500%	6/2/20	1,730,000	1,759,649[(b)]
Three Gorges Finance Ltd., Senior Notes	3.700%	6/10/25	980,000	1,029,857[(b)]
Total Independent Power and Renewable Electricity Producers				*5,192,448*
Multi-Utilities - 0.3%				
Empresas Publicas de Medellin ESP, Senior Notes	7.625%	7/29/19	870,000	*970,050*[(b)(c)]
TOTAL UTILITIES				14,346,898
TOTAL CORPORATE BONDS & NOTES				
(Cost - $176,328,410)				164,948,948
			SHARES	
COMMON STOCKS - 0.3%				
TELECOMMUNICATION SERVICES - 0.3%				
Diversified Telecommunication Services - 0.3%				
Axtel SAB de CV, ADR (Cost - $906,816)			319,792	944,314*[(b)]

	EXPIRATION DATE	WARRANTS	
WARRANTS - 0.0%			
Bolivarian Republic of Venezuela, Oil-linked payment obligations (Cost - $356,500)	4/15/20	11,500	51,750
		CONTRACTS	
PURCHASED OPTIONS - 0.0%			
U.S. Dollar/Saudi Arabian Riyal, Call @ 3.84[SAR] (Cost - $220,581)	1/17/17	9,966,000	102,580
TOTAL INVESTMENTS BEFORE SHORT-TERM INVESTMENTS (Cost - $382,991,385)			374,122,719

See Notes to Schedule of Investments.

WESTERN ASSET EMERGING MARKETS INCOME FUND INC.

Schedule of investments (unaudited) (cont d) **February 29, 2016**

SECURITY	RATE	SHARES	VALUE
SHORT-TERM INVESTMENTS - 1.3%			
State Street Institutional U.S. Government Money Market Fund, Premier Class (Cost - $4,407,134)	0.276%	4,407,134	$ 4,407,134
TOTAL INVESTMENTS - 112.5% (Cost - $387,398,519#)			378,529,853
Liabilities in Excess of Other Assets - (12.5)%			(42,054,914)
TOTAL NET ASSETS - 100.0%			$ 336,474,939

Face amount denominated in U.S. dollars, unless otherwise noted.

* Non-income producing security.

(a) Security is exempt from registration under Regulation S of the Securities Act of 1933. Regulation S applies to securities offerings that are made outside of the United States and do not involve direct selling efforts in the United States. This security has been deemed liquid pursuant to guidelines approved by the Board of Directors, unless otherwise noted.

(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) All or a portion of this security is pledged as collateral pursuant to the loan agreement.

(d) The coupon payment on these securities is currently in default as of February 29, 2016.

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

(f) Security has no maturity date. The date shown represents the next call date.

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

<u>Abbreviations used in this schedule:</u>

ADR American Depositary Receipts

CNY	Chinese Yuan Renminbi
MXN	Mexican Peso
SAR	Saudi Arabian Riyal

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 Emerging Markets Income Fund Inc. (the Fund) was incorporated in Maryland and is registered as a non-diversified, closed-end management investment company under the Investment Company Act of 1940, as amended (the 1940 Act). The Fund s primary investment objective is to seek high current income. As a secondary objective, the Fund seeks capital appreciation. In pursuit of these objectives, the Fund, under normal conditions, invests at least 80% of its net assets plus any borrowings for investment purposes in debt securities of government and government related issuers located in emerging market countries (including participations in loans between governments and financial institutions), and of entities organized to restructure the outstanding debt of such issuers, and in debt securities of corporate issuers located in emerging market countries.

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. Equity securities for which market quotations are available are valued at the last reported sales price or official closing price on the primary market or exchange on which they trade. When the Fund holds securities or other assets that are denominated in a foreign currency, the Fund will normally use the currency exchange rates as of 4:00 p.m. (Eastern Time). 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:

ASSETS

DESCRIPTION	QUOTED PRICES (LEVEL 1)	OTHER SIGNIFICANT OBSERVABLE INPUTS (LEVEL 2)	SIGNIFICANT UNOBSERVABLE INPUTS (LEVEL 3)	TOTAL
Long-term investments :				
Sovereign Bonds		$ 208,075,127		$ 208,075,127
Corporate Bonds & Notes		164,948,948		164,948,948
Common Stocks		944,314		944,314
Warrants		51,750		51,750
Purchased Options		102,580		102,580
Total Long-Term Investments		$ 374,122,719		$ 374,122,719
Short-Term Investments	$ 4,407,134			$ 4,407,134
Total investments	$ 4,407,134	$ 374,122,719		$ 378,529,853
Other Financial Instruments:				
Forward Foreign Currency Contracts		$ 184,903		$ 184,903
Total	$ 4,407,134	$ 374,307,622		$ 378,714,756

LIABILITIES

DESCRIPTION	QUOTED PRICES (LEVEL 1)	OTHER SIGNIFICANT OBSERVABLE INPUTS (LEVEL 2)	SIGNIFICANT UNOBSERVABLE INPUTS (LEVEL 3)	TOTAL
Other Financial Instruments:				
Forward Foreign Currency Contracts		$ 102,610		$ 102,610

See Schedule of Investments for additional detailed categorizations.

2. Investments

At February 29, 2016, the aggregate gross unrealized appreciation and depreciation of investments for federal income tax purposes were substantially as follows:

Gross unrealized appreciation	$ 18,393,614
Gross unrealized depreciation	(27,262,280)
Net unrealized depreciation	$ (8,868,666)

Notes to Schedule of Investments (unaudited) (continued)

At February 29, 2016, the Fund had the following open forward foreign currency contracts:

Currency Purchased		Currency Sold		Counterparty	Settlement Date	Unrealized Appreciation (Depreciation)
USD	824,897	CNY	5,500,000	Citibank, N.A.	3/8/16	$ (14,924)
INR	229,867,701	USD	3,352,063	Bank of America, N.A.	5/13/16	(40,114)
USD	636,324	MXN	11,801,015	Barclays Bank PLC	5/13/16	(10,773)
USD	3,413,190	SGD	4,859,700	Citibank, N.A.	5/13/16	(36,799)
USD	6,541,107	BRL	26,030,335	JPMorgan Chase & Co.	5/13/16	184,903
Total						$ 82,293

Abbreviations used in this table:

BRL	Brazilian Real
CNY	Chinese Yuan Renminbi
INR	Indian Rupee
MXN	Mexican Peso
SGD	Singapore Dollar
USD	United States Dollar

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 Emerging Markets Income Fund Inc.

By /s/ JANE TRUST
Jane Trust
Chief Executive Officer

Date: April 20, 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: April 20, 2016

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

Date: April 20, 2016