TEMPLETON EMERGING MARKETS INCOME FUND
Form N-CSR
October 30, 2009

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM N-CSR

CERTIFIED SHAREHOLDER REPORT OF REGISTERED MANAGEMENT INVESTMENT COMPANIES

Investment Company Act file number 811-07866

TEMPLETON EMERGING MARKETS INCOME FUND
(Exact name of registrant as specified in charter)

500 EAST BROWARD BLVD., SUITE 2100, FORT LAUDERDALE, FL 33394-3091
(Address of principal executive offices) (Zip code)

CRAIG S. TYLE, ONE FRANKLIN PARKWAY, SAN MATEO, CA 94403-1906
(Name and address of agent for service)

Registrant's telephone number, including area code: (954) 527-7500

Date of fiscal year end: 8/31

Date of reporting period: 8/31/09

ITEM 1. REPORTS TO STOCKHOLDERS.

AUGUST 31, 2009

ANNUAL REPORT

(GRAPHIC)

FIXED INCOME

TEMPLETON EMERGING MARKETS
INCOME FUND

(FRANKLIN TEMPLETON INVESTMENTS(R) LOGO)

Franklin - TEMPLETON - Mutual Series

Franklin Templeton Investments

GAIN FROM OUR PERSPECTIVE(R)

Franklin Templeton's distinct multi-manager
structure combines the specialized expertise of
three world-class investment management

groups--Franklin, Templeton and Mutual Series.

SPECIALIZED EXPERTISE

Each of our portfolio management groups operates autonomously, relying on its own research and staying true to the unique investment disciplines that underlie its success.

FRANKLIN. Founded in 1947, Franklin is a recognized leader in fixed income investing and also brings expertise in growth- and value-style U.S. equity investing.

TEMPLETON. Founded in 1940, Templeton pioneered international investing and, in 1954, launched what has become the industry's oldest global fund. Today, with offices in over 25 countries, Templeton offers investors a truly global perspective.

MUTUAL SERIES. Founded in 1949, Mutual Series is dedicated to a unique style of value investing, searching aggressively for opportunity among what it believes are undervalued stocks, as well as arbitrage situations and distressed securities.

TRUE DIVERSIFICATION

Because our management groups work independently and adhere to different investment approaches, Franklin, Templeton and Mutual Series funds typically have distinct portfolios. That's why our funds can be used to build truly diversified allocation plans covering every major asset class.

RELIABILITY YOU CAN TRUST

At Franklin Templeton Investments, we seek to consistently provide investors with exceptional risk-adjusted returns over the long term, as well as the reliable, accurate and personal service that has helped us become one of the most trusted names in financial services.

MUTUAL FUNDS | RETIREMENT PLANS | 529 COLLEGE SAVINGS PLANS | SEPARATE ACCOUNTS

(GRAPHIC)

Not part of the annual report

Contents

ANNUAL REPORT

Annual Report

Templeton Emerging Markets Income Fund

YOUR FUND'S GOALS AND MAIN INVESTMENTS: Templeton Emerging Markets Income Fund seeks high, current income, with a secondary goal of capital appreciation, by investing, under normal market conditions, at least 80% of its total net assets in income-producing securities of sovereign or sovereign-related entities and private sector companies in emerging market countries.

GEOGRAPHIC BREAKDOWN*

Based on Total Net Assets as of 8/31/09

(BAR CHART)

Americas	37.8%
Asia Pacific	32.9%
Middle East & Africa	11.9%
Other Europe	7.5%
Supranationals**	4.9%
EMU***	1.7%
Other Net Assets	3.3%

* The Geographic Breakdown is a snapshot of the Fund on 8/31/09 and may not reflect ongoing repositioning or reinvestment of cash in the Fund.

** The Fund's supranational investments were denominated in the Mexican peso, Ghanaian cedi and U.S. dollar.

*** The Fund's EMU investment was in the Netherlands.

Dear Shareholder:

We are pleased to bring you Templeton Emerging Markets Income Fund's annual report for the fiscal year ended August 31, 2009.

PERFORMANCE OVERVIEW

For the 12 months under review, Templeton Emerging Markets Income Fund had cumulative total returns of +6.57% based on market price and +8.02% based on net asset value. The Fund outperformed the J.P. Morgan (JPM) Emerging Markets Bond Index Global (EMBIG), which had a +5.37% cumulative total return in U.S. dollar terms for the same period.(1) You can find the Fund's long-term performance data in the Performance Summary on page 7.

(1.) Source: (C) 2009 Morningstar. All Rights Reserved. The information contained herein: (1) is proprietary to Morningstar and/or its content providers; (2) may not be copied or distributed; and (3) is not warranted to be accurate, complete or timely. Neither Morningstar nor its content providers are responsible for any damages or losses arising from any use of this information. Past performance is no guarantee of future results. The JPM EMBIG tracks total returns for U.S. dollar-denominated debt instruments issued by emerging market sovereign and quasi-sovereign entities: Brady bonds, loans and Eurobonds. Country and regional bond market returns are based on subindexes of the JPM EMBIG. The index is unmanaged and includes reinvested interest. One cannot invest directly in an index, and an index is not representative of the Fund's portfolio.

THE DOLLAR VALUE, NUMBER OF SHARES OR PRINCIPAL AMOUNT, AND NAMES OF ALL PORTFOLIO HOLDINGS ARE LISTED IN THE FUND'S STATEMENT OF INVESTMENTS (SOI). THE SOI BEGINS ON PAGE 10.

CURRENCY BREAKDOWN
8/31/09

	% OF TOTAL NET ASSETS
AMERICAS	84.4%
U.S. Dollar	70.0%
Brazilian Real	13.4%
Mexican Peso	0.7%
Peruvian Nuevo Sol	0.3%
ASIA PACIFIC	14.6%
Indonesian Rupiah	11.0%
Sri Lankan Rupee	2.0%
South Korean Won	0.9%
Malaysian Ringgit	0.7%
MIDDLE EAST & AFRICA	1.0%
Ghanaian Cedi	0.9%
Egyptian Pound	0.1%
EUROPE	0.0%
Euro*	-0.8%
Polish Zloty	0.8%

* Holding is a negative percentage because of the Fund's holdings of forward currency exchange contracts.

ECONOMIC AND MARKET OVERVIEW

The year under review consisted of two distinct halves. In the first half, the U.S. recession spread throughout the world as the financial crisis intensified, with economic activity and security prices falling sharply. Frozen credit markets and depressed consumer sentiment levels caused a steep drop in economic activity despite policymakers' best efforts. In addition to continued global interest rate easing, the U.S., eurozone and the U.K. implemented quantitative and credit easing policies, and governments worldwide boosted fiscal stimuli to counter the deepening global recession. Partially as a result of this coordinated global response, investor confidence began to improve in March, which gradually benefited economic activity through the increased flow of credit, especially in interbank lending and trade financing. Strong economic activity in China, the unfreezing of credit markets and the G20 meeting in April also gave investors confidence.(2) The turnaround led to a more favorable outlook that benefited the global economy through a shift in the inventory adjustment cycle and better corporate bond and equity market performance. Many investors appeared to believe the worst of the financial crisis was over, and by the end of the period there was substantial evidence that an economic recovery was under way. Greater risk appetite in the second half of the year benefited currency and developing bond markets as investors' outlook on the economy improved. Although financial markets and economic activity improved significantly from their very low levels, relative to the prior year, economic activity remained weak as deleveraging continued, global trade contracted and unemployment rose.

Inflation fell during the period as weak global growth led to lower prices for commodities, and slackening labor and capital markets pushed most other prices down gradually. Monetary easing in the eurozone continued, although at a slower pace than many economists would have preferred, given the recession's depth and lesser fiscal policy action compared with those of the U.S. In the first half of 2009 compared with the first half of 2008 (year-over-year), the eurozone's gross domestic product (GDP) contracted 4.8%, which was greater than the U.S. economy's 3.7% contraction.(3) However, the European Central Bank maintained its primary focus on inflation. Outside the eurozone, the economic slowdown was more severe in many emerging European countries. Central and eastern Europe was one of the regions most damaged by the financial crisis as it exposed those countries' external imbalances characterized by large foreign borrowing to finance substantial current account deficits. Several countries including Ukraine, Hungary and Latvia sought help from the

(2.) The G20 is an informal forum that promotes open and constructive discussion between industrial and emerging market countries on key issues related to global economic stability. It is made up of the finance ministers and central bank governors of 19 countries and the European Union.

(3.) Source: Eurostat.

International Monetary Fund (IMF). Even Poland, which was in a comparatively strong position relative to its regional peers, took advantage of the IMF's new, prequalified loan facility, though it did not draw on these resources.

In Asia, growth differed significantly between large economies with higher domestic demand and small economies more dependent on exports. The large economies, particularly China, India and Indonesia, were more resistant to the global recession as aggressive fiscal and monetary responses outweighed declining exports. Within these three countries, domestic demand was resilient and accounts for a bigger share of these economies. In contrast, the smaller economies suffered quick, severe downturns as their reliance on demand for exports made them very vulnerable to the global downturn. Exemplifying this dependence, production dropped more than export demand, allowing inventories to fall to levels more in line with reduced global consumption. However, even some of these very badly affected economies showed signs of improvement toward period-end. On the other hand, the Japanese economy was the weakest among the large, developed economies. GDP contracted an average of 6.5% year-over-year during the past three quarters due to subdued consumption, weak external demand and lackluster government spending.(4) Japan's trade balance worsened as the global recession and difficulties in obtaining credit negatively impacted machinery exports, an important sector for the economy.

INVESTMENT STRATEGY

We invest selectively in bonds around the world to generate income for the Fund, seeking opportunities while monitoring changes in interest rates, currency exchange rates and credit risk.

MANAGER'S DISCUSSION

The Fund purchased investment-grade and lower-rated sovereign debt that typically compensates for greater credit risk by offering higher yields relative to U.S. and European benchmark Treasury securities. Improved risk appetite benefited high yield products during the second half of the period, particularly sovereign bonds, following the G20 summit in April 2009. It was decided at the summit that the IMF would receive additional resources, and the IMF eased conditions to help countries in need of balance of payments support or access to liquidity. U.S. dollar-denominated emerging market debt posted a +5.37% total return during the period as measured by the JPM EMBIG, but the Fund's return was even stronger as it added exposure to sovereign bonds

WHAT IS A CURRENT ACCOUNT?

A current account is that part of the balance of payments where all of one country's international transactions in goods and services are recorded.

WHAT IS BALANCE OF PAYMENTS?

Balance of payments is a record of all of a country's exports and imports of goods and services, borrowing and lending with the rest of the world during a particular time period. It helps a country evaluate its competitive strengths and weaknesses and forecast the strength of its currency.

(4.) Source: Economic and Social Research Institute.

TOP 10 COUNTRIES
8/31/09

	% OF TOTAL NET ASSETS
Brazil	14.1%
Indonesia	11.6%
Argentina	7.4%
Russia	7.2%
Kazakhstan	5.8%
Iraq	5.1%
Supranational	4.9%
Ukraine	4.5%
Peru	4.5%
Mexico	3.3%

following the initial sell-off.(1) The index fell 28.83% to its low in late October, and rose 48.05% from that point to the end of the period.(1) Our analysis indicated that sovereign spreads were at distressed levels during the early stages of the financial crisis, reflecting a higher probability of default than we thought was appropriate. In our opinion, most emerging market sovereign bonds were in much better positions than in previous crises and unlikely to suffer to the same extent as they have in the past. Despite these fundamentals, forced and panicked selling hit sovereign bonds, and so we sought to capitalize on this market inefficiency by adding exposure. Sovereign interest rate credit spreads fell 325 basis points from their peak in mid-March as most emerging economies were fairly well positioned entering the crisis.(5) Regionally, Latin American sovereign debt had a +2.19% total return, Asian debt a +11.77% total return and central and eastern European debt a +5.70% total return.(1) Emerging market local debt returned +11.31% as measured by the JPM Government Bond Index-Emerging Markets (GBI-EM) in local currency terms as interest rates fell around the world.(6)

LATIN AMERICA

The first and second halves of the Fund's fiscal year contrasted sharply in Latin America as they did globally. In the first part of the year, currencies depreciated very quickly against the U.S. dollar and credit spreads widened to levels not reached for several years. A combination of influences such as economies slowing due to high interest rates and fear of corporate losses on derivatives and very weak demand for exports and freezing of credit markets led to a severe and rapid downturn. In the second part of the year, as risk appetite returned to global financial markets, currencies strengthened against the U.S. dollar and credit spreads narrowed. Commodity prices recovered, which helped exports. Imports falling faster than exports also benefited trade balances in many countries. The Fund's overweighted Brazilian real position hurt relative performance as the currency depreciated 12.67% against the U.S. dollar despite a strong rally in the latter part of the period.(7) However, sovereign credit and duration exposure in Brazil outperformed for the year as a whole. In contrast, the Mexican peso did not recover as much of its first half's fall as most other regional currencies. Argentina was one of the most volatile sovereign credits during the period, and the Fund sought to capitalize on that by adding exposure at distressed prices.

(5.) Source: J.P. Morgan.

(6.) Source: J.P. Morgan. The JPM GBI-EM tracks total returns for liquid, fixed-rate, local currency emerging market government bonds.

(7.) Source: IDC/Exshare.

EUROPE & MIDDLE EAST

Central and eastern Europe were among the most adversely impacted regions globally by the financial crisis, but we felt there was significant differentiation between credits that was not reflected in market valuations. In particular, we avoided Fund exposure to credits with the most dire outlooks, such as Latvia, and instead focused on the opportunities created by indiscriminate risk reduction in higher quality sovereigns. We viewed the risk of default in countries such as Poland and Russia as being overpriced by the market. While the sharp drop in oil prices led to significant challenges for Russia's fiscal accounts and external balances, the country's sovereign credit entered the crisis in a strong position with a low debt level and a significant accumulation of reserves. There were certainly warranted concerns about some local corporations, but these did not extend to the sovereign or the very highest quality companies.

ASIA

Asian sovereign credit was among the strongest in the index, as many of the large economies suffered less than other parts of the world. In part a legacy of the Asian financial crisis of the late 1990s, Asian economies generally used less leverage than those in other regions. Further, their governments had lowered their external debt burdens and many had built large cushions of foreign exchange reserves. Exports dropped significantly due to lower demand from the developed world, and this particularly hurt economic activity in small open economies. However, in Indonesia, significant monetary and fiscal stimulus supported growth and benefited the Fund's sovereign credit and duration exposure. Similarly, in South Korea, the central bank aggressively cut interest rates to stimulate demand, and that benefited our duration position.

WHAT IS DURATION?

Duration is a measure of a bond's price sensitivity to interest rate changes. In general, a portfolio of securities with a lower duration can be expected to be less sensitive to interest rate changes than a portfolio with a higher duration.

Thank you for your continued participation in Templeton Emerging Markets Income Fund. We look forward to serving your future investment needs.

Sincerely,

(PHOTO OF MICHAEL HASENSTAB)

/s/ Michael Hasenstab
Michael Hasenstab, Ph.D.
Portfolio Manager
Templeton Emerging Markets Income Fund

THE FOREGOING INFORMATION REFLECTS OUR ANALYSIS, OPINIONS AND PORTFOLIO HOLDINGS AS OF AUGUST 31, 2009, THE END OF THE REPORTING PERIOD. THE WAY WE IMPLEMENT OUR MAIN INVESTMENT STRATEGIES AND THE RESULTING PORTFOLIO HOLDINGS MAY CHANGE DEPENDING ON FACTORS SUCH AS MARKET AND ECONOMIC CONDITIONS. THESE OPINIONS MAY NOT BE RELIED UPON AS INVESTMENT ADVICE OR AN OFFER FOR A PARTICULAR SECURITY. THE INFORMATION IS NOT A COMPLETE ANALYSIS OF EVERY ASPECT OF ANY MARKET, COUNTRY, INDUSTRY, SECURITY OR THE FUND. STATEMENTS OF FACT ARE FROM SOURCES CONSIDERED RELIABLE, BUT THE INVESTMENT MANAGER MAKES NO REPRESENTATION OR WARRANTY AS TO THEIR COMPLETENESS OR ACCURACY. ALTHOUGH HISTORICAL PERFORMANCE IS NO GUARANTEE OF FUTURE RESULTS, THESE INSIGHTS MAY HELP YOU UNDERSTAND OUR INVESTMENT MANAGEMENT PHILOSOPHY.

Performance Summary as of 8/31/09

Your dividend income will vary depending on dividends or interest paid by securities in the Fund's portfolio, adjusted for operating expenses. Capital gain distributions are net profits realized from the sale of portfolio securities. Total return reflects reinvestment of the Fund's dividends and capital gain distributions, if any, and any unrealized gains or losses. Total returns do not reflect any sales charges paid at inception or brokerage commissions paid on secondary market purchases. The performance table does not reflect any taxes that a shareholder would pay on Fund dividends, capital gains distributions, if any, or any realized gains on the sale of Fund shares.

PRICE AND DISTRIBUTION INFORMATION

SYMBOL: TEI		CHANGE	8/31/09	8/31/08
Net Asset Value (NAV)		-$0.63	$13.82	$14.45
Market Price (NYSE)		-$1.10	$13.11	$14.21
DISTRIBUTIONS (9/1/08-8/31/09)				
Dividend Income	$1.3617			
Long-Term Capital Gain	$0.0788			
TOTAL	$1.4405			

PERFORMANCE

	1-YEAR	5-YEAR	10-YEAR
Cumulative Total Return(1)			
Based on change in NAV(2)	+8.02%	+59.55%	+204.64%
Based on change in market price(3)	+6.57%	+62.88%	+260.19%
Average Annual Total Return(1)			
Based on change in NAV(2)	+8.02%	+9.80%	+11.78%
Based on change in market price(3)	+6.57%	+10.25%	+13.67%

PERFORMANCE DATA REPRESENT PAST PERFORMANCE, WHICH DOES NOT GUARANTEE FUTURE RESULTS. INVESTMENT RETURN AND PRINCIPAL VALUE WILL FLUCTUATE, AND YOU MAY HAVE A GAIN OR LOSS WHEN YOU SELL YOUR SHARES. CURRENT PERFORMANCE MAY DIFFER FROM FIGURES SHOWN.

ENDNOTES

CHANGES IN INTEREST RATES WILL AFFECT THE VALUE OF THE FUND'S PORTFOLIO AND ITS SHARE PRICE AND YIELD. BOND PRICES GENERALLY MOVE IN THE OPPOSITE DIRECTION OF INTEREST RATES. THUS, AS PRICES OF BONDS IN THE FUND ADJUST TO A RISE IN INTEREST RATES, THE FUND'S SHARE PRICE MAY DECLINE. SPECIAL RISKS ARE ASSOCIATED WITH FOREIGN INVESTING, INCLUDING CURRENCY FLUCTUATIONS, ECONOMIC INSTABILITY AND POLITICAL DEVELOPMENTS. INVESTMENTS IN DEVELOPING MARKETS INVOLVE HEIGHTENED RISKS RELATED TO THE SAME FACTORS, IN ADDITION TO THOSE ASSOCIATED WITH THEIR RELATIVELY SMALL SIZE AND LESSER LIQUIDITY. THE FUND'S USE OF FOREIGN CURRENCY TECHNIQUES INVOLVES SPECIAL RISKS AS SUCH TECHNIQUES MAY NOT ACHIEVE THE ANTICIPATED BENEFITS AND/OR MAY RESULT IN LOSSES TO THE FUND. ALSO, AS A NONDIVERSIFIED INVESTMENT COMPANY, THE FUND MAY INVEST IN A RELATIVELY SMALL NUMBER OF ISSUERS AND, AS A RESULT, BE SUBJECT TO A GREATER RISK OF LOSS WITH RESPECT TO ITS PORTFOLIO SECURITIES.

(1.) Total return calculations represent the cumulative and average annual changes in value of an investment over the periods indicated.

(2.) Assumes reinvestment of distributions based on net asset value.

(3.) Assumes reinvestment of distributions based on the dividend reinvestment and cash purchase plan.

Important Notice to Shareholders

SHARE REPURCHASE PROGRAM

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

OPTIONS ON SWAP AGREEMENTS (SWAPTIONS)

Generally, the Fund may purchase and write (sell) both put and call options on swap agreements, commonly known as swaptions, although currently the Fund only intends to purchase options on interest rate swaps. The Fund may buy options on interest rate swaps to help hedge the Fund's risk of potentially rising interest rates. A swaption is an over-the-counter (OTC) option that gives the buyer of the option the right, but not the obligation, to enter into a previously negotiated swap agreement, or to extend, terminate, or otherwise modify the terms of an existing swap agreement, in exchange for the payment of a premium to the writer (seller) of the option. The writer (seller) of a swaption receives premium payments from the buyer and, in exchange, becomes obligated to enter into or modify an underlying swap agreement upon the exercise of the option by the buyer.

The Fund generally assumes a greater risk when it writes (sells) a swaption than when it purchases a swaption. When the Fund purchases a swaption, it risks losing the amount of premium it has paid, should it elect not to exercise the option, plus any related transaction costs. When the Fund writes (sells) a swaption, however, the Fund is bound by the terms of the underlying swap agreement upon exercise of the option by the buyer, which may result in losses to the Fund in excess of the premium it received. Swaptions also involve other risks associated with both OTC options and swap agreements, such as counterparty risk (the risk that the counterparty defaults on its obligation), market risk, credit risk, and interest rate risk. With respect to the Fund's purchase of options on interest rate swaps, depending on the movement of interest rates between the time of purchase and expiration of the swaption, the value of the underlying interest rate swap and therefore the value of the swaption will change.

Templeton Emerging Markets Income Fund

FINANCIAL HIGHLIGHTS

	YEAR ENDED AUGUST 31,				
	2009	2008	2007	2006	
PER SHARE OPERATING PERFORMANCE					
(for a share outstanding throughout the year)					
Net asset value, beginning of year	$ 14.45	$ 14.76	$ 14.63	$ 13.75	$
Income from investment operations:					

Net investment income(a)	1.03	1.08	1.00	0.89	
Net realized and unrealized gains (losses)	(0.22)	(0.05)	0.25	0.90	
Total from investment operations	0.81	1.03	1.25	1.79	
Less distributions from:					
Net investment income and net realized foreign currency gains	(1.36)	(1.34)	(1.12)	(0.91)	
Net realized gains	(0.08)	--	--	--	
Total distributions	(1.44)	(1.34)	(1.12)	(0.91)	
Net asset value, end of year	$ 13.82	$ 14.45	$ 14.76	$ 14.63	$
Market value, end of year(b)	$ 13.11	$ 14.21	$ 13.52	$ 13.49	$
Total return (based on market value per share)	6.57%	15.84%	8.39%	8.71%	
RATIOS TO AVERAGE NET ASSETS					
Expenses(c)	1.20%	1.19%	1.17%	1.22%	
Net investment income	8.59%	7.30%	6.63%	6.29%	
SUPPLEMENTAL DATA					
Net assets, end of year (000's)	$653,992	$684,152	$698,702	$692,469	$
Portfolio turnover rate	34.03%	25.04%	36.26%	23.68%	

(a) Based on average daily shares outstanding.

(b) Based on the last sale on the New York Stock Exchange.

(c) Benefit of expense reduction rounds to less than 0.01%.

The accompanying notes are an integral part of these financial statements.

Templeton Emerging Markets Income Fund

STATEMENT OF INVESTMENTS, AUGUST 31, 2009

		PRINCIPAL AM
	BONDS 94.2%	
	ARGENTINA 7.4%	
(b, c)	Government of Argentina, senior bond, FRN,	
	0.943%, 8/03/12	140,605,00
	2.280%, 12/15/35	219,745,00
	BOSNIA & HERZEGOVINA 0.9%	
(b)	Government of Bosnia & Herzegovina, FRN, 2.288%, 12/11/17	6,281,24
	BRAZIL 14.1%	
(d)	Centrais Eletricas Brasileiras SA, senior note, 144A, 6.875%, 7/30/19	4,150,00
	Nota Do Tesouro Nacional,	
	9.609%, 1/01/12	35,35
	9.609%, 1/01/14	20,00

	9.609%, 1/01/17	46,40
(f)	Index Linked, 6.00%, 5/15/15	22,05
(f)	Index Linked, 6.00%, 5/15/45	17,82
	COLOMBIA 1.4%	
	Government of Colombia,	
	senior bond, 11.75%, 2/25/20	4,255,00
	senior note, 7.375%, 3/18/19	3,000,00
	EL SALVADOR 0.4%	
(d)	Government of El Salvador, 144A, 7.65%, 6/15/35	2,650,00
	FIJI 1.8%	
	Republic of Fiji, 6.875%, 9/13/11	12,360,00
	GEORGIA 1.0%	
	Government of Georgia, 7.50%, 4/15/13	6,950,00
	GHANA 0.7%	
(g)	Government of Ghana, Reg S, 8.50%, 10/04/17	5,300,00
	HUNGARY 0.5%	
	Government of Hungary,	
	3.50%, 7/18/16	190,00
	4.375%, 7/04/17	560,00
	5.75%, 6/11/18	1,255,00
	senior note, 3.875%, 2/24/20	535,00
	INDIA 1.5%	
(d)	ICICI Bank Ltd.,	
	144A, 6.625%, 10/03/12	6,625,00
(b)	sub. bond, 144A, FRN, 6.375%, 4/30/22	4,100,00

Templeton Emerging Markets Income Fund

STATEMENT OF INVESTMENTS, AUGUST 31, 2009 (CONTINUED)

	PRINCIPAL AM
BONDS (CONTINUED)	
INDONESIA 11.6%	
Government of Indonesia,	
FR26, 11.00%, 10/15/14	120,832,000,00
FR28, 10.00%, 7/15/17	18,800,000,00

	FR31, 11.00%, 11/15/20	132,050,000,00
	FR36, 11.50%, 9/15/19	40,000,000,00
	FR40, 11.00%, 9/15/25	387,140,000,00
	FR46, 9.50%, 7/15/23	3,200,000,00
	FR47, 10.00%, 2/15/28	12,210,000,00
	FR48, 9.00%, 9/15/18	5,450,000,00
(d)	senior note, 144A, 11.625%, 3/04/19	2,745,00
	IRAQ 5.1%	
	Government of Iraq,	
(d)	144A, 5.80%, 1/15/28	46,800,00
(g)	Reg S, 5.80%, 1/15/28	1,675,00
	KAZAKHSTAN 5.8%	
	HSBK (Europe) BV,	
(d)	144A, 7.25%, 5/03/17	4,305,00
(g)	Reg S, 7.25%, 5/03/17	21,730,00
(d)	Kazmunaigaz Finance Sub BV, 144A, 9.125%, 7/02/18	19,200,00
	LUXEMBOURG 0.8%	
(d)	RSHB Capital SA, 144A, 9.00%, 6/11/14	4,880,00
	MEXICO 3.3%	
(d)	Alestra SA, senior note, 144A, 11.75%, 8/11/14	1,400,00
	Government of Mexico, M 20, 7.50%, 6/03/27	2,978,00
	NETHERLANDS 1.7%	
	Rabobank Nederland, senior note, 8.75%, 1/24/17	157,900,00
	PAKISTAN 1.9%	
(d)	Government of Pakistan, 144A, 6.875%, 6/01/17	15,000,00
	PANAMA 1.0%	
	Government of Panama, 6.70%, 1/26/36	6,639,00
	PERU 4.5%	
	Government of Peru,	
	7.35%, 7/21/25	9,420,00
	8.75%, 11/21/33	12,550,00
(d)	Peru Enhanced Pass-Through Finance Ltd., senior secured bond, A-1, 144A, zero cpn., 5/31/18	4,443,66

STATEMENT OF INVESTMENTS, AUGUST 31, 2009 (CONTINUED)

		PRINCIPAL AM
	BONDS (CONTINUED)	
	PHILIPPINES 2.1%	
	Government of the Philippines,	
	9.00%, 2/15/13	7,960,00
(g)	Reg S, 8.75%, 10/07/16	3,750,00
	POLAND 0.8%	
	Government of Poland, 6.25%, 10/24/15	15,380,00
	RUSSIA 7.2%	
(g)	Alfa MTN Markets Ltd. for ABH Financial Ltd., Reg S, 8.20%, 6/25/12	1,575,00
(g)	Gaz Capital SA, senior bond, Reg S, 8.146%, 4/11/18	6,000,00
(d)	Gazprom, secured note, 144A, 7.51%, 7/31/13	4,550,00
(g)	Government of Russia, senior bond, Reg S, 7.50%, 3/31/30	5,116,80
	LUKOIL International Finance BV,	
(d)	144A, 6.356%, 6/07/17	890,00
(d)	144A, 6.656%, 6/07/22	4,540,00
(g)	Reg S, 6.356%, 6/07/17	2,300,00
(g)	Reg S, 6.656%, 6/07/22	3,970,00
	VTB Capital (VNESHTORGBK), 6.315% to 2/04/10 , 7.815% thereafter,	
	2/04/15	17,000,00
(d)	VTB Capital SA, senior note, 144A, 6.25%, 6/30/35	2,400,00
	SOUTH AFRICA 2.1%	
(b, d)	Edcon Holdings, 144A, FRN, 6.777%, 6/15/15	1,200,00
(b, g)	Edcon Proprietary Ltd., senior secured note, Reg S, FRN, 4.527%,	
	6/15/14	2,100,00
	Government of South Africa,	
	4.50%, 4/05/16	4,000,00
	senior note, 5.875%, 5/30/22	5,000,00
	SOUTH KOREA 0.9%	
	Korea Treasury Bond,	
	0400-1206, 4.00%, 6/10/12	1,572,920,00
	0475-1112, 4.75%, 12/10/11	2,804,070,00
	0475-1203, 4.75%, 3/10/12	2,255,000,00
	0525-2703, 5.25%, 3/10/27	478,770,00
	SRI LANKA 2.0%	
	Government of Sri Lanka, A,	
	8.50%, 1/15/13	312,300,00
	13.50%, 2/01/13	303,200,00
	11.25%, 7/15/14	354,200,00
	11.00%, 8/01/15	607,700,00

Templeton Emerging Markets Income Fund

STATEMENT OF INVESTMENTS, AUGUST 31, 2009 (CONTINUED)

		PRINCIPAL AM
	BONDS (CONTINUED)	
(i)	SUPRANATIONAL 4.9%	
	African Development Bank, senior note, 340, 25.50%, 6/24/11	8,200,00
	Corporacion Andina De Fomento, 8.125%, 6/04/19	4,550,00
	Inter-American Development Bank, senior note, 7.50%, 12/05/24	355,000,00
	TRINIDAD AND TOBAGO 0.8%	
	Petro Co. of Trinidad and Tobago Ltd., senior note,	
(d)	144A, 9.75%, 8/14/19	4,500,00
(g)	Reg S, 9.75%, 8/14/19	210,00
	UKRAINE 4.5%	
(d)	City of Kiev, 144A, 8.625%, 7/15/11	22,400,00
(d)	Government of the Ukraine, 144A, 7.65%, 6/11/13	11,948,00
	UNITED ARAB EMIRATES 1.0%	
(d)	DP World Ltd., 144A, 6.85%, 7/02/37	8,080,00
	UNITED STATES 1.8%	
	General Electric Capital Corp., senior note, A, 8.50%, 4/06/18	185,000,00
	VENEZUELA 0.7%	
	Government of Venezuela, 10.75%, 9/19/13	3,800,00
(g)	senior bond, Reg S, 5.375%, 8/07/10	870,00
	TOTAL BONDS (COST $631,048,615)	
	SHORT TERM INVESTMENTS 2.5%	
	FOREIGN GOVERNMENT AND AGENCY SECURITIES (COST $352,519) 0.1%	
	EGYPT 0.1%	
(j)	Egypt Treasury Bill, 9/22/09	1,950,00
	TOTAL INVESTMENTS BEFORE MONEY MARKET FUNDS (COST $631,401,134)	

		SHARES
	MONEY MARKET FUNDS (COST $15,772,256) 2.4%	
	UNITED STATES 2.4%	
(k)	Institutional Fiduciary Trust Money Market Portfolio, 0.00%	15,772,25
	TOTAL INVESTMENTS (COST $647,173,390) 96.7%	
	OTHER ASSETS, LESS LIABILITIES 3.3%	
	NET ASSETS 100.0%	

Templeton Emerging Markets Income Fund

STATEMENT OF INVESTMENTS, AUGUST 31, 2009 (CONTINUED)

(a) The principal amount is stated in U.S. dollars unless otherwise indicated.

(b) The coupon rate shown represents the rate at period end.

(c) The principal amount is stated in original face, and scheduled paydowns are reflected in the market price on ex-date.

(d) Security was purchased pursuant to Rule 144A under the Securities Act of 1933 and may be sold in transactions exempt from registration only to qualified institutional buyers or in a public offering registered under the Securities Act of 1933. These securities have been deemed liquid under guidelines approved by the Fund's Board of Trustees. At August 31, 2009, the aggregate value of these securities was $150,601,786, representing 23.03% of net assets.

(e) Principal amount is stated in 1,000 Brazilian Real units

(f) Redemption price at maturity is adjusted for inflation. See Note 1(e).

(g) Security was purchased pursuant to Regulation S under the Securities Act of 1933, which exempts from registration securities offered and sold outside of the United States. Such a security cannot be sold in the United States without either an effective registration statement filed pursuant to the Securities Act of 1933, or pursuant to an exemption from registration. These securities have been deemed liquid under guidelines approved by the Fund's Board of Trustees. At August 31, 2009, the aggregate value of these securities was $48,404,109, representing 7.40% of net assets.

(h) Principal amount is stated in 100 Mexican Peso Units.

(i) A supranational organization is an entity formed by two or more central governments through international treaties.

(j) The security is traded on a discount basis with no stated coupon rate.

(k) See Note 7 regarding investments in the Institutional Fiduciary Trust Money Market Portfolio. The rate shown is the annualized seven-day yield at period end.

At August 31, 2009, the Fund had the following forward exchange contracts outstanding. See Note 1(c).

CURRENCY	COUNTERPARTY	TYPE	QUANTITY	CONTRACT AMOUNT	SETTLEMENT DATE	UNREALIZE APPRECIATI
Euro	DBAB	Sell	725,485	$ 1,013,684	9/10/09	$ -
Euro	UBSW	Sell	362,390	505,680	9/11/09	-
Mexican Peso	DBAB	Sell	13,012,157	1,157,459	9/15/09	184,73
Euro	DBAB	Sell	688,058	970,299	9/21/09	-
Mexican Peso	DBAB	Sell	39,897,968	3,467,579	10/01/09	491,07
Mexican Peso	MLCO	Sell	39,728,544	3,462,183	10/05/09	499,91
Mexican Peso	CITI	Sell	11,801,000	871,083	12/01/09	-
Mexican Peso	CITI	Sell	34,649,958	2,467,155	12/14/09	-
Mexican Peso	DBAB	Sell	96,948,564	7,150,021	12/22/09	-
Mexican Peso	DBAB	Buy	96,948,564	6,847,859	12/22/09	306,73
Mexican Peso	DBAB	Buy	40,262,564	2,853,275	12/23/09	117,60
Mexican Peso	DBAB	Sell	40,262,564	2,971,824	12/23/09	94
Mexican Peso	DBAB	Sell	64,556,594	4,747,856	12/24/09	-
Mexican Peso	DBAB	Buy	64,556,594	4,565,239	12/24/09	197,60
Mexican Peso	DBAB	Sell	7,781,929	571,256	1/20/10	-
Mexican Peso	DBAB	Buy	7,781,929	524,565	1/20/10	47,47
Mexican Peso	HSBC	Sell	115,740,103	8,493,876	1/21/10	-
Mexican Peso	HSBC	Buy	115,740,103	7,868,482	1/21/10	638,24
Mexican Peso	CITI	Sell	11,914,000	873,973	1/29/10	-
Euro	DBAB	Sell	180,829	254,419	2/19/10	-
Mexican Peso	DBAB	Sell	61,551,442	4,619,159	2/19/10	112,87
Mexican Peso	DBAB	Sell	457,957,173	34,604,592	2/22/10	1,090,35
Euro	DBAB	Sell	7,600,000	10,313,656	3/29/10	-
Peruvian Nuevo Sol ..	DBAB	Buy	5,367,447	1,749,032	5/18/10	57,86
Mexican Peso	DBAB	Sell	67,925,352	4,869,725	6/09/10	-
Malaysian Ringgit ...	DBAB	Buy	2,499,000	694,553	7/16/10	8,25
Malaysian Ringgit ...	DBAB	Buy	3,942,000	1,103,954	7/20/10	4,61

Templeton Emerging Markets Income Fund

STATEMENT OF INVESTMENTS, AUGUST 31, 2009 (CONTINUED)

CURRENCY	COUNTERPARTY	TYPE	QUANTITY	CONTRACT AMOUNT	SETTLEMENT DATE	UNREALIZE APPRECIATI
Malaysian Ringgit ...	DBAB	Buy	4,793,000	1,353,572	7/23/10	$ -
Malaysian Ringgit ...	JPHQ	Buy	5,039,000	1,419,437	7/27/10	-
Euro	UBSW	Sell	2,260,000	3,185,809	8/20/10	-
Euro	DBAB	Sell	2,260,000	3,192,024	8/20/10	-
Euro	BZWS	Sell	2,260,000	3,193,493	8/20/10	-
Mexican Peso	DBAB	Sell	74,700,583	5,514,993	8/27/10	192,40
Unrealized appreciation (depreciation)						3,950,69
Net unrealized appreciation (depreciation)						$3,001,00

=========

At August 31, 2009, the Fund had the following interest rate swap contracts outstanding. See Note 1(c).

COUNTERPARTY	PAY/RECEIVE FLOATING RATE	FIXED RATE	FLOATING RATE	NOTIONAL AMOUNT(a)	EXPIRATIO DATE
MLCO	Pay	7.053%	Tasa Nominal Annual Rate	4,700,000,000 CLP	6/13/18
JPHQ	Pay	7.06%	Tasa Nominal Annual Rate	1,568,000,000 CLP	6/13/18
MLCO	Pay	7.094%	Tasa Nominal Annual Rate	5,100,000,000 CLP	6/16/18
JPHQ	Pay	7.15%	Tasa Nominal Annual Rate	1,600,000,000 CLP	6/18/18
JPHQ	Pay	7.855%	Tasa Nominal Annual Rate	403,200,000 CLP	7/17/18
MLCO	Pay	9.03%	MXN Interbank Equilibrium Interest Rate	241,000,000 MXN	8/17/18
MLCO	Pay	9.10%	MXN Interbank Equilibrium Interest Rate	80,000,000 MXN	8/04/28

Unrealized appreciation (depreciation) ....

Net unrealized appreciation (depreciation) ....

(a) In U.S. dollars unless otherwise indicated.

See Abbreviations on page 27.

The accompanying notes are an integral part of these financial statements.

Templeton Emerging Markets Income Fund

FINANCIAL STATEMENTS

STATEMENT OF ASSETS AND LIABILITIES
August 31, 2009

Assets:	
Investments in securities:	
Cost - Unaffiliated issuers	$631,401,134
Cost - Sweep Money Fund (Note 7)	15,772,256
Total cost of investments	$647,173,390
Value - Unaffiliated issuers	$616,881,012
Value - Sweep Money Fund (Note 7)	15,772,256
Total value of investments	632,653,268
Cash	4,582,000
Foreign currency, at value (cost and $284,088)	286,542
Receivable from interest	14,322,149

Unrealized appreciation on forward exchange contracts ...	3,950,698
Unrealized appreciation on swap contracts	4,763,672
Total assets	660,558,329
Liabilities:	
Payables:	
Affiliates	544,752
Custodian fees (Note 4)	165,863
Transfer agent fees	231,019
Due to brokers	4,582,000
Unrealized depreciation on forward exchange contracts ...	949,690
Accrued expenses and other liabilities	92,860
Total liabilities	6,566,184
Net assets, at value	$653,992,145
Net assets consist of:	
Paid-in capital	$661,118,506
Undistributed net investment income	8,780,824
Net unrealized appreciation (depreciation)	(6,643,289)
Accumulated net realized gain (loss)	(9,263,896)
Net assets, at value	$653,992,145
Shares outstanding	47,338,848
Net asset value per share	$13.82

The accompanying notes are an integral part of these financial statements.

Templeton Emerging Markets Income Fund

FINANCIAL STATEMENTS (CONTINUED)

STATEMENT OF OPERATIONS
for the year ended August 31, 2009

Investment income:	
Dividends - Sweep Money Fund (Note 7)	$ 91,414
Interest (net of foreign taxes of $1,072,092)	55,238,465
Total investment income	55,329,879
Expenses:	
Management fees (Note 3a)	4,748,964
Administrative fees (Note 3b)	847,460
Transfer agent fees	650,345
Custodian fees (Note 4)	265,075
Reports to shareholders	51,801
Registration and filing fees	42,517
Professional fees	61,477
Trustees' fees and expenses	70,748

Other	40,157
Total expenses	6,778,544
Expense reductions (Note 4)	(2,137)
Net expenses	6,776,407
Net investment income	48,553,472
Realized and unrealized gains (losses):	
Net realized gain (loss) from:	
Investments	(12,059,535)
Foreign currency transactions	15,543,750
Swap contracts	648,855
Net realized gain (loss)	4,133,070
Net change in unrealized appreciation (depreciation) on:	
Investments	(17,347,568)
Translation of other assets and liabilities denominated in foreign currencies	2,692,657
Net change in unrealized appreciation (depreciation)	(14,654,911)
Net realized and unrealized gain (loss)	(10,521,841)
Net increase (decrease) in net assets resulting from operations	$ 38,031,631

The accompanying notes are an integral part of these financial statements.

Templeton Emerging Markets Income Fund

FINANCIAL STATEMENTS (CONTINUED)

STATEMENTS OF CHANGES IN NET ASSETS

	YEAR ENDED AUG	
	2009	
Increase (decrease) in net assets:		
Operations:		
Net investment income	$ 48,553,472	$
Net realized gain (loss) from investments, foreign currency transactions and swap contracts	4,133,070	
Net change in unrealized appreciation (depreciation) on investments and translation of other assets and liabilities denominated in foreign currencies	(14,654,911)	(
Net increase (decrease) in net assets resulting from operations	38,031,631	

Distributions to shareholders from:		
Net investment income and net realized foreign currency gains	(64,461,309)	(
Net realized gains	(3,730,301)	
Total distributions to shareholders	(68,191,610)	(
Net increase (decrease) in net assets	(30,159,979)	(
Net assets:		
Beginning of year	684,152,124	6
End of year	$653,992,145	$6
Undistributed net investment income included in net assets:		
End of year	$ 8,780,824	$

The accompanying notes are an integral part of these financial statements.

Templeton Emerging Markets Income Fund

NOTES TO FINANCIAL STATEMENTS

1. ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

Templeton Emerging Markets Income Fund (Fund) is registered under the Investment Company Act of 1940, as amended, (1940 Act) as a closed-end investment company.

The following summarizes the Fund's significant accounting policies.

A. SECURITY VALUATION

Corporate debt securities and government securities generally trade in the over-the-counter market rather than on a securities exchange. The Fund may utilize independent pricing services, quotations from bond dealers, and information with respect to bond and note transactions, to assist in determining a current market value for each security. The Fund's pricing services may use valuation models or matrix pricing which considers information with respect to comparable bond and note transactions, quotations from bond dealers, or by reference to other securities that are considered comparable in such characteristics as rating, interest rate and maturity date, option adjusted spread models, prepayment projections, interest rate spreads and yield curves, to determine current value. Debt securities denominated in a foreign currency are converted into their U.S. dollar equivalent at the foreign exchange rate in effect at the close of the NYSE on the date that the values of the foreign debt securities are determined. Investments in open-end mutual funds are valued at the closing net asset value.

The Fund has procedures to determine the fair value of individual securities and other assets for which market prices are not readily available or which may not be reliably priced. Methods for valuing these securities may include: fundamental analysis based upon the underlying investment book value, anticipated future cash flows, market changes in comparable or similar securities, matrix pricing, discounts from market prices of similar securities, or discounts applied due to the nature and duration of restrictions on the disposition of the securities. Due to the inherent uncertainty of valuations of such securities, the fair values may differ significantly from the values that would have been used had a ready market for such investments existed. Occasionally, events occur between the time at which trading in a security is completed and the close of the NYSE that might call into question the availability (including the reliability) of the value of a portfolio security held by the Fund. If such an event occurs, the securities may be valued using fair value procedures, which may include the use of independent pricing services. All security valuation procedures are approved by the Fund's Board of Trustees.

B. FOREIGN CURRENCY TRANSLATION

Portfolio securities and other assets and liabilities denominated in foreign currencies are translated into U.S. dollars based on the exchange rate of such currencies against U.S. dollars on the date of valuation. Purchases and sales of securities, income and expense items denominated in foreign currencies are translated into U.S. dollars at the exchange rate in effect on the transaction date. Occasionally, events may impact the availability or reliability of foreign exchange rates used to convert the U.S. dollar equivalent value. If such an event occurs, the foreign exchange rate will be valued at fair value using procedures established and approved by the Fund's Board of Trustees.

1. ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

B. FOREIGN CURRENCY TRANSLATION (CONTINUED)

The Fund does not separately report the effect of changes in foreign exchange rates from changes in market prices on securities held. Such changes are included in net realized and unrealized gain or loss from investments on the Statement of Operations.

Realized foreign exchange gains or losses arise from sales of foreign currencies, currency gains or losses realized between the trade and settlement dates on securities transactions and the difference between the recorded amounts of dividends, interest, and foreign withholding taxes and the U.S. dollar equivalent of the amounts actually received or paid. Net unrealized foreign exchange gains and losses arise from changes in foreign exchange rates on foreign denominated assets and liabilities other than investments in securities held at the end of the reporting period.

C. DERIVATIVE FINANCIAL INSTRUMENTS

The Fund may invest in derivative financial instruments (derivatives) in order to manage risk or gain exposure to various other investments or markets. Derivatives are financial contracts based on an underlying or notional amount, require no initial investment or an initial net investment that is smaller than would normally be required to have a similar response to changes in market factors, and require or permit net settlement. Derivatives may contain various risks including the potential inability of the counterparty to fulfill their obligations under the terms of the contract, the potential for an illiquid secondary market, and the potential for market movements which may expose the Fund to gains or losses in excess of the amounts shown on the Statement of Assets and Liabilities.

Derivatives are marked to market daily based upon quotations from market makers or the Fund's independent pricing services and the Fund's net benefit or obligation under the contract, as measured by the fair market value of the contract, is included in net assets. Realized gain and loss and unrealized appreciation and depreciation on these contracts for the period are included in the Statement of Operations.

The Fund enters into forward exchange contracts in order to hedge against fluctuations in foreign exchange rates or to gain exposure to certain foreign currencies. A forward exchange contract is an agreement between the Fund and a counterparty to buy or sell a foreign currency for a specific exchange rate on a future date. Pursuant to the terms of the forward exchange contracts, cash or securities may be required to be deposited as collateral.

The Fund enters into interest rate swap contracts generally in order to manage interest rate risk. An interest rate swap is an agreement between the Fund and a counterparty to exchange cash flows based on the difference between two interest rates, applied to a notional principal amount. Over the term of the contract, contractually required payments to be paid and to be received are

1. ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

C. DERIVATIVE FINANCIAL INSTRUMENTS (CONTINUED)

accrued daily and recorded as unrealized depreciation and appreciation until the payments are made, at which time they are realized. Pursuant to the terms of the interest rate swap contract, cash or securities may be required to be deposited as collateral. Any cash received may be invested according to the Fund's investment objectives.

See Note 10 regarding other derivative information.

D. INCOME TAXES

No provision has been made for U.S. income taxes because it is the Fund's policy to qualify as a regulated investment company under the Internal Revenue Code and to distribute to shareholders substantially all of its taxable income and net realized gains.

The Fund has reviewed the tax positions, taken on federal income tax returns, for each of the three open tax years and as of August 31, 2009, and has determined that no provision for income tax is required in the Fund's financial statements.

Foreign securities held by the Fund may be subject to foreign taxation on interest income received. Foreign taxes, if any, are recorded based on the tax regulations and rates that exist in the foreign markets in which the Fund invests.

E. SECURITY TRANSACTIONS, INVESTMENT INCOME, EXPENSES AND DISTRIBUTIONS

Security transactions are accounted for on trade date. Realized gains and losses on security transactions are determined on a specific identification basis.

Interest income and estimated expenses are accrued daily. Amortization of premium and accretion of discount on debt securities are included in interest income. Dividend income is recorded on the ex-dividend date. Distributions to shareholders are recorded on the ex-dividend date and are determined according to income tax regulations (tax basis). Distributable earnings determined on a tax basis may differ from earnings recorded in accordance with accounting principles generally accepted in the United States of America. These differences may be permanent or temporary. Permanent differences are reclassified among capital accounts to reflect their tax character. These reclassifications have no impact on net assets or the results of operations. Temporary differences are not reclassified, as they may reverse in subsequent periods.

Inflation-indexed bonds provide an inflation hedge through periodic increases or decreases in the security's interest accruals and principal redemption value, by amounts corresponding to the current rate of inflation. Any such adjustments, including adjustments to principal redemption value, are recorded as interest income.

1. ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

F. ACCOUNTING ESTIMATES

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the amounts of income and expenses during the reporting period. Actual results could differ from those estimates.

G. GUARANTEES AND INDEMNIFICATIONS

Under the Fund's organizational documents, its officers and trustees are indemnified by the Fund against certain liabilities arising out of the performance of their duties to the Fund. Additionally, in the normal course of business, the Fund enters into contracts with service providers that contain general indemnification clauses. The Fund's maximum exposure under these arrangements is unknown as this would involve future claims that may be made against the Fund that have not yet occurred. Currently, the Fund expects the risk of loss to be remote.

2. SHARES OF BENEFICIAL INTEREST

At August 31, 2009, there were an unlimited number of shares authorized ($0.01 par value). During the year ended August 31, 2009, there were no shares issued; all reinvested distributions were satisfied with previously issued shares purchased in the open market.

The Fund's Board of Trustees previously authorized an open-market share repurchase program pursuant to which the Fund may purchase, from time to time, Fund shares in open-market transactions, at the discretion of management. This authorization remains in effect. Through August 31, 2009, the Fund had repurchased a total of 610,500 shares. During the years ended August 31, 2008 and August 31, 2009, there were no shares repurchased.

3. TRANSACTIONS WITH AFFILIATES

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

SUBSIDIARY	AFFILIATION
Franklin Advisers, Inc. (Advisers)	Investment manager
Franklin Templeton Services, LLC (FT Services)	Administrative manager

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

3. TRANSACTIONS WITH AFFILIATES (CONTINUED)

A. MANAGEMENT FEES

The Fund pays an investment management fee to Advisers based on the average daily net assets of the Fund as follows:

ANNUALIZED FEE RATE	NET ASSETS
0.850%	Up to and including $1 billion
0.830%	Over $1 billion, up to and including $5 billion
0.810%	Over $5 billion, up to and including $10 billion
0.790%	Over $10 billion, up to and including $15 billion
0.770%	Over $15 billion, up to and including $20 billion
0.750%	In excess of $20 billion

B. ADMINISTRATIVE FEES

The Fund pays an administrative fee to FT Services of 0.15% per year of the average daily net assets of the Fund.

4. EXPENSE OFFSET ARRANGEMENT

The Fund has entered into an arrangement with its custodian whereby credits realized as a result of uninvested cash balances are used to reduce a portion of the Fund's custodian expenses. During the year ended August 31, 2009, the custodian fees were reduced as noted in the Statement of Operations.

5. INCOME TAXES

For tax purposes, capital losses may be carried over to offset future capital gains, if any. At August 31, 2009, the Fund had tax basis capital losses of $1,231,202 expiring in 2017.

For tax purposes, realized currency losses occurring subsequent to October 31, may be deferred and treated as occurring on the first day of the following fiscal year. At August 31, 2009, the Fund deferred realized currency losses of $7,025,551.

The tax character of distributions paid during the years ended August 31, 2009 and August 31, 2008, was as follows:

	2009	2008
Distributions paid from:		
Ordinary income	$64,463,389	$63,410,387
Long term capital gain	3,728,221	--
	$68,191,610	$63,410,387

5. INCOME TAXES (CONTINUED)

At August 31, 2009, the cost of investments, net unrealized appreciation (depreciation), undistributed ordinary income for income tax purposes were as follows:

Cost of investments	$648,989,780
Unrealized appreciation	$ 31,820,962
Unrealized depreciation	(48,157,474)
Net unrealized appreciation (depreciation)	$(16,336,512)
Distributable earnings - undistributed ordinary income	$ 15,401,370

Net investment income differs for financial statement and tax purposes primarily due to differing treatments of defaulted securities, foreign currency transactions, bond discounts and premiums, swaps and tax straddles.

Net realized gains (losses) differ for financial statement and tax purposes primarily due to differing treatments of wash sales, foreign currency transactions, bond discounts and premiums, swaps and tax straddles.

6. INVESTMENT TRANSACTIONS

Purchases and sales of investments (excluding short term securities) for the year ended August 31, 2009, aggregated $194,535,565 and $178,012,148, respectively.

7. INVESTMENTS IN INSTITUTIONAL FIDUCIARY TRUST MONEY MARKET PORTFOLIO

The Fund may invest in the Institutional Fiduciary Trust Money Market Portfolio (Sweep Money Fund), an open-end investment company managed by Advisers. Management fees paid by the Fund are reduced on assets invested in the Sweep Money Fund, in an amount not to exceed the management and administrative fees paid by the Sweep Money Fund.

8. CREDIT RISK

At August 31, 2009, the Fund had 52.55% of its portfolio invested in high yield, senior secured floating rate notes, or other securities rated below investment grade. These securities may be more sensitive to economic conditions causing greater price volatility and are potentially subject to a greater risk of loss due to default than higher rated securities.

9. CONCENTRATION OF RISK

Investing in foreign securities may include certain risks and considerations not typically associated with investing in U.S. securities, such as fluctuating currency values and changing local and regional economic, political and social conditions, which may result in greater market volatility. In addition, certain foreign securities may not be as liquid as U.S. securities.

10. OTHER DERIVATIVE INFORMATION

At August 31, 2009, the Fund has invested in derivative contracts which are reflected on the Statement of Assets and Liabilities as follows:

DERIVATIVE CONTRACTS NOT ACCOUNTED FOR AS HEDGING INSTRUMENTS UNDER FASB STATEMENT NO. 133	ASSET DERIVATIVES		LIABILITY DERIVATIVES	
	STATEMENT OF ASSETS AND LIABILITIES LOCATION	FAIR VALUE AMOUNT	STATEMENT OF ASSETS AND LIABILITIES LOCATION	FAI A
Interest rate contracts ..	Unrealized appreciation on swap contracts	$4,763,672	Unrealized depreciation on swap contracts	$
Foreign exchange contracts	Unrealized appreciation on forward exchange contracts	3,950,698	Unrealized depreciation on forward exchange contracts	(9

The effect of derivative contracts on the Fund's Statement of Operations was as follows:

DERIVATIVE CONTRACTS NOT ACCOUNTED FOR AS HEDGING INSTRUMENTS UNDER FASB STATEMENT NO. 133	STATEMENT OF OPERATIONS LOCATIONS	REALIZED GAIN (LOSS)(a)	U AP (DEPR
Interest rate contracts ..	Net realized gain (loss) from swap contracts / Net change in unrealized appreciation (depreciation) on investments	$ 700,929	$
Foreign exchange contracts	Net realized gain (loss) from foreign currency transactions / Net change in unrealized appreciation (depreciation) on investments	12,677,220	(2

(a) For the six months ended August 31, 2009.

(b) Represents the average notional amount outstanding during the period. For derivative contracts denominated in foreign currencies, notional amounts are converted to U.S. dollars.

See Note 1(c) regarding derivative financial instruments.

11. FAIR VALUE MEASUREMENTS

The Fund adopted Financial Accounting Standards Board (FASB) issued FASB Statement No. 157, "Fair Value Measurement" (SFAS 157), on September 1, 2008. SFAS 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. The Fund has determined that the implementation of SFAS 157 did not have a material impact on the Fund's financial statements.

SFAS 157 establishes a fair value hierarchy that distinguishes between market data obtained from independent sources (observable inputs) and the Fund's own market assumptions (unobservable inputs). These inputs are used in determining the value of the Fund's investments and are summarized in the following fair value hierarchy:

- Level 1 - quoted prices in active markets for identical securities

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

- Level 3 - significant unobservable inputs (including the Fund's own assumptions in determining the fair value of investments)

The inputs or methodology used for valuing securities are not an indication of the risk associated with investing in those securities.

The following is a summary of the inputs used as of August 31, 2009, in valuing the Fund's assets and liabilities carried at fair value:

	LEVEL 1	LEVEL 2	LEVEL 3	TOTAL
ASSETS:				
Investments in Securities:				
Bonds	$ --	$616,530,847	$--	$616,530,847
Short Term Investments	15,772,256	350,165	--	16,122,421
Total Investments in Securities	$15,772,256	$616,881,012	$--	$632,653,268
Forward Exchange Contracts	$ --	$ 3,950,698	$--	$ 3,950,698
Swaps	--	4,763,672	--	4,763,672
LIABILITIES:				
Forward Exchange Contracts	--	949,690	--	949,690

Templeton Emerging Markets Income Fund

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

12. SUBSEQUENT EVENTS

The Fund has evaluated subsequent events through October 20, 2009, the issuance date of the financial statements and determined that no events have occurred that require disclosure.

ABBREVIATIONS

CURRENCY

BRL - Brazilian Real
CLP - Chilean Peso
EGP - Egyptian Pound
EUR - Euro
GHS - Ghana Cedi
IDR - Indonesian Rupiah
KRW - South Korean Won
LKR - Sri Lankan Rupee
MXN - Mexican Peso
PLN - Polish Zloty

SELECTED PORTFOLIO

FRN - Floating Rate Note

COUNTERPARTY

BZWS - Barclays Bank PLC
CITI - Citibank, Inc.
DBAB - Deutsche Bank AG
HSBC - HSBC Bank USA, N.A.
JPHQ - JP Morgan Chase & Co.

MLCO - Merrill Lynch & Co., Inc.
UBSW - UBS AG

Templeton Emerging Markets Income Fund

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

TO THE BOARD OF TRUSTEES AND SHAREHOLDERS OF TEMPLETON EMERGING MARKETS INCOME FUND

In our opinion, the accompanying statement of assets and liabilities, including the statement of investments, and the related statements of operations and of changes in net assets and the financial highlights present fairly, in all material respects, the financial position of Templeton Emerging Markets Income Fund (the "Fund") at August 31, 2009, the results of its operations for the year then ended, the changes in its net assets for each of the two years in the period then ended and the financial highlights for each of the five years in the period then ended, in conformity with accounting principles generally accepted in the United States of America. These financial statements and financial highlights (hereafter referred to as "financial statements") are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these financial statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits, which included confirmation of securities at August 31, 2009 by correspondence with the custodian, provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

San Francisco, California
October 20, 2009

Templeton Emerging Markets Income Fund

TAX DESIGNATION (UNAUDITED)

Under Section 852(b)(3)(C) of the Internal Revenue Code (Code), the Fund designates the maximum amount allowable but no less than $3,728,221 as a long term capital gain dividend for the fiscal year ended August 31, 2009.

At August 31, 2008, more than 50% of the Fund's total assets were invested in securities of foreign issuers. In most instances, foreign taxes were withheld from income paid to the Fund on these investments. As shown in the table below, the Fund designates to shareholders the foreign source income and foreign taxes paid, pursuant to Section 853 of the Code. This designation will allow shareholders of record on September 30, 2008, to treat their proportionate share of foreign taxes paid by the Fund as having been paid directly by them. The shareholder shall consider these amounts as foreign taxes paid in the tax year in which they receive the Fund distribution.

The following table provides a detailed analysis of foreign tax paid, and foreign source income as designated by the Fund, to shareholders of record.

RECORD DATE: 9/30/2008

	FOREIGN TAX PAID PER SHARE	FOREIGN SOURCE INCOME PER SHARE	FOREIGN QUALIFIED DIVIDENDS PER SHARE
Class A	$0.0225	$1.0326	$--

Foreign Tax Paid Per Share (Column 1) is the amount per share available to you, as a tax credit (assuming you held your shares in the Fund for a minimum of 16 days during the 31-day period beginning 15 days before the ex-dividend date of the Fund's distribution to which the foreign taxes relate), or, as a tax deduction.

Foreign Source Income Per Share (Column 2) is the amount per share of income dividends paid to you that is attributable to foreign securities held by the Fund, plus any foreign taxes withheld on these dividends. The amounts reported include foreign source qualified dividends that have not been adjusted for the rate differential applicable to such dividend income.(1)

Foreign Qualified Dividends Per Share (Column 3) is the amount per share of foreign source qualified dividends the Fund paid to you, plus any foreign taxes withheld on these dividends. These amounts represent the portion of the Foreign Source Income reported to you in column 2 that were derived from qualified foreign securities held by the Fund.(1)

In January 2009, shareholders received Form 1099-DIV which included their share of taxes paid and foreign source income distributed during the calendar year 2008. The Foreign Source Income reported on Form 1099-DIV has not been adjusted for the rate differential on foreign source qualified dividend income. Shareholders are advised to check with their tax advisors for information on the treatment of these amounts on their 2008 individual income tax returns.

(1) Qualified dividends are taxed at a maximum rate of 15% (5% for those in the 10% and 15% income tax bracket). In determining the amount of foreign tax credit that may be applied against the U.S. tax liability of individuals receiving foreign source qualified dividends, adjustments may be required to the foreign tax credit limitation calculation to reflect the rate differential applicable to such dividend income. The rules however permit certain individuals to elect not to apply the rate differential adjustments for capital gains and/or dividends for any taxable year. Please consult your tax advisor and the instructions to Form 1116 for more information.

Templeton Emerging Markets Income Fund

ANNUAL MEETING OF SHAREHOLDERS, FEBRUARY 20, 2009 (UNAUDITED)

The Annual Meeting of Shareholders of the Fund was held at the Fund's offices, 500 E. Broward Blvd., Fort Lauderdale, Florida, on February 20, 2009. The purpose of the meeting was to elect four Trustees of the Fund. At the meeting, the following persons were elected by the shareholders to serve as Trustees of the Fund: Ann Torre Bates, David W. Niemiec, Larry D. Thompson and Robert E. Wade.* No other business was transacted at the meeting.

The results of the voting at the Annual Meeting are as follows:

The election of four Trustees:

TERM EXPIRING 2010	FOR	% OF OUTSTANDING SHARES	% OF SHARES PRESENT AND VOTING	WITHHELD	% OF OUTSTANDING SHARES	% OF SHARES PRESENT AND VOTING
Ann Torre Bates	42,561,668	89.91%	97.09%	1,227,650	2.70%	2.91%
David W. Niemiec	42,602,392	89.99%	97.18%	1,236,926	2.61%	2.82%
Larry D. Thompson ...	42,606,375	90.00%	97.19%	1,232,943	2.60%	2.81%
Robert E. Wade	42,700,989	90.20%	97.40%	1,138,329	2.40%	2.60%

* Harris J. Ashton, Frank J. Crothers, Edith E. Holiday, Charles B. Johnson, Gregory E. Johnson, Frank A. Olson and Constantine D. Tseretopoulos are Trustees of the Fund who are currently serving and whose terms of office continued after the Annual Meeting of Shareholders.

Templeton Emerging Markets Income Fund

DIVIDEND REINVESTMENT AND CASH PURCHASE PLAN

The Fund offers a Dividend Reinvestment and Cash Purchase Plan (the "Plan") with the following features:

If shares of the Fund are held in the shareholder's name, the shareholder will automatically be a participant in the Plan unless he elects to withdraw. If the shares are registered in the name of a broker-dealer or other nominee (i.e., in "street name"), the broker-dealer or nominee will elect to participate in the Plan on the shareholder's behalf unless the shareholder instructs them otherwise, or unless the reinvestment service is not provided by the broker-dealer or nominee.

Participants should contact BNY Mellon Shareowner Services, P.O. Box 358035, Pittsburgh, PA, 15252-8035, to receive the Plan brochure.

To receive dividends or distributions in cash, the shareholder must notify The Bank of New York Mellon (the "Plan Administrator") at the address above or the institution in whose name the shares are held. The Plan Administrator must receive written notice within ten business days before the record date for the distribution.

Whenever the Fund declares dividends in either cash or shares of the Fund, if the market price is equal to or exceeds net asset value at the valuation date, the participant will receive the dividends entirely in new shares at a price equal to the net asset value, but not less than 95% of the then current market price of the Fund's shares. If the market price is lower than net asset value or if dividends and/or capital gains distributions are payable only in cash, the participant will receive shares purchased on the New York Stock Exchange or otherwise on the open market.

A participant has the option of submitting additional cash payments to the Plan Administrator, in any amounts of at least $100, up to a maximum of $5,000 per month, for the purchase of Fund shares for his or her account. These payments can be made by check or money order payable to The Bank of New York Mellon and sent to BNY Mellon Shareowner Services, P.O. Box 382009, Pittsburgh, PA 15250-8009, Attention: Templeton Emerging Markets Income Fund. The Plan Administrator will apply such payments (less a $5.00 service charge and less a pro rata share of trading fees) to purchases of the Fund's shares on the open market.

The automatic reinvestment of dividends and/or capital gains does not relieve the participant of any income tax that may be payable on dividends or distributions.

Whenever shares are purchased on the New York Stock Exchange or otherwise on the open market, each participant will pay a pro rata portion of trading fees. Trading fees will be deducted from amounts to be invested. The Plan Administrator's fee for a sale of shares through the Plan is $15.00 per transaction plus a $0.12 per share trading fee.

DIVIDEND REINVESTMENT AND CASH PURCHASE PLAN (CONTINUED)

A participant may withdraw from the Plan without penalty at any time by written notice to the Plan Administrator sent to BNY Mellon Shareowner Services, P. O. Box 358035, Pittsburgh, PA, 15252-8035. Upon withdrawal, the participant will receive, without charge, share certificates issued in the participant's name for all full shares held by the Plan Administrator; or, if the participant wishes, the Plan Administrator will sell the shares and send the proceeds to the participant, less a service charge of $15.00 and less trading fees of $0.12 per share. The Plan Administrator will convert any fractional shares you hold at the time of your withdrawal to cash at current market value and send you a check for the net proceeds.

DIRECT DEPOSIT SERVICE FOR REGISTERED SHAREHOLDERS

Cash distributions can now be electronically credited to a checking or savings account at any financial institution that participates in the Automated Clearing House ("ACH") system. The Direct Deposit service is provided for registered shareholders at no charge. To enroll in the service, access your account online by going to http://vault.bnymellon.com/isd or dial 1-800-416-5585 (toll free) and follow the instructions. Direct Deposit will begin with the next scheduled distribution payment date following enrollment in the service.

Templeton Emerging Markets Income Fund

TRANSFER AGENT

BNY Mellon Shareowner Services
P.O. Box 358035
Pittsburgh, PA 15252-8035
1-800-416-5585
www.bnymellon.com

DIRECT REGISTRATION

If you are a registered shareholder of the Fund, purchases of shares of the Fund can be electronically credited to your Fund account at BNY Mellon Shareowner Services through Direct Registration. The service provides shareholder with a convenient way to keep track of shares through book entry transactions, electronically move book-entry shares between broker-dealers, transfer agents and DRS eligible issuers, and eliminate the possibility of lost certificates. For additional information, please contact BNY Mellon Shareowner Services at 1-800-416-5585.

SHAREHOLDER INFORMATION

Shares of Templeton Emerging Markets Income Fund are traded on the New York Stock Exchange under the symbol "TEI." Information about the net asset value and the market price is published each Monday in the WALL STREET JOURNAL, weekly in BARRON'S and each Saturday in THE NEW YORK TIMES and other newspapers. Daily market prices for the Fund's shares are published in the "New York Stock Exchange Composite Transactions" section of newspapers.

For current information about distributions and shareholder accounts, call 1-800-416-5585. Registered shareholders can access their Fund account on-line with INVESTOR SERVICEDIRECT(R). For information go to BNY Mellon Shareowner Services' website at https://vault.bnymellon.com/isd and follow the instructions.

The daily closing net asset value as of the previous business day may be obtained when available by calling Franklin Templeton Fund Information after 7 a.m. Pacific time any business day at 1-800/DIAL BEN(R) (1-800/342-5236). The Fund's net asset value and dividends are also listed on the NASDAQ Stock Market, Inc.'s Mutual Fund Quotation Service ("NASDAQ MFQS").

Shareholders not receiving copies of reports to shareholders because their shares are registered in the name of a broker or a custodian can request that they be added to the Fund's mailing list by writing Templeton Emerging Markets Income Fund, 100 Fountain Parkway, P.O. Box 33030, St. Petersburg, FL 33733-8030.

Templeton Emerging Markets Income Fund

BOARD MEMBERS AND OFFICERS

The name, year of birth and address of the officers and board members, as well as their affiliations, positions held with the Fund, principal occupations during the past five years and number of U.S. registered portfolios overseen in the Franklin Templeton Investments fund complex are shown below. Generally, each board member serves a three-year term that continues until that person's successor is elected and qualified.

INDEPENDENT BOARD MEMBERS

NAME, YEAR OF BIRTH AND ADDRESS	POSITION	LENGTH OF TIME SERVED	NUMBER OF PORTFOLIOS IN FUND COMPLEX OVERSEEN BY BOARD MEMBER*	---
HARRIS J. ASHTON (1932) 500 East Broward Blvd. Suite 2100 Fort Lauderdale, FL 33394-3091	Trustee	Since 1993	134	Bar com

PRINCIPAL OCCUPATION DURING PAST 5 YEARS:

Director of various companies; and FORMERLY, Director, RBC Holdings, Inc. (bank holding company)
Executive Officer and Chairman of the Board, General Host Corporation (nursery and craft centers)

NAME, YEAR OF BIRTH AND ADDRESS	POSITION	LENGTH OF TIME SERVED	NUMBER OF PORTFOLIOS IN FUND COMPLEX OVERSEEN BY BOARD MEMBER*	
ANN TORRE BATES (1958) 500 East Broward Blvd. Suite 2100 Fort Lauderdale, FL 33394-3091	Trustee	Since 2008	31	SLM All ser

PRINCIPAL OCCUPATION DURING PAST 5 YEARS:

Independent strategic and financial consultant; and FORMERLY, Executive Vice President and Chief
(manager of multifamily housing) (1995-1997); and Vice President and Treasurer, US Airways, Inc.

NAME, YEAR OF BIRTH AND ADDRESS	POSITION	LENGTH OF TIME SERVED	NUMBER OF PORTFOLIOS IN FUND COMPLEX OVERSEEN BY BOARD MEMBER*	
FRANK J. CROTHERS (1944) 500 East Broward Blvd. Suite 2100 Fort Lauderdale, FL 33394-3091	Trustee	Since 1999	23	For com exp (re

PRINCIPAL OCCUPATION DURING PAST 5 YEARS:

Director and Vice Chairman, Caribbean Utilities Company, Ltd.; and director of various other priv
organizations.

NAME, YEAR OF BIRTH AND ADDRESS	POSITION	LENGTH OF TIME SERVED	NUMBER OF PORTFOLIOS IN FUND COMPLEX OVERSEEN BY BOARD MEMBER*	
EDITH E. HOLIDAY (1952) 500 East Broward Blvd. Suite 2100 Fort Lauderdale, FL 33394-3091	Trustee	Since 1996	134	Hes ref Com pro Inc tit (ra Ins com

PRINCIPAL OCCUPATION DURING PAST 5 YEARS:

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

NAME, YEAR OF BIRTH AND ADDRESS	POSITION	LENGTH OF TIME SERVED	NUMBER OF PORTFOLIOS IN FUND COMPLEX OVERSEEN BY BOARD MEMBER*	---
DAVID W. NIEMIEC (1949) 500 East Broward Blvd. Suite 2100 Fort Lauderdale, FL 33394-3091	Trustee	Since 2005	23	Eme and (ph

PRINCIPAL OCCUPATION DURING PAST 5 YEARS:

Advisor, Saratoga Partners (private equity fund); and FORMERLY, Managing Director, Saratoga Partn
Dillon Read (investment banking) (1997-1998); Vice Chairman, Dillon, Read & Co. Inc. (investment
Financial Officer, Dillon, Read & Co. Inc. (1982-1997).

NAME, YEAR OF BIRTH AND ADDRESS	POSITION	LENGTH OF TIME SERVED	NUMBER OF PORTFOLIOS IN FUND COMPLEX OVERSEEN BY BOARD MEMBER*	---
FRANK A. OLSON (1932) 500 East Broward Blvd. Suite 2100 Fort Lauderdale, FL 33394-3091	Trustee	Since 2003	134	Hes ref

PRINCIPAL OCCUPATION DURING PAST 5 YEARS:

Chairman Emeritus, The Hertz Corporation (car rental) (since 2000) (Chairman of the Board (1980-2
(1977-1999)); and FORMERLY, Chairman of the Board, President and Chief Executive Officer, UAL Cor

NAME, YEAR OF BIRTH AND ADDRESS	POSITION	LENGTH OF TIME SERVED	NUMBER OF PORTFOLIOS IN FUND COMPLEX OVERSEEN BY BOARD MEMBER*	---
LARRY D. THOMPSON (1945) 500 East Broward Blvd. Suite 2100 Fort Lauderdale, FL 33394-3091	Trustee	Since 2005	142	Non

PRINCIPAL OCCUPATION DURING PAST 5 YEARS:

Senior Vice President - Government Affairs, General Counsel and Secretary, PepsiCo, Inc. (consume
Director, Delta Airlines (aviation) (2003-2005) and Providian Financial Corp. (credit card provid
The Brookings Institution (2003-2004); Visiting Professor, University of Georgia School of Law (2
U.S. Department of Justice (2001-2003).

NAME, YEAR OF BIRTH AND ADDRESS	POSITION	LENGTH OF TIME SERVED	NUMBER OF PORTFOLIOS IN FUND COMPLEX OVERSEEN BY BOARD MEMBER*	---
CONSTANTINE D. TSERETOPOULOS (1954) 500 East Broward Blvd. Suite 2100 Fort Lauderdale, FL 33394-3091	Trustee	Since 1999	23	Non

PRINCIPAL OCCUPATION DURING PAST 5 YEARS:

Physician, Lyford Cay Hospital (1987-present); director of various nonprofit organizations; and F
University of Maryland (1985-1987) and Internal Medicine Resident, Greater Baltimore Medical Cent

NAME, YEAR OF BIRTH AND ADDRESS	POSITION	LENGTH OF TIME SERVED	NUMBER OF PORTFOLIOS IN FUND COMPLEX OVERSEEN BY BOARD MEMBER*	---
ROBERT E. WADE (1946) 500 East Broward Blvd. Suite 2100 Fort Lauderdale, FL 33394-3091	Trustee	Since 2006	38	El

PRINCIPAL OCCUPATION DURING PAST 5 YEARS:
Attorney at law.

INTERESTED BOARD MEMBERS AND OFFICERS

NAME, YEAR OF BIRTH AND ADDRESS	POSITION	LENGTH OF TIME SERVED	NUMBER OF PORTFOLIOS IN FUND COMPLEX OVERSEEN BY BOARD MEMBER*	---
**CHARLES B. JOHNSON (1933) One Franklin Parkway San Mateo, CA 94403-1906	Trustee, Chairman of the Board and Vice President	Trustee, Chairman of the Board since 1995 and Vice President since 1992	134	Non

PRINCIPAL OCCUPATION DURING PAST 5 YEARS:

Chairman of the Board, Member - Office of the Chairman and Director, Franklin Resources, Inc.; Di
and officer and/or director or trustee, as the case may be, of some of the other subsidiaries of
of the investment companies in Franklin Templeton Investments.

**GREGORY E. JOHNSON (1961) One Franklin Parkway San Mateo, CA 94403-1906	Trustee	Since 2007	90	Non

PRINCIPAL OCCUPATION DURING PAST 5 YEARS:

Director, President and Chief Executive Officer, Franklin Resources, Inc.; President, Templeton W
Asset Management Ltd.; and officer and/or director or trustee, as the case may be, of some of the
Resources, Inc. and of 32 of the investment companies in Franklin Templeton Investments.

JAMES M. DAVIS (1952) One Franklin Parkway San Mateo, CA 94403-1906	Chief Compliance Officer and Vice President - AML Compliance	Chief Compliance Officer since 2004 and Vice President - AML Compliance since 2006	Not Applicable	Not

PRINCIPAL OCCUPATION DURING PAST 5 YEARS:

Director, Global Compliance, Franklin Resources, Inc.; officer of some of the other subsidiaries
45 of the investment companies in Franklin Templeton Investments; and FORMERLY, Director of Compl
Inc. (1994-2001).

LAURA F. FERGERSON (1962) One Franklin Parkway San Mateo, CA 94403-1906	Chief Executive Officer - Finance and Administration	Since March 2009	Not Applicable	Not

PRINCIPAL OCCUPATION DURING PAST 5 YEARS:

Vice President, Franklin Templeton Services, LLC; officer of 45 of the investment companies in Fr
FORMERLY, Director and member of Audit and Valuation Committees, Runkel Funds, Inc. (2003-2004);
investment companies in Franklin Templeton Investments (1997-2003); and Vice President, Franklin
(1997-2003).

ALIYA S. GORDON (1973) One Franklin Parkway	Vice President	Since March 2009	Not Applicable	Not

San Mateo, CA 94403-1906

PRINCIPAL OCCUPATION DURING PAST 5 YEARS:

Associate General Counsel, Franklin Templeton Investments; officer of 45 of the investment compan
Investments; and FORMERLY, Litigation Associate, Steefel, Levitt & Weiss, LLP (2000-2004).

NAME, YEAR OF BIRTH AND ADDRESS	POSITION	LENGTH OF TIME SERVED	NUMBER OF PORTFOLIOS IN FUND COMPLEX OVERSEEN BY BOARD MEMBER*	---
DAVID P. GOSS (1947) One Franklin Parkway San Mateo, CA 94403-1906	Vice President	Since 2000	Not Applicable	Not

PRINCIPAL OCCUPATION DURING PAST 5 YEARS:

Senior Associate General Counsel, Franklin Templeton Investments; officer and/or director, as the
subsidiaries of Franklin Resources, Inc. and of 45 of the investment companies in Franklin Temple

STEVEN J. GRAY (1955) One Franklin Parkway San Mateo, CA 94403-1906	Vice President	Since August 2009	Not Applicable	Not

PRINCIPAL OCCUPATION DURING PAST 5 YEARS:

Senior Associate General Counsel, Franklin Templeton Investments; Vice President, Franklin Temple
of 45 of the investment companies in Franklin Templeton Investments.

RUPERT H. JOHNSON, JR. (1940) One Franklin Parkway San Mateo, CA 94403-1906	Vice President	Since 1996	Not Applicable	Not

PRINCIPAL OCCUPATION DURING PAST 5 YEARS:

Vice Chairman, Member - Office of the Chairman and Director, Franklin Resources, Inc.; Director,
Templeton Worldwide, Inc.; Senior Vice President, Franklin Advisory Services, LLC; and officer an
case may be, of some of the other subsidiaries of Franklin Resources, Inc. and of 43 of the inves
Templeton Investments.

MARK MOBIUS (1936) 17th Floor, Chater House 8 Connaught Road Central Hong Kong	President and Chief Executive Officer - Investment Management	President since 1987 and Chief Executive Officer - Investment Managementsince 2002	Not Applicable	Not

PRINCIPAL OCCUPATION DURING PAST 5 YEARS:

Portfolio Manager of various Templeton advisory affiliates; Executive Chairman, Templeton Asset M
director, as the case may be, of some of the other subsidiaries of Franklin Resources, Inc. and o
in Franklin Templeton Investments; and FORMERLY, President, International Investment Trust Compan
Taiwan R.O.C. Fund) (1986-1987); and Director, Vickers da Costa, Hong Kong (1983-1986).

MARK H. OTANI (1968) One Franklin Parkway San Mateo, CA 94403-1906	Treasurer, Chief Financial Officer and Chief Accounting Officer	Since March 2009	Not Applicable	Not

PRINCIPAL OCCUPATION DURING PAST 5 YEARS:

Director, Global Fund Accounting Operations, Franklin Templeton Investments; and officer of 14 of
Franklin Templeton Investments.

ROBERT C. ROSSELOT (1960) 500 East Broward Blvd. Suite 2100 Fort Lauderdale, FL 33394-3091	Secretary and Vice President	Secretary since 2004 and Vice President since August 2009	Not Applicable	Not

PRINCIPAL OCCUPATION DURING PAST 5 YEARS:

Senior Associate General Counsel, Franklin Templeton Investments; Assistant Secretary, Franklin R
Secretary, Templeton Investment Counsel, LLC; Vice President, Secretary and Trust Officer, Fiduci
South; and officer of 45 of the investment companies in Franklin Templeton Investments.

NAME, YEAR OF BIRTH AND ADDRESS	POSITION	LENGTH OF TIME SERVED	NUMBER OF PORTFOLIOS IN FUND COMPLEX OVERSEEN BY BOARD MEMBER*	---
KAREN L. SKIDMORE (1952) One Franklin Parkway San Mateo, CA 94403-1906	Vice President	Since August 2009	Not Applicable	Not

PRINCIPAL OCCUPATION DURING PAST 5 YEARS:

Senior Associate General Counsel, Franklin Templeton Investments; and officer of 45 of the invest
Templeton Investments.

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

PRINCIPAL OCCUPATION DURING PAST 5 YEARS:

General Counsel and Executive Vice President, Franklin Resources, Inc.; officer of some of the ot

(5)

Represents aggregate holdings under a joint filing on a Schedule 13D dated November 29, 2005 by North Atlantic Value, LLP, Christopher H. B.

with its principal office and business at P.O. Box N-4857, Unit No. 2, Cable Beach Court, West Bay Street, Nassau, The Bahamas. Christopher Harwood Bernard Mills is a British citizen whose business address is Ryder Court, 14 Ryder Street, London SW1Y 6QB England. American Opportunity Trust is a corporation organized under the laws of England with its principal office and business at Ryder Court, 14 Ryder Street, London SW1Y 6QB England. North Atlantic Smaller Companies Investment Trust (NASCIT) is an investment limited liability company organized under the laws of England with its principal office and business at Ryder Court, 14 Ryder Street, London SW1Y 6QB England. Gildea Management Company is a corporation organized under the laws of the State of Delaware with its principal office and business address at PO Box 938, 65 Vitti Street, New Canaan, Connecticut. John W. Gildea is a U.S. citizen whose principal business address is PO Box 938, 65 Vitti Street, New Canaan, Connecticut. Axia Value Partners LLC (Axia Value Partners) is a limited liability company organized under the laws of the State of Delaware with its principal office and business address at PO Box 938, 65 Vitti Street, New Canaan, Connecticut. North Atlantic Value is the investment manager and/or investment adviser to each of American Opportunity Trust, Trident North Atlantic, Trident Holdings, Trident High Tor and its private clients and as such it has the authority to vote or dispose of the Common Stock. Christopher H. B. Mills is the Chief Executive Officer of American Opportunity Trust. Christopher H. B. Mills is also a partner of North Atlantic Value. Gildea Management Company is the investment manager to Axia Value Partners and as such it has the authority to vote or dispose of the Company s common shares owned by Axia Value Partners. John W. Gildea is a managing director of Gildea Management Company and is also a director of American Opportunity Trust. The aggregate number and percentage of the outstanding common shares of the Company reported by the Group to be beneficially owned by each of the Group and to the knowledge of the Group, by each other person who may be deemed to be a member of the Group is as follows:

Group Member	Aggregate Number of Shares	Number of Shares: Sole Power to Vote	Number of Shares: Shared Power to Vote	Number of Shares: Sole Power to Dispose	Number of Shares: Shared Power to Dispose	Approximate Percentage
North Atlantic Value	1,232,300		1,232,300		1,232,300	17.0%
Christopher H. B. Mills	1,232,300		1,232,300		1,232,300	17.0%
American Opportunity Trust	302,844		302,844		302,844	4.2%
Trident North Atlantic Fund	239,302		239,302		239,302	3.3%
Trident Holdings	123,670		123,670		123,670	1.7%
NASCIT	87,400		87,400		87,400	1.2%
John W. Gildea	107,800	2,800	105,000	2,800	105,000	1.5%
Gildea Management Company	105,000		105,000		105,000	1.5%
Axia Value Partners	105,000		105,000		105,000	1.5%

(6) Information with respect to Mr. Girard and his holdings is based on a Schedule 13D dated March 16, 2004, which contained information as of such date. Mr. Girard reports that he has sole voting and dispositive power with respect to, and is the beneficial owner of, 388,700 shares.

Common Shares Owned By Management

The following table sets forth the number of common shares of the Company beneficially owned as of September 13, 2006 by each named executive officer listed in the Summary Compensation Tables on pages 17 and 18, by each current director, and by all directors, nominees and executive officers of the Company as a group.

	Common Shares Beneficially Owned As of September 13, 2006	
Name	**Number**	**% of Class**
Robert M. Thornton, Jr. Director, Chairman, President and Chief Executive Officer	507,557(1)	6.91
Joseph T. Morris Chief Financial Officer	155,316(2)	2.16
Harry R. Alvis Chief Operating Officer	112,300(3)	1.53
Jerome D. Orth Vice President Technical and Compliance Services	46,849(4)	*
Mark J. Stockslager Corporate Controller and Principal Accounting Officer	100,148(5)	1.36
Steven J. Baileys Director	584,201(6)	7.96
Karen B. Brenner Director	259,167(7)	3.53
Gene E. Burleson Director	78,993(8)	1.08
C. Michael Ford Director	54,250(9)	*
Michael W. Hall Director	27,350(9)	*
Howard E. Turner Director	234,687(9)	3.20
Directors, Nominees and Executive Officers as a Group (11 persons)	2,161,818(10)	29.44

* Less than 1%

(1) Includes 172,833 shares that may be acquired upon the exercise of options exercisable within 60 days of September 13, 2006.

(2) Includes 99,666 shares that may be acquired under options exercisable within 60 days of September 13, 2006

(3) Includes 94,500 shares that may be acquired under options exercisable within 60 days of September 13, 2006.

(4) Includes 43,867 shares that may be acquired under options exercisable within 60 days of September 13, 2006.

(5) Includes 47,884 shares that may be acquired under options exercisable within 60 days of September 13, 2006.

(6) Includes 19,250 shares that may be acquired under options exercisable within 60 days of September 13, 2006. Also includes 346,249 shares held by Beilihis Investments, LLC. Dr. Baileys is managing member of Beilihis.

(7) Includes 19,250 shares that may be acquired under options exercisable within 60 days of September 13, 2006. Also includes 2,411 warrants to purchase shares of SunLink common stock held by Ms. Brenner s spouse and exercisable within 60 days of September 13, 2006.

(8) Includes 11,750 shares that may be acquired under options exercisable within 60 days of September 13, 2006.

(9) Includes 19,250 shares that may be acquired under options exercisable within 60 days of September 13, 2006.

(10) Includes 2,411 shares that may be acquired upon the exercise of warrants and 566,750 shares that may be acquired under options exercisable within 60 days of September 13, 2006.

EXECUTIVE COMPENSATION

Compensation Committee Report

Overview

The Compensation Committee of the Board of Directors currently is comprised of three directors, who are not current or former members of the Company, each of whom is independent under the applicable rules of the American Stock Exchange. The committee is responsible for establishing the compensation policies and evaluating the compensation programs for the Company s executive officers and other key employees. In carrying out its duties, the committee make all reasonable attempts to comply with the $1 million deduction limitation for executive compensation under Section 162(m) of the Internal Revenue Code of 1986, as amended, unless the committee determines that such compliance in given circumstances would not be in the best interest of the Company and its shareholders.

Compensation Philosophy

- Emphasize performance-based compensation;

- Encourage strong financial performance by establishing goals that are internally equitable and externally competitive, enabling the Company to attract and retain qualified management; and

- Encourage executive stock ownership and alignment with shareholder interests by providing a significant portion of compensation in Company common stock.

The three key elements of executive compensation are base salary, short-term incentives and long-term incentives. The Company s philosophy is to position an aggregate of these elements of compensation at a level that is commensurate with the Company s size and performance relative to other regional hospital companies, as well as a larger group of general medical industry companies.

Compensation Consultant

During the latter part of fiscal 2005 the Compensation Committee retained a compensation consulting firm to review and evaluate the current compensation packages for the three highest paid executives of the Company as compared to those of the executives of other health care companies with comparable revenues. The Committee considered the results of such survey as one source of information in formulating 2006 and future compensation packages and the reasonableness of potential compensation levels.

Base salaries

The Company s base salaries are intended to be consistent with its understanding of competitive practices, levels of executive responsibility, qualifications necessary for the particular executive position, and the expertise and experience of the executive officer. Salary adjustments reflect the Compensation Committee s belief as to competitive trends, the performance of the individual and, to some extent, the overall financial condition of the Company.

During the fiscal year ended June 30, 2006, the CEO, Mr. Thornton, was employed under an employment agreement which provided for an annual base salary of $335,000. In the opinion of the Compensation Committee, and after consultation with a compensation consulting firm at the end of fiscal year 2005, Mr. Thornton s salary continues to be on the low end of salaries for CEOs of regional hospital management companies and also below that of CEOs for healthcare companies with similar revenues.

Short-Term Incentives

The short-term incentive for an executive is the opportunity to earn an annual cash bonus. The Committee has concluded that bonus payments should be primarily based on the achievement of specific predetermined financial targets while a smaller portion should be discretionary based on the Compensation Committee s evaluation of an executive s performance in specific qualitative areas.

The Executive Bonus Plan for the fiscal year ended June 30, 2006 provided that bonuses would be payable based on two factors: (1) the net income of the Company from continuing operations during fiscal 2006 and (2) the achievement of certain unweighted discretionary criteria.

The net income goal was set forth in the budget adopted by the Board in June 2005 for the 2006 fiscal year and represented a significant increase over the net income from continuing operations for fiscal 2006. The Company s net income from continuing operations substantially exceeded the goal set forth in the 2006 budget. Based on this positive result and the Compensation Committee s evaluation of each executive s performance against his discretionary criteria, the executive officers of the Company, were paid the bonuses set forth in the Summary Compensation Tables on page 17 and 18.

During the fiscal year ended June 30, 2006, Mr. Thornton was granted the opportunity to earn a bonus equal to sixty percent of his 2006 annual salary if certain criteria established by the Compensation Committee, after consultation with him, were met. (A more complete description of Mr. Thornton s employment agreement is contained on page 22 under the heading Employment Contracts, Termination of Employment and Change-in-Control Agreements). In the opinion of the Compensation Committee Mr. Thornton s cash bonus opportunity (which is calculated as a percentage of his salary) is somewhat on the low side for comparable positions for healthcare companies with similar revenues and below the market median for healthcare companies with similar revenues. If SunLink s revenues continue to increase, such disparity may be expected to increase.

Under the Executive Bonus Plan for fiscal 2006, Mr. Thornton s bonus for fiscal 2006 was weighted as follows: (1) 70% was based on the Company s net income from continuing operations for fiscal 2006 and (2) 30% was based on certain un-weighted discretionary criteria. As explained above, the Company exceeded the net earnings from continuing operations goal set for fiscal 2006 so a maximum bonus was paid to Mr. Thornton based on this factor. The un-weighted discretionary criteria chosen to evaluate Mr. Thornton s performance were: (i) maintaining an active acquisition program which capitalizes on suitable opportunities and (ii), maintaining an active program of investor relations and major shareholder contacts. The Committee concluded, and the Board agreed, that Mr. Thornton had substantially performed discretionary criteria and therefore had earned a proportionate bonus based thereon. Mr. Thornton was also granted 38,500 options for Company common stock on November 11, 2005. These options will vest one third each on November 11, 2006, 2007 and 2008.

Long-Term Incentives

While salary and short-term incentives are primarily designed to compensate current and past performance, the primary goal of the long-term incentive compensation program is to directly link management compensation with the long-term interests of the shareholders. The Company currently uses, as it has for many years, stock options to provide that link. Options are intended to provide strong incentives for superior long-term performance. On November 7, 2005, Company shareholders adopted the 2005 Equity Incentive Plan. In the future, the Compensation Committee may, at its discretion, grant awards to executive officers through this plan.

This report has been submitted by the Compensation Committee:

Karen B. Brenner (Chair)	Dr. Steven J. Baileys	Gene E. Burleson

Other Executive Compensation Information

The following sections of this Proxy Statement set forth compensation information relating to the Chief Executive Officer and the four other most highly compensated executive officers of the Company, other than the Chief Executive Officer (the *Named Executive Officers*), for the fiscal year ended June 30, 2006.

The following table shows the compensation awarded or paid by SunLink for services rendered for the fiscal years ended June 30, 2006, 2005 and 2004 to the Chief Executive Officer and the other Named Executive Officers.

Summary Compensation Table

		Annual Compensation[1]			Long-Term Compensation			
Name and Principal Position	**Year**	**Salary ($)**	**Bonus ($)**	**Other Annual Compensation ($)**	**Restricted Stock Awards ($)**	**Securities Underlying Options (#)**	**Long-Term Incentive Plan Payout ($)**	**All Other Compensation ($)[2]**
Robert M. Thornton, Jr.								
Chairman, President and	2006	$ 335,000	$ 170,850			38,500		6,300
	2005	310,000	180,420					1,711
Chief Executive Officer	2004	283,500	50,425					7,715
Joseph T. Morris	2006	$ 244,000	$ 122,000			14,000		6,300
	2005	240,000	139,680					2,468
Chief Financial Officer	2004	237,300	42,205					7,713
Harry R. Alvis	2006	$ 244,000	$ 122,000			17,500		6,300
	2005	236,000	118,000			20,000		1,772
Chief Operating Officer	2004	212,930	30,417					7,209
Jerome D. Orth								
Vice President, Technological	2006	149,333	47,189			8,468		5,962
	2005	142,000	53,392					2,375
and Compliance Services	2004	142,000	10,400					5,715
Mark J. Stockslager								
Corporate Controller and	2006	106,088	39,253			7,536		4,318
	2005	101,100	40,440					2,578
Principal Accounting Officer	2004	96,348	18,800					3,455

(1) The amounts shown do not include certain indirect compensation, perquisites and other personal benefits in the value of which for each executive officer did not exceed the lesser of $50,000 or 10% of the aggregate compensation for such officer.

(2) All other compensation consists of 401k contributions made by the Company.

The following table shows the compensation as disclosable under the new executive compensation rules effective November 7, 2006 awarded or paid by SunLink for services rendered for the fiscal years ended June 30, 2006, 2005 and 2004 to the Chief Executive Officer and the other Named Executive Officers.

Summary Compensation Table

Name and Principal Position	Year	Salary ($)	Bonus ($)	Stock Awards ($)	Option Awards ($)	Non-Equity Incentive Plan Compensation (4)	Change in Pension Value and Nonqualified Deferred Compensation Earnings ($)	All Other Compensation ($)(1) (2)	Total ($)
Robert M. Thornton, Jr.	2006	335,000	170,850		154,385				660,235
Chairman, President and Chief Executive	2005	310,000	180,420					1,711	492,131
Officer	2004	283,500	50,425					7,715	341,460
Joseph T. Morris	2006	244,000	122,000		56,140				422,100
Chief Financial Officer	2005	240,000	139,680					2,468	382,148
	2004	237,300	42,205					7,713	287,218
Harry R. Alvis	2006	244,000	122,000		70,175				436,175
Chief Operating Officer	2005	236,000	118,000		63,200			1,772	418,972
	2004	212,930	30,417					7,209	250,556
Jerome D. Orth	2006	149,333	47,189		33,957				230,429
Vice President, Technological and	2005	142,000	53,392					2,375	197,767
Compliance Services	2004	142,000	10,400					5,715	158,115
Mark J. Stockslager	2006	106,088	39,253		30,219				175,560
Corporate Controller and Principal	2005	101,100	40,440					2,578	144,078
Accounting Officer	2004	96,348	18,800					3,455	118,603

(1) The amounts shown for 2006 do not include certain indirect compensation, perquisites and other personal benefits in the value of which for each named executive officer did not exceed the lesser of $10,000.

(2) The amounts shown for 2005 and 2004 include 401k contributions made by the Company.

Option Grants in Last Fiscal Year

The following tables show information about stock option awards under Company approved plans during fiscal 2006 for the Named Executive Officers.

Grants of Plan-Based Awards

Name	Number of Securities Underlying Options Granted	% of Total Options Granted to Employees in Fiscal Year	Exercise Price	Expiration Date	Appreciated Total Value 5%	10%
Robert M. Thornton, Jr.	38,500	17.38%	$ 9.63	11/10/2010	$ 102,433	$ 226,350
Joseph T. Morris	14,000	6.32%	$ 9.63	11/10/2010	$ 37,248	$ 82,309
Harry R. Alvis	17,500	7.90%	$ 9.63	11/10/2010	$ 46,560	$ 102,886
Jerome D. Orth	8,468	3.82%	$ 9.63	11/10/2010	$ 22,530	$ 49,785
Mark J. Stockslager	7,536	3.40%	$ 9.63	11/10/2010	$ 20,050	$ 44,306

(1) The dollar amounts under these columns are the result of calculations at the 5% and 10% rates set by the SEC and therefore are not intended to forecast possible future appreciation, if any, of the price of our stock.

		Estimated Future Payouts Under Non-Equity Incentive Plan Awards			Estimated Future Payouts Under Equity Incentive Plan Awards [(1)]			All Other Stock Awards: Number of Shares of Stock or Units	All Other Option Awards: Number of Securities Underlying Options	Exercise or Base Price of Option Awards
		Threshold	Target	Maximum	Threshold	Target	Maximum			
Name	Grant Date	($)	($)	($)	(#)	($)	(#)	(#)	(#)	($/Sh)
Robert M. Thornton, Jr.	Nov. 11, 2005	N/A	N/A	N/A	N/A	N/A	N/A		38,500	$ 9.63
Joseph T. Morris	Nov. 11, 2005	N/A	N/A	N/A	N/A	N/A	N/A		14,000	$ 9.63
Harry R. Alvis	Nov. 11, 2005	N/A	N/A	N/A	N/A	N/A	N/A		17,500	$ 9.63
Jerome D. Orth	Nov. 11, 2005	N/A	N/A	N/A	N/A	N/A	N/A		8,468	$ 9.63
Mark J. Stockslager	Nov. 11, 2005	N/A	N/A	N/A	N/A	N/A	N/A		7,536	$ 9.63

(1) The Company has not granted awards which vest upon achievement of any criteria other than time.

Outstanding Equity Awards at Fiscal Year-End

The following table provides information with respect to the common stock that may be issued upon the exercise of options and other awards under the Company s existing equity compensation plans as of June 30, 2006.

	Option Awards					Stock Awards			
Name	Number of Securities Underlying Unexercised Options Exercisable (#)[(1)]	Number of Securities Underlying Unexercised Options Unexercisable (#)[(1)]	Equity Incentive Plan Awards: Number of Securities Underlying Unexercised Unearned Options (#)	Option Exercise Price ($)	Option Expiration Date	Number of Shares or Units of Stock That Have Not Vested (#)[(2)]	Market Value of Shares or Units of Stock That Have Not Vested ($)	Equity Incentive Plan Awards: Number of Unearned Shares, Units or Other Rights That Have Not Vested	Equity Incentive Plan Awards: Market or Payout Value of Unearned Shares, Units or Other Rights That Have Not

					(#)	Vested ($)
Robert M. Thornton, Jr.	40,000		$ 1.50	3/4/2007		
	40,000		$ 1.50	3/4/2008		
	40,000		$ 1.50	3/4/2009		
	40,000		$ 1.50	3/4/2010		
		38,500	$ 9.63	11/10/2010		
Joseph T. Morris	22,000		$ 1.50	3/4/2007		
	22,000		$ 1.50	3/4/2008		
	22,000		$ 1.50	3/4/2009		
	22,000		$ 1.50	3/4/2010		
	1,750		$ 3.00	8/24/2008		
	1,750		$ 3.00	8/24/2009		
	1,750		$ 3.00	8/24/2010		
		1,750	$ 3.00	8/24/2011		
		14,000	$ 9.63	11/10/2010		

	Option Awards					Stock Awards			
Name	Number of Securities Underlying Unexercised Options Exercisable (#)[1]	Number of Securities Underlying Unexercised Options Unexercisable (#)[1]	Equity Incentive Plan Awards: Number of Securities Underlying Unexercised Unearned Options (#)	Option Exercise Price ($)	Option Expiration Date	Number of Shares or Units of Stock That Have Not Vested (#)[2]	Market Value of Shares or Units of Stock That Have Not Vested ($)	Equity Incentive Plan Awards: Number of Unearned Shares, Units or Other Rights That Have Not Vested (#)	Equity Incentive Plan Awards: Market or Payout Value of Unearned Shares, Units or Other Rights That Have Not Vested ($)
Harry R. Alvis	18,750			$ 1.50	3/4/2007				
	18,750			$ 1.50	3/4/2008				
	18,750			$ 1.50	3/4/2009				
	18,750			$ 1.50	3/3/2010				
	1,750			$ 3.00	8/24/2008				
	1,750			$ 3.00	8/24/2009				
	1,750			$ 3.00	8/24/2010				
		1,750		$ 3.00	8/24/2011				
	6,667	13,333		$ 6.57	2/17/2010				
		17,500		$ 9.63	11/10/2010				
Jerome D. Orth	10,000			$ 1.50	3/4/2007				
	10,000			$ 1.50	3/4/2008				
	10,000			$ 1.50	3/4/2009				
	10,000			$ 1.50	3/3/2010				
	250			$ 3.00	8/24/2008				
	250			$ 3.00	8/24/2009				
	250			$ 3.00	8/24/2010				
		250		$ 3.00	8/24/2011				
		8,468		$ 9.63	11/10/2010				
Mark J. Stockslager	11,250			$ 1.50	3/4/2007				
	11,250			$ 1.50	3/4/2008				
	11,250			$ 1.50	3/4/2009				
	11,250			$ 1.50	3/3/2010				
	250			$ 3.00	8/24/2008				
	250			$ 3.00	8/24/2009				
	250			$ 3.00	8/24/2010				
		250		$ 3.00	8/24/2011				
		7,536		$ 9.63	11/10/2010				

(1) Includes each grant of both exercisable and unexercisable options under the Company s 2001 Long-Term Stock Option Plan and 2005 Equity Incentive Plan.

(2) The Company has not granted stock awards to its named executive officers during the past three years.

Aggregated Option Exercises in Last Fiscal Year and Fiscal Year-End Option Values

The following table shows information about stock option exercises during fiscal 2006 and unexercised stock options at June 30, 2006 for the Named Executive Officers.

Name	Shares Acquired on Exercise (#)	Value Realized ($)[1]	Number of Underlying Unexercised Options At Fiscal Year-End (#)		Value of Unexercised In-The-Money Options At Fiscal Year-End ($)[2]	
			Exercisable	Unexercisable	Exercisable	Unexercisable
Robert M. Thornton, Jr.	40,000	334,000	160,000	38,500	$ 1,344,000	$ 10,395
Joseph T. Morris	2,000	16,880	93,250	15,750	$ 775,425	$ 15,855
Harry R. Alvis	0	0	86,917	32,583	$ 688,426	$ 61,199
Jerome D. Orth	0	0	40,750	8,718	$ 341,175	$ 4,011
Mark J. Stockslager	6,000	28,860	45,750	7,786	$ 383,175	$ 3,760

(1) We base this value on the spread between the exercise price and the closing price of our common shares on the American Stock Exchange at exercise.
(2) We base this value on the closing price of our common shares on the American Stock Exchange on June 30, 2006.

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Option Exercises and Stock Vested

The following table provides information with respect to common shares which were issued upon exercise between July 1, 2005 and June 30, 2006:

	Option Awards		Stock Awards	
Name	Number of Shares Acquired on Exercise (#)	Value Realized on Exercise[1] ($)	Number of Shares Acquired on Vesting (#)	Value Realized on Vesting ($)
Robert M. Thornton, Jr.	40,000	334,000		
Joseph T. Morris	2,000	16,880		
Harry R. Alvis		N/A		
Jerome D. Orth		N/A		
Mark J. Stockslager	6,000	28,860		

(1) We base this value on the spread between the exercise price and the closing price of our common shares on the American Stock Exchange at exercise.

Long-Term Incentive Plan Awards

The Company did not grant any awards to Named Executive Officers during the fiscal year ended June 30, 2006 under any long-term incentive plan.

Pension Plan Benefits

Effective February 28, 1997, SunLink amended its domestic retirement plan to freeze participant benefits and close the plan to new participants. Accordingly, compensation earned after February 28, 1997 is not used in determining a participant s accrued benefit. Mr. Thornton and Mr. Stockslager are participants in the plan. The estimated monthly benefits to be received by them at age 65 are $159.94 and $601.24, respectively.

Name	Plan Name	Number of Years Credited Service (#)	Present Value of Accumulated Benefit ($)	Payments During Last Fiscal Year ($)
Robert M. Thornton, Jr.	SunLink Health Systems Domestic Retirement Plan	1	$14,605	
Joseph T. Morris	N/A	N/A	N/A	N/A
Harry R. Alvis	N/A	N/A	N/A	N/A
Jerome D. Orth	N/A	N/A	N/A	N/A
Mark J. Stockslager	SunLink Health Systems Domestic Retirement Plan	8	$31,106	

Nonqualified Deferred Compensation

The Company does not generally offer nonqualified deferred compensation to its officers, and none of its Named Executive Officers currently participate or have participated in any nonqualified deferred compensation plan during the past fiscal year.

Equity Compensation Plan Information

The following table provides information with respect to the common shares that may be issued upon the exercise of options and other awards under the Company s existing equity compensation plans as of June 30, 2006.

Plan Category	(a) Number of securities to be issued upon exercise of outstanding options, warrants and rights	(b) Weighted-average exercise price of outstanding options, warrants and rights	(c) Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
Equity compensation plans approved by security holders:			
1995 Incentive Stock Option Plan	4,000	$ 5.48	
2001 Outside Directors Stock Ownership and Stock Option Plan	82,500	$ 2.26	
2001 Long-Term Stock Option Plan	634,150	$ 2.58	562,800
2005 Equity Incentive Plan	237,200	$ 9.63	
	957,850	$ 4.31	562,800
Equity compensation plans not approved by security holders:			
None			
Total:	957,850	$ 4.31	562,800

Employment Contracts, Termination of Employment and Change-In-Control Arrangements

Robert M. Thornton, Jr. Mr. Thornton, Chairman, President and Chief Executive Officer, is currently employed by the Company under the terms of an Employment Agreement effective July 1, 2005, as amended to date, for a term ending June 30, 2008 with optional renewal periods of eighteen months. Mr. Thornton s current Employment Agreement provides for a base salary at a rate of not less than $335,000 per annum effective July 1, 2005 and thereafter plus any increases that may be granted from time to time by the Company. Mr. Thornton will be eligible to participate in the company s 2005 Equity Incentive Plan if the Board decides to grant him additional options. Mr. Thornton is also eligible to receive an annual bonus of up to sixty percent of his annual base salary if certain criteria established by the Compensation Committee (in consultation with him) are met.

Mr. Thornton s Employment Agreement also provides for severance payments in the event Mr. Thornton ceases to be employed by the Company. If Mr. Thornton is terminated for cause, disability or death, he is entitled to then accrued benefits under the Agreement, including a pro rata share of any annual bonus. If Mr. Thornton is terminated without cause, he is generally entitled to a total of thirty months salary. If he is terminated without cause during any extended term of the Agreement, he is generally entitled to the lesser of (x) twelve months salary or (y) the salary for the remaining number of months of such extended term.

Upon a change of control of the Company (as defined), if Mr. Thornton s employment is thereafter terminated for any reason other than cause or if he terminates his employment within one year of the change of control, he is entitled to (a) thirty months of base pay, to be paid in accordance with the Company s payroll practices, (b) accrued compensation, including a pro rata share of any annual bonus, (c) a lump sum cash payment equal to a pro rata portion of bonus for goals achieved prior to date of such termination, (d) health and certain ancillary benefits for twelve months thereafter, and (e) full vesting of any then unvested stock options.

Joseph T. Morris. Mr. Morris, Chief Financial Officer, is currently employed by the Company under the terms of an Employment Agreement effective July 1, 2003, as amended to date for a term ending December 31, 2006. Mr. Morris Employment Agreement provides for a salary of no less than $244,000 effective July 1, 2004 and thereafter, plus any increases that may be granted from time to time by the Company. If the Board adopts additional option plans under which senior executives participate, Mr. Morris will be eligible to participate and the Board may grant him additional options. Mr. Morris is also eligible to receive an annual bonus of up to sixty percent of his annual base salary if certain criteria established by the Compensation Committee are met.

Mr. Morris Employment Agreement also provides for severance payments in the event Mr. Morris ceases to be employed by the Company. If Mr. Morris is terminated for cause, disability or death, he is entitled to then accrued benefits under the Agreement, including a pro rata share of any annual bonus. If Mr. Morris is terminated without cause during the term of the Agreement, he is entitled to receive severance payments equal to the lesser of (i) twelve months salary or (ii) the salary for the remaining number of months in the term of the Agreement. If he is terminated without cause during any extended term of the Agreement, he is generally entitled to the lesser of (x) six months salary or (y) the salary for the remaining number of months of such extended term.

Upon a change in control of the Company, if Mr. Morris employment is thereafter terminated for any reason other than cause or if he terminates his employment within one year of the change in control, he is entitled to (a) fifteen months of base pay, to be paid in accordance with the Company s payroll practices, (b) accrued compensation, including a pro rata share of any annual bonus, (c) health and certain ancillary benefits for twelve months thereafter, and (d) full vesting of any then unvested stock options.

Harry R. Alvis. Mr. Alvis, Chief Operating Officer, is currently employed by the Company under the terms of an Employment Agreement effective July 1, 2005, as amended to date for a term ending June 30, 2007. Mr. Alvis Employment Agreement provides for a salary of not less than $244,000 effective July 1, 2005 and thereafter, plus any increases that may be granted from time to time by the Company. Under his Employment Agreement, Mr. Alvis will be eligible to participate in the Company s 2005 Equity Incentive Plan if the Board decides to grant him additional options under this Plan. Mr. Alvis is also eligible to receive an annual bonus of up to fifty percent of his annual base salary if certain criteria established by the Compensation Committee are met.

Mr. Alvis Employment Agreement also provides for severance payments in the event Mr. Alvis ceases to be employed by the Company. If Mr. Alvis is terminated for cause, disability or death, he is entitled to then accrued benefits under the Agreement, including a pro rata share of any annual bonus. If Mr. Alvis is terminated without cause during the term of the Agreement, he is entitled to receive severance payments equal to fifteen months salary, a pro rata portion of any bonus for which annual goals have been met and continuation of certain benefits for 60 days following termination. If he is terminated without cause during any extended term of the Agreement, he is generally entitled to the lesser of (x) six months salary or (y) the salary for the remaining number of months of such extended term.

Upon a change in control of the Company, if Mr. Alvis employment is thereafter terminated for any reason other than cause or if he terminates his employment within one year of the change in control, he is entitled to (a) fifteen months of base pay, to be paid in accordance with the Company s payroll practices, (b) accrued compensation, including a pro rata share of any annual bonus, (c) health and certain ancillary benefits for twelve months thereafter, and (d) full vesting of any then unvested stock options.

Jerome D. Orth. Mr. Orth, Vice President, Technical and Compliance Services, is currently employed by the Company under the terms of an Employment Agreement effective February 1, 2001. Mr. Orth s current Employment Agreement provides for a salary of $12,500 per month or $150,000 on an annualized basis. Mr. Orth s salary will be reevaluated at least annually to determine if any adjustments should be made. Additionally, Mr. Orth has a target incentive opportunity for the fiscal year ending June 30, 2007 of up to forty percent of his base salary based on criteria determined by the Compensation Committee. Mr. Orth is eligible to participate in the Company s stock option program, as well as the Company s medical, dental and disability programs.

Mark J. Stockslager. Mr. Stockslager, Principal Accounting Officer and Corporate Controller, is currently employed by the Company under the terms of an Employment Agreement effective January 1, 2001. Mr. Stockslager s current Employment Agreement provides for a salary of $9,056 per month or $108,675 on an annualized basis. Mr. Stockslager s salary will be reevaluated at least annually to determine if any adjustments should be made. Additionally, Mr. Stockslager has a target incentive opportunity for the fiscal year ending June 30, 2007 of up to forty percent of his base salary based on criteria determined by the Compensation Committee. Mr. Stockslager is eligible to participate in the Company s stock option program, as well as the Company s medical, dental and disability programs.

PERFORMANCE GRAPH

The following graph compares the cumulative total shareholder return on SunLink s common shares over a 63 month period from March 31, 2001 through June 30, 2006 with the cumulative total return of the American Stock Exchange Market Index and a published hospital industry index over the same period. The graph assumes that $100 was invested in each vehicle on March 31, 2001 and that all dividends were reinvested.

SunLink changed its fiscal year-end from March 31 to June 30 beginning with the year ended June 30, 2002, so the measurement period for the performance graph and performance data covers the fiscal years ended March 31, 2001, and 2002, the three-month transition period ended June 30, 2002 and fiscal years ended June 30, 2003, 2004, 2005 and 2006.

PERFORMANCE DATA

Cumulative Value of $100 invested on March 31, 2001

	3/31/01	3/31/02	6/30/02	6/30/03	6/30/04	6/30/05	6/30/06
SUNLINK HEALTH SYSTEMS, INC.	100.00	344.97	211.41	161.74	372.48	528.86	664.43
HOSPITALS INDEX	100.00	113.53	112.24	118.94	155.42	193.69	236.22
AMEX MARKET INDEX	100.00	121.28	130.28	70.60	90.94	116.01	88.24

COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION

The members of the Compensation Committee are Ms. Brenner (Chairperson), Dr. Baileys, and Mr. Burleson, none of whom were officers or employees of the Company.

CERTAIN TRANSACTIONS

A director of the Company and the company secretary (who was a director of SunLink until November 2003 and is now director emeritus) are members of two different law firms, each of which provides services to SunLink.

CERTAIN ACCOUNTING AND AUDITING MATTERS

Report Of The Audit Committee

The authority, duties and responsibilities of the Audit Committee of the Board of Directors of the Company are set forth in detail in the written Audit Committee Charter, which was adopted by the Board of Directors of the Company and which complies with the applicable rules of the American Stock Exchange. The Audit Committee reviews and assesses the adequacy of its Charter on an annual basis. The Company s management is responsible for preparing the Company s financial statements and has represented to the Committee that the financial statements were prepared in accordance with generally accepted accounting principles. An independent registered public accounting firm is responsible for auditing the financial statements.

The Audit Committee has three members, each of whom is independent under the applicable rules of the American Stock Exchange. The Audit Committee met seven times during the 2006 fiscal year. In addition, the members of the Audit Committee reviewed, and the Chairman of the Audit Committee discussed with management, Cherry, Bekaert & Holland, L.L.P. (the Company s current independent registered accounting firm) and Deloitte & Touche, (the Company s former independent registered accounting firm) the interim financial information contained in each quarterly earnings release (for the periods such firms were engaged as the Company s accountants) prior to the release of such information to the public.

The Audit Committee discussed with the Company s independent registered public accounting firm the overall scope and plans for their respective audits. The Audit Committee meets with the independent auditors, with and without management present, to discuss the results of the examinations, their evaluations of the Company s internal controls and the overall quality of the company s financial reporting. In addition, the Audit Committee met with the Chief Executive Officer and Chief Financial Officer of the Company to discuss the processes that they have undertaken to evaluate the accuracy and fair presentation of the Company s financial statements and the effectiveness of the Company s system of disclosure controls and procedures.

The Audit Committee has reviewed and discussed the audited consolidated financial statements of the Company for the fiscal year ended June 30, 2006 with management and Cherry, Bekaert & Holland, L.L.P., including discussing with Cherry, Bekaert & Holland, L.L.P. the matters required to be discussed by Statement on Auditing Standards No. 61, Communication with Audit Committees, as amended and by Rule 2-07 of Regulation S-X.

The Audit Committee received from Cherry, Bekaert & Holland, L.L.P. the written disclosures, including the letter, required by Independence Standards Board Standard No. 1, Independence Discussions with Audit Committees, and has discussed with Cherry, Bekaert & Holland, L.L.P. the subject of their independence in connection with their performance of services for the Company and has considered whether the independent auditor s provision of non-audit services to the Company is compatible with maintaining the auditor s independence.

As a result of the reviews and discussions with management and Cherry, Bekaert & Holland, L.L.P. referred to above, the Audit Committee recommended to the Board of Directors and the Board has approved that the audited financial statements of the Company be included in the Annual Report on Form 10-K for the fiscal year ended June 30, 2006 for filing with the Securities and Exchange Commission.

This report has been submitted by the Audit Committee:

C. Michael Ford (Chair)	Karen B. Brenner	Michael W. Hall

Policy On Pre-Approval Of Services Provided By Independent Registered Public Accounting Firms

Pursuant to the requirements of the Sarbanes-Oxley Act of 2002, the terms of the engagement of Cherry, Bekaert & Holland, L.L.P. are subject to the specific pre-approval of the Audit Committee. All audit and permitted non-audit services to be performed by Cherry, Bekaert & Holland, L.L.P. require pre-approval by the Audit Committee in accordance with pre-approved procedures established by the Audit Committee. The procedures require all proposed engagements of Cherry, Bekaert & Holland, L.L.P. for services of any kind to be directed to the Company s Principal Accounting Officer and then submitted for approval to the Audit Committee prior to the beginning of any services.

In fiscal 2006, 100% of the audit fees, audit related fees and tax fees were approved either by the Audit Committee or its designee. The Audit Committee has considered whether the provision of non-audit services by the Company s independent registered public accounting firm is compatible with maintaining auditor independence and believes that the provision of such services is compatible.

Independent Registered Public Accounting Firm Fees

The following tables show the type of services and the aggregate fees billed to SunLink for such services during the fiscal years ended June 30, 2006 and 2005 by SunLink s independent registered public accounting firm, Cherry, Bekaert & Holland, L.L.P. and its former independent registered accounting firm Deloitte & Touche, LLP. Descriptions of the service types follow the table.

Services Rendered by Cherry Bekaert & Holland, L.L.P.	**Fiscal 2006**	**Fiscal 2005**
Audit Fees	$ 150,000	$ 124,239
Audit Related Fees	$ 11,188	$ 0
Tax Fees	$ 53,085	$ 77,765
All Other Fees	$ 0	$ 0

Services Rendered by Deloitte & Touche, LLP	**Fiscal 2006**	**Fiscal 2005**
Audit Fees	$ 0	$ 183,145
Audit Related Fees	$ 18,560	$ 0
Tax Fees	$ 0	$ 26,030
All Other Fees	$ 0	$ 0

Audit Fees

The aggregate fees billed by Cherry Bekaert & Holland, L.L.P. and Deloitte & Touche, LLP for each of the last two fiscal years include fees for professional services rendered for the audit of the Company s annual financial statements, review of financial statements included in the Company s Quarterly Reports on Form 10-Q and services that were provided in connection with statutory and regulatory audits, filings, or engagements and other attest services and the issuance of comfort letters and consents.

Audit-Related Fees

Audit-related fees may include fees for assurance and related services that are reasonably related to the performance of the audit or review of the Company s financial statements. The nature of the services performed for these fees may include, among other things, employee benefit plan audits, internal control reviews, attest services not required by statute or regulation and consultations concerning financial accounting and reporting matters not classified as an audit.

Tax Fees

The aggregate fees billed by Cherry Bekaert & Holland, L.L.P. and Deloitte & Touche, LLP in each of the last two fiscal years include fees for professional services rendered for tax compliance, including the preparation of tax returns.

Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

On October 21, 2004, the Company s Audit Committee dismissed Deloitte & Touche, LLP as its independent registered public accounting firm.

The report of Deloitte & Touche, LLP on our consolidated financial statements for the fiscal year ended June 30, 2004 contained no adverse opinion or a disclaimer of opinion, and was not qualified or modified as to uncertainty, audit scope or accounting principles.

During the fiscal year ended June 30, 2004 and through October 21, 2004, there were no disagreements between SunLink and Deloitte & Touche, LLP on any matters of accounting principles or practices, financial statement disclosure or auditing scope or procedure, which disagreements, if not resolved to the satisfaction of Deloitte & Touche, LLP, would have caused it to make a reference to the subject matter of the disagreements in connection with its report.

In connection with the audit of the fiscal year ended June 30, 2004 and through October 21, 2004, there have been no reportable events (as defined in Item 304(a)(1)(v) of Regulation S-K under the Securities Exchange Act of 1934).

We requested that Deloitte & Touche, LLP furnish us with a letter addressed to the SEC stating whether it agreed with the above statements. A copy of such letter, dated October 26, 2004, was filed as Exhibit 16.1 to our Form 8-K filed on October 26, 2004.

On October 21, 2004, the Audit Committee on behalf of the Company engaged Cherry, Bekaert & Holland, L.L.P. as SunLink s independent registered public accounting firm for the fiscal year ended June 30, 2006.

During the years ended June 30, 2006 and 2005 and the subsequent unaudited interim period through the date hereof, neither SunLink nor any of its representatives consulted with Cherry, Bekaert & Holland, L.L.P. regarding (i) the application of accounting principles to a specific completed or contemplated transaction or the type of audit opinion that might be rendered on SunLink s financial statements, which advice was an important factor considered by SunLink in reaching a decision as to the accounting, auditing or financial reporting issue, or (ii) any matter that was the subject of a disagreement with Deloitte & Touche, LLP or a reportable event as described above.

We requested Cherry, Bekaert & Holland, L.L.P. to review the disclosures therein which were required by Item 304(a) of Regulation S-K prior to the filing of such Form 8-K and provided Cherry, Bekaert & Holland, L.L.P. with the opportunity to furnish the Company with a letter addressed to the SEC containing any new information, clarification of views or disagreements with the statements. Cherry, Bekaert & Holland, L.L.P. did not issue any such letter.

SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Securities Exchange Act of 1934 requires directors and certain officers of the Company and owners of more than 10% of the Company s common shares to file an initial ownership report with the Securities and Exchange Commission and a monthly or annual report listing any subsequent change in their ownership of any of the Company s equity securities. The Company believes, based on information provided to the Company by the persons required to file such reports, that all filing requirements applicable to such persons during the period from July 1, 2005 through June 30, 2006 have been met, except that Ms. Brenner and Messrs. Thornton, Baileys, Burleson, Ford, Hall, Turner, Morris, Alvis, Orth and Stockslager failed to timely file a Form 4 for grants of Company common stock and stock options made on November 11, 2005. Mr. Thornton and Mr. Morris filed a Form 4 reporting such grant on February 27, 2006. Ms. Brenner and Messrs. Baileys, Burleson, Ford, Hall, Turner, Alvis, Orth and Stockslager each filed a Form 4 reporting such grant on March 2, 2006.

INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Cherry, Bekaert & Holland, L.L.P. was engaged to perform the Company s annual audit for the fiscal year ended June 30, 2006 and is expected to continue to provide audit services to the Company for fiscal 2007. It is anticipated that representatives of Cherry, Bekaert & Holland, L.L.P. will be present at the Annual Meeting of Shareholders to respond to appropriate questions and to make a statement if such representatives so desire.

The Board of Directors of the Company annually appoints the independent registered public accounting firm for the Company after receiving the recommendation of its Audit Committee.

OTHER BUSINESS

The Board and our management have not received notice of, and are not aware of, any business to come before the Annual Meeting other than the items we refer to in this Proxy Statement. The Board of Directors currently does not intend to present any other business at the meeting. However, if any other matters are properly brought before the meeting, it is intended that the holders of proxies in the enclosed form will vote thereon in their discretion.

COST OF SOLICITATION

The cost of solicitation of proxies will be borne by the Company. In addition to the use of the mails, proxy solicitations may be made by directors, officers and employees of the Company, personally or by telephone or other means of communication, without receiving additional compensation. It is also anticipated that banks, brokerage houses and other custodians, nominees and fiduciaries will be requested to forward soliciting material to their principals and to obtain authorization for the execution of proxies. The Company will reimburse banks, brokerage houses and other custodians, nominees and fiduciaries for their out-of-pocket expenses. The Company has also engaged Georgeson Shareholder Communications, Inc. for a fee not to exceed $10,000 to assist in the solicitation of proxies.

REQUIREMENTS, INCLUDING DEADLINES, FOR SUBMISSION OF PROXY PROPOSALS,

NOMINATION OF DIRECTORS AND OTHER BUSINESS OF SHAREHOLDERS

Under SEC rules, if a shareholder wants us to include a proposal in our proxy statement and form of proxy for the 2007 Annual Meeting of Shareholders, our Secretary must receive the proposal at 900 Circle 75 Parkway, Suite 1120, Atlanta, Georgia 30339, Attention: Secretary, on or before June 2, 2007 in order to be eligible for such inclusion.

Under our Code of Regulations, and as SEC rules permit, shareholders must follow certain procedures to nominate a person for election as a Director at an annual or special meeting. Under these procedures, shareholders must submit the proposed nominee or item of business by delivering a notice to the Secretary of the Company at our principal executive offices. We must receive notice as follows:

Normally, we must receive notice of a shareholder s intention to introduce a nomination or proposed item of business for an annual meeting not less than 50 days nor more than 75 days before the first anniversary of the prior year s meeting. Assuming that our 2006 Annual Meeting is held on schedule, we must receive notice pertaining to the 2007 Annual Meeting no earlier than August 23, 2007 and no later than September 17, 2007.

However, if we give less than 60 days notice or public announcement of the annual meeting date, we must receive the notice no later than the close of business ten days after the earlier of the date we first provide notice of the meeting to shareholders or announce it publicly.

If we hold a special meeting to elect directors which is on less than sixty days notice, the effect of our Code of Regulations will be that we must receive a shareholder s notice of intention to introduce a nomination no later than the close of business ten days after the earlier of the date we first provide notice of the meeting to shareholders or announce it publicly.

A notice of a proposed nomination must include certain information about the shareholder and the nominee, as well as a written consent of the proposed nominee to serve if elected.

WHERE YOU CAN FIND ADDITIONAL INFORMATION

We have mailed our 2006 Annual Report to Shareholders in connection with this proxy solicitation. IF YOU WOULD LIKE A COPY OF OUR 2006 FORM 10-K, EXCLUDING CERTAIN EXHIBITS, PLEASE CONTACT, SUNLINK HEALTH SYSTEMS, INC. 900 CIRCLE 75 PARKWAY, SUITE 1120, ATLANTA, GEORGIA 30339.

ADMISSION TO MEETING

Please vote by telephone or the Internet or sign, date and return the enclosed proxy or voting instruction form in the prepaid envelope. We encourage you to attend the November 6, 2006 meeting. To assure that attendance is limited to shareholders, please bring with you some proof of SunLink Health Systems, Inc. common stock ownership, such as a current brokerage statement and an identification bearing a photograph. No cellular telephones, beepers or recording devices will be allowed in the meeting room.

APPENDIX A

SUNLINK HEALTH SYSTEMS, INC.

AUDIT COMMITTEE CHARTER

ADOPTED BY THE BOARD OF DIRECTORS

ON SEPTEMBER 20, 2004

I. PURPOSE

The primary function of the Audit Committee is to assist the Board of Directors in fulfilling its oversight responsibilities by reviewing: the integrity of the financial statements and other financial information provided by the Company to the Company s shareholders, the general public and the Securities and Exchange Commission (SEC); the Company s systems of internal controls regarding finance, accounting, legal and compliance that management and the Board have established; the Company s auditing, accounting and financial reporting processes generally; and the independence and performance of the Company s external auditors.

II. COMPOSITION

The Audit Committee shall be comprised of at least three directors as determined by the Board, who shall meet the independence and audit committee composition requirements under any rules and regulations of the American Stock Exchange, Section 121A and Rule 10A-3 of the Securities Exchange Act of 1934 (the Exchange Act) and the rules and regulations of the SEC, as in effect from time to time. Each Audit Committee member shall be independent and free from any relationship that would interfere with the exercise of his or her independent judgment as a member of the Audit Committee. All members of the Committee shall be able to read and understand fundamental financial statements, including a company s balance sheet, income statement, and cash flow statement and shall have working familiarity with basic finance and accounting practices. The Committee shall include at least one member who has past employment experience in finance or accounting, requisite professional certification in accounting, or any other comparable experience or background which results in the member s financial sophistication satisfying the applicable requirements of the American Stock Exchange, the Exchange Act and the rules and regulations of the SEC.

The members of the Committee shall be elected by the Board. Unless a Chair is elected by the full Board, the members of the Committee shall designate a Chair by majority vote of the full Committee membership.

III. MEETINGS

The Committee shall meet quarterly, or more frequently as circumstances dictate. As part of its job to foster open communication, the Committee shall meet at least annually with the management and the independent auditors in separate executive sessions to discuss any matters that the Committee or either group believes should be discussed privately.

IV. RESPONSIBILITIES AND DUTIES

The Audit Committee is vested with all responsibilities and authority required by Rule 10A-3 under the Exchange Act. The Audit Committee s primary duties and responsibilities are to:

Serve as an independent and objective party that reviews, appraises and provides recommendations on the Company s financial reporting process and internal control system.