

PIMCO MUNICIPAL INCOME FUND III

Form N-CSR

November 25, 2014

Table of Contents

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: 811-21187

PIMCO Municipal Income Fund III

(Exact name of registrant as specified in charter)

1633 Broadway, New York, NY 10019

(Address of principal executive offices)

William G. Galipeau

Treasurer, Principal Financial & Accounting Officer

650 Newport Center Drive

Newport Beach, CA 92660

(Name and address of agent for service)

Copies to:

David C. Sullivan

Ropes & Gray LLP

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800 Boylston Street

Boston, MA 02199

Registrant's telephone number, including area code: (844) 337-4626

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Date of fiscal year end: September 30, 2014

Date of reporting period: September 30, 2014

Form N-CSR is to be used by management investment companies to file reports with the Commission not later than 10 days after the transmission to stockholders of any report that is required to be transmitted to stockholders under Rule 30e-1 under the Investment Company Act of 1940 (17 CFR 270.30e-1). The Commission may use the information provided on Form N-CSR in its regulatory, disclosure review, inspection, and policymaking roles.

A registrant is required to disclose the information specified by Form N-CSR, and the Commission will make this information public. A registrant is not required to respond to the collection of information contained in Form N-CSR unless the Form displays a currently valid Office of Management and Budget (OMB) control number. Please direct comments concerning the accuracy of the information collection burden estimate and any suggestions for reducing the burden to Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609. The OMB has reviewed this collection of information under the clearance requirements of 44 U.S.C. § 3507.

Table of Contents

Item 1. Reports to Shareholders.

The following is a copy of the report transmitted to shareholders pursuant to Rule 30e-1 under the Investment Company Act of 1940, as amended (the 1940 Act) (17 CFR 270.30e-1).

Table of Contents

Your Global Investment Authority

PIMCO Closed-End Funds

Annual Report

September 30, 2014

PIMCO Municipal Income Fund III

PIMCO California Municipal Income Fund III

PIMCO New York Municipal Income Fund III

Table of Contents

Table of Contents

	Page
<u>Chairman/President Letter</u>	2
<u>Important Information About the Funds</u>	5
<u>Financial Highlights</u>	14
<u>Statements of Assets and Liabilities</u>	16
<u>Statements of Operations</u>	17
<u>Statements of Changes in Net Assets</u>	18
<u>Notes to Financial Statements</u>	36
<u>Report of Independent Registered Public Accounting Firm</u>	52
<u>Glossary</u>	53
<u>Shareholder Meeting Results</u>	54
<u>Changes to the Boards of Trustees</u>	56
<u>Dividend Reinvestment Plan</u>	57
<u>Management of the Funds</u>	59
<u>Matters Relating to the Trustees - Consideration of the Investment Management and Portfolio Management</u>	
<u>Agreements</u>	62
<u>Privacy Policy</u>	67
Fund	
	Fund Summary
	Schedule of Investments
<u>PIMCO Municipal Income Fund III</u>	8 <u>20</u>
<u>PIMCO California Municipal Income Fund III</u>	10 28
<u>PIMCO New York Municipal Income Fund III</u>	12 <u>33</u>

Table of Contents

Letter from the Chairman of the Board & President

Dear Shareholder:

As previously announced, on September 26, 2014, prior to the close of the reporting period, William Bill Gross, PIMCO's former Chief Investment Officer (CIO) and co-founder, resigned from the firm. PIMCO's Managing Directors elected Daniel Ivascyn to serve as Group Chief Investment Officer (Group CIO). In addition, PIMCO appointed Andrew Balls, CIO Global; Mark Kiesel, CIO Global Credit; Virginie Maisonneuve, CIO Global Equities; Scott Mather, CIO U.S. Core Strategies; and Mihir Worah, CIO Real Return and Asset Allocation. Outside of the reporting period on November 3, 2014, PIMCO announced that Marc Seidner will return to the firm effective November 12 in a new role as CIO Non-traditional Strategies and Head of Portfolio Management in the New York office. Under this leadership structure, Andrew and Mihir have additional managerial responsibility for PIMCO's Portfolio Management group and trade floor activities globally. Andrew will oversee Portfolio Management and trade floor activities in Europe and Asia-Pacific, and Mihir will oversee Portfolio Management and trade floor activities in the U.S. There have not been any changes to the portfolio management of PIMCO Municipal Income Fund III, PIMCO California Municipal Income Fund III or PIMCO New York Municipal Income Fund III.

Douglas Hodge, PIMCO's Chief Executive Officer, and Jay Jacobs, PIMCO's President, will continue to serve as the firm's senior executive leadership team, spearheading PIMCO's business strategy, client service and the firm's operations.

These appointments are a further evolution of the structure that PIMCO established earlier in 2014, reflecting our belief that the best approach for PIMCO's clients and our firm is an investment leadership team of seasoned, highly skilled investors overseeing all areas of PIMCO's investment activities.

During his 43 years at PIMCO, Mr. Gross made great contributions to building the firm and delivering value to PIMCO's clients. Over this period, PIMCO developed into a global asset manager, expanding beyond core fixed income, now encompassing nearly 2,500 employees across 13 offices, including over 250 portfolio managers. Mr. Gross was also responsible for starting PIMCO's robust investment process, with a focus on long-term macroeconomic views and bottom-up security selection—a process that is well institutionalized and will continue into PIMCO's future.

For the twelve-month reporting period ended September 30, 2014

After a period of weakness in late 2013, municipal bonds rallied and produced positive returns during the fiscal 12 months ended September 30, 2014. Longer-term U.S. Treasury yields declined, whereas shorter-term yields (between 1- and 7-year maturities) moved higher during the reporting period. Despite a number of potential headwinds, including a host of geopolitical issues, investor demand for municipal securities was robust overall given improving fundamentals.

2 PIMCO CLOSED-END FUNDS

Table of Contents

The Barclays Municipal Bond Index gained 7.93% while the broad taxable bond market, as represented by the Barclays U.S. Aggregate Bond Index, returned 3.96% during the reporting period.

After several years of positive growth, severe winter weather in parts of the country appeared to be a headwind for the U.S. economy in early 2014. Looking back, gross domestic product (GDP), the value of goods and services produced in the country, the broadest measure of economic activity and the principal indicator of economic performance, expanded at a 3.5% annual pace during the fourth quarter of 2013. According to the U.S. Commerce Department, GDP then contracted at an annual pace of 2.1% during the first quarter of 2014. However, this was a temporary setback, as GDP expanded at a 4.6% annual pace during the second quarter of 2014. This represented the strongest growth rate since the fourth quarter of 2011. According to the Commerce Department's initial estimate, released on October 30, 2014, GDP expanded at an annual pace of 3.5% during the third quarter.

The Federal Reserve (the Fed) began tapering its monthly asset purchase program in January 2014. At each of its next six meetings, the Fed announced that it would further taper its asset purchases. Following its meeting in September 2014, the Fed announced its intention to end its asset purchases in November 2014. However, the Fed again indicated that it would not raise interest rates in the near future, saying in September that it likely will be appropriate to maintain the current target range for the federal funds rate for a considerable time after the asset purchase program ends, especially if projected inflation continues to run below the Committee's 2 percent longer-run goal, and provided that longer-term inflation expectations remain well anchored.

Outlook

PIMCO's forecast for the next 12 months in the U.S. predicts a continuation of the economic recovery. With the ongoing assistance of easy monetary policy, combined with healthy private financial sector balance sheets, we believe the U.S. economy is poised to grow between 2.5% and 3.0% in the coming calendar year. We expect to see corporate capital expenditures accelerate on the back of rising pricing power and expected returns on newly invested capital. We expect very gradually rising wages and product prices, which will allow the Fed to maintain its accommodative monetary policy for another 12 months or so. One potential wildcard for the economy is geopolitical issues in Ukraine, the Middle East and elsewhere.

On the following pages of this PIMCO Closed-End Funds Annual Report, please find specific details regarding investment performance and a discussion of factors that most affected performance over the 12-month reporting period ended September 30, 2014.

Table of Contents

Letter from the Chairman of the Board & President (Cont.)

Thank you for investing with us. We value your trust and will continue to work diligently to meet your investment needs. If you have questions regarding any of your PIMCO Closed-End Funds investments, please contact your financial advisor or call the Funds shareholder servicing agent at (844) 33-PIMCO (844-337-4626). We also invite you to visit our website at www.pimco.com/investments to learn more about our views and global thought leadership.

We remain dedicated to serving your investment needs.

Sincerely,

Hans W. Kertess
Chairman of the Board of Trustees

Peter G. Strelow
President, Principal Executive Officer

4 PIMCO CLOSED-END FUNDS

Table of Contents

Important Information About the Funds

We believe that bond funds have an important role to play in a well-diversified investment portfolio. It is important to note, however, that in an environment where interest rates may trend upward, rising rates would negatively impact the performance of most bond funds, and fixed-income securities held by a Fund are likely to decrease in value. A number of factors can cause interest rates to rise (e.g., central bank monetary policies, inflation rates, general economic conditions, etc.). Accordingly, changes in interest rates can be sudden, and there is no guarantee that Fund Management will anticipate such movement.

As of the date of this report, interest rates in the U.S. are at or near historically low levels. As such, bond funds may currently face an increased exposure to the risks associated with rising interest rates. This is especially true since the Federal Reserve Board has begun tapering its quantitative easing program. Further, while the U.S. bond market has steadily grown over the past three decades, dealer inventories of corporate bonds have remained relatively stagnant. As a result, there has been a significant reduction in the ability of dealers to make markets in corporate bonds. All of the factors mentioned above, individually or collectively, could lead to increased volatility and/or lower liquidity in the fixed income markets, which could result in increased losses to a Fund. Bond funds and individual bonds with a longer duration (a measure of the sensitivity of a security's price to changes in interest rates) tend to be more sensitive to changes in interest rates, usually making them more volatile than securities or funds with shorter durations. In addition, in the current low interest rate environment, the market price of the Funds common shares may be particularly sensitive to changes in interest rates or the perception that there will be a change in interest rates.

The use of derivatives may subject the Funds to greater volatility than investments in traditional securities. The Funds may use derivative instruments for hedging purposes or as part of an investment strategy. Use of these instruments may involve certain costs and risks such as liquidity risk, interest rate risk, market risk, credit risk, management risk and the risk that a Fund could not close out a position when it would be most advantageous to do so. Certain derivative transactions may have a leveraging effect on a Fund. For example, a small investment in a derivative instrument may have a significant impact on a Fund's exposure to interest rates, currency exchange rates or other investments. As a result, a relatively small price movement in a derivative instrument may cause an immediate and substantial loss or gain, which translates into heightened volatility in the Fund. A Fund may engage in such transactions regardless of whether the Fund owns the asset, instrument or components of the index underlying the derivative instrument. A Fund may invest a significant portion of its assets in these types of instruments. If it does, a Fund's investment exposure could far exceed the value of its portfolio securities and its investment performance could be primarily dependent upon securities it does not own.

A Fund's use of leverage creates the opportunity for increased income for the Fund's common shareholders, but also creates special risks. Leverage is a speculative technique that may expose a Fund to greater risk and increased costs. If shorter-term interest rates rise relative to the rate of return on a Fund's portfolio, the interest and other costs to the Fund of leverage could exceed the rate of return on the debt obligations and other investments held by the Fund, thereby reducing return to the Fund's common shareholders. In addition, fees and expenses of any form of leverage used by a Fund will be borne entirely by its common shareholders (and not by preferred shareholders, if any) and will reduce the investment return of the Fund's common shares. There can be no assurance that a Fund's use of leverage will result in a higher yield on its common shares, and it may result in losses. Leverage creates several major types of risks for a Fund's common shareholders, including: (1) the likelihood of greater volatility of net asset value and market price of the Fund's common shares, and of the investment return to the Fund's common shareholders, than a comparable portfolio without leverage; (2) the possibility either that the Fund's common share dividends will fall if the interest and other costs of leverage rise, or that dividends paid on the Fund's common shares will fluctuate because such costs vary over time; and (3) the effects of leverage in a

Table of Contents

Important Information About the Funds (Cont.)

declining market or a rising interest rate environment, as leverage is likely to cause a greater decline in the net asset value of the Fund's common shares than if the Fund were not leveraged and may result in a greater decline in the market value of the Fund's common shares.

There is a risk that a Fund investing in a tender option bond program will not be considered the owner of a tender option bond for federal income tax purposes, and thus will not be entitled to treat such interest as exempt from federal income tax. Certain tender option bonds may be illiquid or may become illiquid as a result of, among other things, a credit rating downgrade, a payment default or a disqualification from tax-exempt status. Regulators recently finalized rules implementing Section 619 (the Volcker Rule) and Section 941 (the Risk Retention Rules) of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Both the Volcker Rule and the Risk Retention Rules apply to tender option bond programs and may require that such programs be restructured. The results of these rules are not certain, and there can be no assurance that appropriate restructuring of existing trusts will be possible or that the creation of new trusts will continue. Because of the role that tender option bond programs play in the municipal bond market, it is possible that implementation of these rules may adversely impact the municipal bond market. For example, as a result of the implementation of these rules, the municipal bond market may experience reduced demand or liquidity and increased financing costs. A Fund's investment in the securities issued by a tender option bond trust may involve greater risk and volatility than an investment in a fixed rate bond, and the value of such securities may decrease significantly when market interest rates increase. Tender option bond trusts could be terminated due to market, credit or other events beyond the Funds' control, which could require the Funds to reduce leverage and dispose of portfolio investments at inopportune times and prices. A Fund may use a tender option bond program as a way of achieving leverage in its portfolio, in which case the Fund will be subject to leverage risk.

High-yield bonds (commonly referred to as junk bonds) typically have a lower credit rating than other bonds. Lower-rated bonds generally involve a greater risk to principal than higher-rated bonds. Further, markets for lower-rated bonds are typically less liquid than for higher-rated bonds, and public information is usually less abundant in such markets. Thus, high-yield investments increase the chance that a Fund will lose money. The credit quality of a particular security or group of securities does not ensure the stability or safety of the overall portfolio.

Mortgage-Related and Asset-Backed Securities represent ownership interests in pools of mortgages or other assets such as consumer loans or receivables. As a general matter, Mortgage-Related and Asset-Backed Securities are subject to interest rate risk, extension risk, prepayment risk, and credit risk. These risks largely stem from the fact that returns on Mortgage-Related and Asset-Backed Securities depend on the ability of the underlying assets to generate cash flow.

The common shares of the Funds trade on the New York Stock Exchange. As with any stock, the price of a Fund's common shares will fluctuate with market conditions and other factors. If you sell your common shares of a Fund, the price received may be more or less than your original investment. Shares of closed-end management investment companies frequently trade at a discount from their net asset value. The common shares of a Fund may trade at a price that is less than the initial offering price and/or the net asset value of such shares.

The Funds may be subject to various risks in addition to those described above. Some of these risks may include, but are not limited to, the following: asset allocation risk, credit risk, stressed securities risk, distressed and defaulted securities risk, corporate bond risk, market risk, issuer risk, liquidity risk, equity securities and related market risk, mortgage-related and other asset-backed securities risk, extension risk, prepayment risk, privately issued mortgage-related securities risk, mortgage market/subprime risk, foreign (non-U.S.) investment risk, emerging markets risk, currency risk, redenomination risk, non-diversification risk, management risk, municipal bond risk, tender option bond risk, inflation-indexed security risk, senior debt risk, loans, participations and assignments risk,

6 PIMCO CLOSED-END FUNDS

Table of Contents

reinvestment risk, real estate risk, U.S. Government securities risk, foreign (non-U.S.) government securities risk, valuation risk, segregation and cover risk, focused investment risk, credit default swaps risk, event-linked securities risk, counterparty risk, preferred securities risk, confidential information access risk, other investment companies risk, private placements risk, inflation/deflation risk, regulatory risk, tax risk, recent economic conditions risk, market disruptions and geopolitical risk, potential conflicts of interest-allocation of investment opportunities, repurchase agreements risk, securities lending risk, zero-coupon bond and payment-in-kind securities risk, portfolio turnover risk, smaller company risk, short sale risk and convertible securities risk. A description of certain of these risks is available in the Notes to Financial Statements of this Report.

On each individual Fund Summary page in this Shareholder Report the Common Share Average Annual Total Return table and Common Share Cumulative Return (if applicable) measure performance assuming that all dividend and capital gain distributions were reinvested. Total return is calculated by determining the percentage change in NAV or market price (as applicable) in the specified period. Returns do not reflect the deduction of taxes that a shareholder would pay on Fund distributions. Total return for a period of more than one year represents the average annual total return. Performance at market price will differ from results at NAV. Although market price returns tend to reflect investment results over time, during shorter periods returns at market price can also be influenced by factors such as changing views about the Fund, market conditions, supply and demand for the Fund's shares, or changes in the Fund's dividends. Performance shown is net of fees and expenses.

The following table discloses the commencement of operations of each Fund:

Fund Name	Commencement of Operations
PIMCO Municipal Income Fund III	10/31/02
PIMCO California Municipal Income Fund III	10/31/02
PIMCO New York Municipal Income Fund III	10/31/02

An investment in a Fund is not a deposit of a bank and is not guaranteed or insured by the Federal Deposit Insurance Corporation or any other government agency. It is possible to lose money on investments in the Funds.

PIMCO has adopted written proxy voting policies and procedures (Proxy Policy) as required by Rule 206(4)-6 under the Investment Advisers Act of 1940. The Proxy Policy has been adopted by the Funds as the policies and procedures that PIMCO will use when voting proxies on behalf of the Funds. A description of the policies and procedures that PIMCO uses to vote proxies relating to portfolio securities of each Fund, and information about how each Fund voted proxies relating to portfolio securities held during the most recent twelve-month period ended June 30, are available without charge, upon request, by calling the Funds at (844) 33-PIMCO (844-337-4626), on the Funds' website at www.pimcofunds.com/closedendfunds, and on the Securities and Exchange Commission's (SEC) website at <http://www.sec.gov>.

Each Fund files a complete schedule of its portfolio holdings with the SEC for the first and third quarters of its fiscal year on Form N-Q. A copy of each Fund's Form N-Q is available on the SEC's website at <http://www.sec.gov> and may be reviewed and copied at the SEC's Public Reference Room in Washington, D.C., and is available without charge, upon request by calling the Funds at (844) 33-PIMCO (844-337-4626) and on the Funds' website at www.pimco.com/closedendfunds. Updated portfolio holdings information about a Fund will be available at www.pimco.com/closedendfunds approximately 15 calendar days after such Fund's most recent fiscal quarter end, and will remain accessible until such Fund files a Form N-Q or a shareholder report for the period which includes the date of the information. Information on the operation of the Public Reference Room may be obtained by calling 1-800-SEC-0330.

Table of Contents

PIMCO Municipal Income Fund III

Symbol on NYSE - **PMX**

Allocation Breakdown

California	17.4%
New York	12.2%
Texas	10.9%
Alabama	10.2%
Arizona	6.7%
Ohio	6.1%
South Carolina	5.3%
Other	31.2%

% of Investments, at value as of 09/30/14

Fund Information (as of September 30, 2014)⁽¹⁾

Market Price	\$10.71
NAV	\$10.78
Premium/(Discount) to NAV	(0.65%)
Market Price Distribution Yield ⁽²⁾	6.98%
NAV Distribution Yield ⁽²⁾	6.94%
Regulatory Leverage Ratio ⁽³⁾	38.24%

Average Annual Total Return for the period ended September 30, 2014

	1 Year	5 Year	10 Year	Commencement of Operations (10/31/02)
Market Price	10.69%	6.94%	4.49%	4.44%
NAV	21.81%	9.96%	4.85%	5.17%

All Fund returns are net of fees and expenses.

⁽¹⁾ Performance quoted represents past performance. Past performance is not a guarantee or a reliable indicator of future results. Current performance may be lower or higher than performance shown. Investment return and the principal value of an investment will fluctuate. Total return, market price, NAV, market price distribution yield, and NAV distribution yield will fluctuate with changes in market conditions. For performance current to the most recent month-end, visit www.pimco.com or call (844) 33-PIMCO.

⁽²⁾ Distribution yields are not performance and are calculated by annualizing the most recent distribution per share and dividing by the NAV or Market Price, as applicable, as of the reported date. Distributions may be comprised of ordinary income, net capital gains, and/or a return of capital (ROC) of your investment in the Fund. Because the distribution rate may include a ROC, it should not be confused with yield or income. If the Fund estimates that a portion of its distribution may be comprised of amounts from sources other than net investment income, the Fund will notify shareholders of the estimated composition of such distribution through a Section 19 Notice. Please refer to the most recent Section 19 Notice, if applicable, for additional information regarding the composition of distributions. Please visit www.pimco.com for most recent Section 19 Notice, if applicable. Final determination of a distribution's tax character will be made on Form 1099 DIV sent to shareholders each January.

⁽³⁾ Represents regulatory leverage outstanding, as a percentage of total managed assets. Regulatory leverage may include preferred shares, tender option bond transactions, reverse repurchase agreements, and other borrowings (collectively "Leverage"). Total managed assets refer to total assets (including assets attributable to Leverage that may be outstanding) minus accrued liabilities (other than liabilities representing Leverage).

8 PIMCO CLOSED-END FUNDS

Table of Contents

Portfolio Insights

- » After a weak start, the municipal bond market generated strong results during the 12-month reporting period ended September 30, 2014. The overall municipal market, as measured by the Barclays Municipal Bond Index (the Index), was initially hurt by rising interest rates and weak demand given concerns over the city of Detroit's bankruptcy filing and credit issues in Puerto Rico. However, the Index then posted positive returns during the last nine months of the reporting period. This turnaround was triggered by generally improving fundamentals, attractive valuations and falling longer-term interest rates. In addition, investor demand improved, while new municipal supply fell sharply. All told, the Index gained 7.93% during the 12 months ended September 30, 2014. In comparison, the overall taxable fixed income market, as measured by the Barclays U.S. Aggregate Bond Index, gained 3.96%.

- » The Fund's overweight duration position relative to the Index contributed to performance as municipal yields moved lower across the curve. The Fund's overweight exposure to the Revenue-Backed sector was beneficial for results as the sector outperformed the Index. Elsewhere, the Fund's overweight exposure for the majority of the reporting period to the Water and Sewer and Tobacco sectors was rewarded given the sectors' outperformance versus the Index.

- » The Fund's underweight exposures to the Transportation and Education sectors detracted from results, as they both outperformed the Index. The Fund's select exposure to the Lease-Backed sector was a drag on results given its underperformance versus the Index.

Table of Contents

PIMCO California Municipal Income Fund III

Symbol on NYSE - **PZC**

Allocation Breakdown

California	93.4%
Short-Term Instruments	4.2%
Indiana	1.3%
New York	0.9%
New Jersey	0.2%

% of Investments, at value as of 09/30/14
Fund Information (as of September 30, 2014)⁽¹⁾

Market Price	\$10.40
NAV	\$10.02
Premium/(Discount) to NAV	3.79%
Market Price Distribution Yield ⁽²⁾	6.92%
NAV Distribution Yield ⁽²⁾	7.19%
Regulatory Leverage Ratio ⁽³⁾	41.74%

Average Annual Total Return for the period ended September 30, 2014⁽¹⁾

	1 Year	5 Year	10 Year	Commencement of Operations (10/31/02)
Market Price	19.73%	8.59%	4.35%	3.96%
NAV	18.95%	9.07%	3.81%	4.14%

All Fund returns are net of fees and expenses.

- ⁽¹⁾ Performance quoted represents past performance. Past performance is not a guarantee or a reliable indicator of future results. Current performance may be lower or higher than performance shown. Investment return and the principal value of an investment will fluctuate. Total return, market price, NAV, market price distribution yield, and NAV distribution yield will fluctuate with changes in market conditions. For performance current to the most recent month-end, visit www.pimco.com or call (844) 33-PIMCO.
- ⁽²⁾ Distribution yields are not performance and are calculated by annualizing the most recent distribution per share and dividing by the NAV or Market Price, as applicable, as of the reported date. Distributions may be comprised of ordinary income, net capital gains, and/or a return of capital (ROC) of your investment in the Fund. Because the distribution rate may include a ROC, it should not be confused with yield or income. If the Fund estimates that a portion of its distribution may be comprised of amounts from sources other than net investment income, the Fund will notify shareholders of the estimated composition of such distribution through a Section 19 Notice. Please refer to the most recent Section 19 Notice, if applicable, for additional information regarding the composition of distributions. Please visit www.pimco.com for most recent Section 19 Notice, if applicable. Final determination of a distribution's tax character will be made on Form 1099 DIV sent to shareholders each January.
- ⁽³⁾ Represents regulatory leverage outstanding, as a percentage of total managed assets. Regulatory leverage may include preferred shares, tender option bond transactions, reverse repurchase agreements, and other borrowings (collectively "Leverage"). Total managed assets refer to total assets (including assets attributable to Leverage that may be outstanding) minus accrued liabilities (other than liabilities representing Leverage).

10 PIMCO CLOSED-END FUNDS

Table of Contents

Portfolio Insights

- » After a weak start, the municipal bond market generated strong results during the 12-month reporting period ended September 30, 2014. The overall municipal market, as measured by the Barclays Municipal Bond Index (the Index), was initially hurt by rising interest rates and weak demand given concerns over the city of Detroit's bankruptcy filing and credit issues in Puerto Rico. However, the Index then posted positive returns during the last nine months of the reporting period. This turnaround was triggered by generally improving fundamentals, attractive valuations and falling longer-term interest rates. In addition, investor demand improved, while new municipal supply fell sharply. All told, the Index gained 7.93% during the 12 months ended September 30, 2014. In comparison, the overall taxable fixed income market, as measured by the Barclays U.S. Aggregate Bond Index, gained 3.96%.

- » The Fund's overweight duration position relative to the Index contributed to performance as municipal yields moved lower across the curve. The Fund's overweight exposures to the Revenue-Backed, Health Care and Tobacco sectors were beneficial for results, as these sectors outperformed the Index.

- » The Fund's underweight exposures to the Transportation and Water and Sewer sectors detracted from results, as they both outperformed the Index.

Table of Contents

PIMCO New York Municipal Income Fund III

Symbol on NYSE - **PYN**

Allocation Breakdown

New York	96.5%
Ohio	1.9%
Short-Term Instruments	0.8%
U.S. Virgin Islands	0.6%
District of Columbia	0.2%

% of Investments, at value as of 09/30/14

Fund Information (as of September 30, 2014)⁽¹⁾

Market Price	\$9.49
NAV	\$9.43
Premium/(Discount) to NAV	0.64%
Market Price Distribution Yield ⁽²⁾	6.64%
NAV Distribution Yield ⁽²⁾	6.68%
Regulatory Leverage Ratio ⁽³⁾	40.90%

Average Annual Total Return for the period ended September 30, 2014⁽¹⁾

	1 Year	5 Year	10 Year	Commencement of Operations (10/31/02)
Market Price	9.47%	6.79%	2.39%	2.64%
NAV	19.01%	8.07%	2.27%	2.98%

All Fund returns are net of fees and expenses.

(1) Performance quoted represents past performance. Past performance is not a guarantee or a reliable indicator of future results. Current performance may be lower or higher than performance shown. Investment return and the principal value of an investment will fluctuate. Total return, market price, NAV, market price distribution yield, and NAV distribution yield will fluctuate with changes in market conditions. For performance current to the most recent month-end, visit www.pimco.com or call (844) 33-PIMCO.

(2) Distribution yields are not performance and are calculated by annualizing the most recent distribution per share and dividing by the NAV or Market Price, as applicable, as of the reported date. Distributions may be comprised of ordinary income, net capital gains, and/or a return of capital (ROC) of your investment in the Fund. Because the distribution rate may include a ROC, it should not be confused with yield or income. If the Fund estimates that a portion of its distribution may be comprised of amounts from sources other than net investment income, the Fund will notify shareholders of the estimated composition of such distribution through a Section 19 Notice. Please refer to the most recent Section 19 Notice, if applicable, for additional information regarding the composition of distributions. Please visit www.pimco.com for most recent Section 19 Notice, if applicable. Final determination of a distribution's tax character will be made on Form 1099 DIV sent to shareholders each January.

(3) Represents regulatory leverage outstanding, as a percentage of total managed assets. Regulatory leverage may include preferred shares, tender option bond transactions, reverse repurchase agreements, and other borrowings (collectively Leverage). Total managed assets refer to total assets (including assets attributable to Leverage that may be outstanding) minus accrued liabilities (other than liabilities representing Leverage).

12 PIMCO CLOSED-END FUNDS

Table of Contents

Portfolio Insights

- » After a weak start, the municipal bond market generated strong results during the 12-month reporting period ended September 30, 2014. The overall municipal market, as measured by the Barclays Municipal Bond Index (the Index), was initially hurt by rising interest rates and weak demand given concerns over the city of Detroit's bankruptcy filing and credit issues in Puerto Rico. However, the Index then posted positive returns during the last nine months of the reporting period. This turnaround was triggered by generally improving fundamentals, attractive valuations and falling longer-term interest rates. In addition, investor demand improved, while new municipal supply fell sharply. All told, the Index gained 7.93% during the 12 months ended September 30, 2014. In comparison, the overall taxable fixed income market, as measured by the Barclays U.S. Aggregate Bond Index, gained 3.96%.

- » The Fund's overweight duration position relative to the Index contributed to performance as municipal yields moved lower across the curve. The Fund's overweight exposures to the Revenue-Backed, Health Care and Tobacco sectors were beneficial for results, as these sectors outperformed the Index.

- » The Fund's underweight exposures to the Transportation and Water and Sewer sectors detracted from results, as they both outperformed the Index. The Fund's select exposure to the Special Tax sector was a drag on results given that sector's underperformance versus the Index.

Table of Contents**Financial Highlights**

Selected Per Common Share Data for the Year Ended:	Net Asset Value Beginning of Year	Net Investment Income (a)	Net Realized/ Unrealized Gain (Loss)	Total Income (Loss) from Investment Operations	Dividends on Preferred Shares from Net Investment Income	Net Increase (Decrease) in Net Assets Applicable to Common Shareholders Resulting from Investment Operations	Distributions to Common Shareholders from Net Investment Income
PIMCO Municipal Income Fund III							
09/30/2014	\$ 9.58	\$ 0.75	\$ 1.25	\$ 2.00	\$ (0.01)	\$ 1.99	\$ (0.79)
09/30/2013	11.02	0.75	(1.34)	(0.59)	(0.01)	(0.60)	(0.84)
09/30/2012	9.69	0.83	1.35	2.18	(0.01)	2.17	(0.84)
09/30/2011	10.29	0.87	(0.61)	0.26	(0.02)	0.24	(0.84)
09/30/2010	10.16	0.86	0.13	0.99	(0.02)	0.97	(0.84)
PIMCO California Municipal Income Fund III							
09/30/2014	\$ 9.09	\$ 0.69	\$ 0.97	\$ 1.66	\$ (0.01)	\$ 1.65	\$ (0.72)
09/30/2013	10.23	0.79	(1.20)	(0.41)	(0.01)	(0.42)	(0.72)
09/30/2012	9.08	0.81	1.07	1.88	(0.01)	1.87	(0.72)
09/30/2011	9.65	0.77	(0.60)	0.17	(0.02)	0.15	(0.72)
09/30/2010	9.55	0.76	0.08	0.84	(0.02)	0.82	(0.72)
PIMCO New York Municipal Income Fund III							
09/30/2014	\$ 8.51	\$ 0.56	\$ 1.00	\$ 1.56	\$ (0.01)	\$ 1.55	\$ (0.63)
09/30/2013	9.65	0.62	(1.12)	(0.50)	(0.01)	(0.51)	(0.63)
09/30/2012	8.82	0.77	0.70	1.47	(0.01)	1.46	(0.63)
09/30/2011	9.38	0.69	(0.60)	0.09	(0.02)	0.07	(0.63)
09/30/2010	9.10	0.66	0.27	0.93	(0.02)	0.91	(0.63)

(a) Per share amounts based on average number of common shares outstanding during the year.

(b) Total investment return is calculated assuming a purchase of a common share at the market price on the first day and a sale of a common share at the market price on the last day of each year reported. Dividends and distributions, if any, are assumed, for purposes of this calculation, to be reinvested at prices obtained under the Fund's dividend reinvestment plan. Total investment return does not reflect brokerage commissions in connection with the purchase or sale of Fund shares.

(c) Calculated on the basis of income and expenses applicable to both common and preferred shares relative to the average net assets of common shareholders.

(d) Interest expense relates to the liability for Floating Rate Notes issued in connection with Inverse Floater transactions and/or participation in reverse repurchase agreement transactions. See Note 4(a) in the Notes to Financial Statements for more information.

Table of Contents

Net Asset Value End of Year	Market Price End of Year	Total Investment Return (b)	Net Assets, Applicable to Common Shareholders End of Year (000s)	Ratio of Expenses to Average Net Assets (c)(d)	Ratio of Expenses to Average Net Assets Excluding Waivers (c)	Ratio of Expenses to Average Net Assets Excluding Interest Expense (c)	Ratio of Expenses to Average Net Assets Excluding Interest Expense and Waivers (c)	Ratio of Net Investment Income to Average Net Assets (c)	Preferred Shares Asset Coverage Per Share	Portfolio Turnover Rate
\$ 10.78	\$ 10.71	10.69%	\$ 351,139	1.29%	1.29%	1.23%	1.23%	7.47%	\$ 71,447	15%
9.58	10.45	(15.39)	311,231	1.27	1.27	1.20	1.20	7.04	66,168	20
11.02	13.31	33.20	357,139	1.27	1.33	1.17	1.23	8.00	72,239	25
9.69	10.75	2.01	313,021	1.44	1.46	1.28	1.30	9.39	66,404	14
10.29	11.45	9.90	330,840	1.40	1.41	1.26	1.27	8.78	68,760	7
\$ 10.02	\$ 10.40	19.73%	\$ 221,415	1.37%	1.37%	1.26%	1.26%	7.29%	\$ 69,282	11%
9.09	9.36	(13.98)	200,245	1.35	1.35	1.25	1.25	7.93	65,409	25
10.23	11.68	31.62	224,596	1.34	1.40	1.20	1.26	8.40	69,918	10
9.08	9.53	(0.47)	198,748	1.48	1.50	1.32	1.34	9.01	64,749	11
9.65	10.39	11.94	210,317	1.45	1.46	1.31	1.32	8.39	67,061	3
\$ 9.43	\$ 9.49	9.47%	\$ 53,369	1.66%	1.66%	1.60%	1.60%	6.31%	\$ 66,695	24%
8.51	9.30	(6.83)	48,007	1.65	1.65	1.56	1.56	6.72	62,505	17
9.65	10.66	26.56	54,327	1.64	1.70	1.50	1.56	8.42	67,441	16
8.82	9.00	(1.27)	49,490	1.73	1.75	1.58	1.60	8.07	63,663	9
9.38	9.81	8.98	52,400	1.66	1.67	1.56	1.57	7.39	65,936	12

Table of Contents**Statements of Assets and Liabilities**

(Amounts in thousands, except per share amounts)	PIMCO Municipal Income Fund III	PIMCO California Municipal Income Fund III	PIMCO New York Municipal Income Fund III
Assets:			
<i>Investments, at value</i>			
Investments in securities*	\$ 562,042	\$ 375,847	\$ 89,030
Cash	535	581	575
Receivable for investments sold	30	0	0
Interest receivable	8,498	5,415	1,138
Other assets	34	24	13
	571,139	381,867	90,756
Liabilities:			
<i>Borrowings & Other Financing Transactions</i>			
Payable for floating rate notes issued	\$ 28,482	\$ 33,690	\$ 4,941
Distributions payable to common shareholders	2,030	1,326	297
Dividends payable to preferred shareholders	2	2	0
Accrued management fees	260	169	50
Other liabilities	226	265	99
	31,000	35,452	5,387
Preferred Shares (\$0.00001 par value and \$25,000 liquidation preference per share applicable to an aggregate of 7,560, 5,000 and 1,280 shares issued and outstanding, respectively)	189,000	125,000	32,000
Net Assets Applicable to Common Shareholders	\$ 351,139	\$ 221,415	\$ 53,369
Composition of Net Assets Applicable to Common Shareholders:			
Common Shares:			
Par value (\$0.00001 per share)	\$ 0	\$ 0	\$ 0
Paid in capital in excess of par	435,349	290,548	75,701
Undistributed (overdistributed) net investment income	(945)	6,342	1,386
Accumulated net realized (loss)	(142,534)	(111,414)	(30,976)
Net unrealized appreciation	59,269	35,939	7,258
	\$ 351,139	\$ 221,415	\$ 53,369
Common Shares Issued and Outstanding	32,577	22,089	5,657
Net Asset Value Per Common Share	\$ 10.78	\$ 10.02	\$ 9.43
Cost of Investments in Securities	\$ 502,775	\$ 339,898	\$ 81,771
* Includes repurchase agreements of:	\$ 10,600	\$ 9,000	\$ 0

Amount is less than \$500.

Table of Contents**Statements of Operations**

Year Ended September 30, 2014

(Amounts in thousands)	PIMCO Municipal Income Fund III	PIMCO California Municipal Income Fund III	PIMCO New York Municipal Income Fund III
Investment Income:			
Interest	\$ 28,771	\$ 18,150	\$ 3,989
Total Income	28,771	18,150	3,989
Expenses:			
Management fees	3,384	2,191	546
Auction agent fees and commissions	312	181	53
Interest expense	207	225	32
Trustee fees and related expenses	33	23	6
Auction rate preferred shares related expenses	18	18	18
Operating expenses pre-transition ^(a)			
Custodian and accounting agent	104	78	47
Audit and tax services	61	55	53
Shareholder communications	43	29	15
New York Stock Exchange listing	29	24	24
Transfer agent	24	23	24
Legal	12	7	3
Insurance	17	13	7
Other expenses	1	2	1
Total Expenses	4,245	2,869	829
Net Investment Income	24,526	15,281	3,160
Net Realized Gain (Loss):			
Investments in securities	(2,929)	(1,900)	192
Net Realized Gain (Loss)	(2,929)	(1,900)	192
Net Change in Unrealized Appreciation (Depreciation):			
Investments in securities	43,465	23,299	5,481
Net Change in Unrealized Appreciation	43,465	23,299	5,481
Net Gain	40,536	21,399	5,673
Net Increase in Net Assets Resulting from Investment Operations	65,062	36,680	8,833
Dividends on Preferred Shares from Net Investment Income	(212)	(144)	(37)
Net Increase in Net Assets Applicable to Common Shareholders Resulting from Investment Operations	\$ 64,850	\$ 36,536	\$ 8,796

^(a) These expenses were incurred by the Fund prior to the close of business on September 5, 2014. Subsequent to the close of business on September 5, 2014, any such operating expenses are borne by PIMCO.

Table of Contents

Statements of Changes in Net Assets

(Amounts in thousands)	PIMCO Municipal Income Fund III				
	Year Ended September 30, 2014		Year Ended September 30, 2013		
	13,091	\$	8,362	\$	21,453
Interest rate swap (Note 7)		\$		\$	5,096
Total liabilities measured at fair value		\$		\$	5,096

Assets and liabilities of the Company measured at fair value on a recurring basis as of June 30, 2010 are summarized as follows (in thousands):

Description	June 30, 2010		Total
	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	
Certificates of deposit	\$	\$	\$
Money market funds	5,321	3,360	5,321
Total assets measured at fair value	\$	\$	\$
Interest rate swap (Note 7)	5,321	8,262	8,262
Total liabilities measured at fair value	\$	\$	\$
	5,321	8,262	8,262

Table of Contents*Money Market Funds*

This asset class consisted of a money market portfolio that is comprised of securities classified within Level 1 of the fair value hierarchy because they are valued using quoted market prices in active markets.

Certificates of Deposit

Certificates of deposit are classified within Level 2 of the fair value hierarchy because they are valued using quoted prices for similar assets.

Interest Rate Swap

The Company's objectives in using interest rate derivatives are to add stability to interest expense and to manage its exposure to interest rate movements. The interest rate swap is valued using broker quotations. As such, the interest rate swap is classified within Level 2.

6. LONG-TERM DEBT

Long-term debt comprises the following (in thousands):

	December 31, 2009	June 30, 2010
Notes payable:		
\$150 million term loan	\$	\$ 148,125
\$75 million term loan	73,875	72,029
\$75 million revolver loan		40,000
Total outstanding debt	73,875	260,154
Less: current portion	(3,694)	(11,194)
Total long-term debt	70,181	248,960
Less: debt discount	(630)	(3,291)
Net carrying amount	\$ 69,551	\$ 245,669

2008 Loan Facility

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On September 10, 2008, the Company, as borrower, entered into a credit agreement with CoBank, ACB and other lenders as referenced within the credit agreement (the 2008 CoBank Credit Agreement). The 2008 CoBank Credit Agreement provided a \$75 million term loan (the 2008 Term Loan) as well as a \$75 million revolving credit facility (the 2008 Revolver Facility , together with the 2008 Term Loan, the 2008 Credit Facility). The 2008 Revolver Facility included a \$5 million letter of credit facility

The 2008 Term Loan required quarterly repayments of principal of \$0.2 million through June 30, 2013 and quarterly repayments of principal of \$1.4 million from September 30, 2013 to June 30, 2015. The remaining outstanding principal balance was to be repaid on September 10, 2015 when the 2008 Term Loan was to mature.

All borrowings under the 2008 Credit Facility were bearing interest at a rate, selected by the Company from one of the options as defined within the agreement, plus a margin. Such interest rate options included (i) a base rate, defined as the greater of the prime rate or the federal funds rate plus 0.5%, or (ii) a LIBOR rate. Margins for base rate borrowings ranged from 0% to 0.5%, depending upon the Company's leverage ratio while margins for LIBOR borrowings ranged from 1.25% to 2% also depending upon the Company's leverage ratio.

The 2008 CoBank Credit Agreement contained certain affirmative and negative covenants of the Company and its subsidiaries. Among other things, these covenants restricted the Company's ability to incur additional debt or to incur liens on its property. The 2008 Credit Agreement also required the Company to maintain certain financial ratios including a net leverage ratio of less than or equal to 3.0 to 1, an interest coverage ratio of greater than or equal to 3.5 to 1 and an equity to assets ratio of greater than or equal to 0.4 to 1.

Table of Contents

2010 Loan Facility

On January 20, 2010, the Company amended and restated its 2008 Credit Facility with CoBank as Administrative Agent. (the 2010 CoBank Credit Agreement). The 2010 CoBank Credit Agreement provides for a \$298.9 million credit facility, consisting of a \$73.9 million term loan (the 2010 Term Loan A), a \$150.0 million term loan (the 2010 Term Loan B) and a \$75.0 million revolver loan (the 2010 Revolver Loan, and together with the 2010 Term Loan A and 2010 Term Loan B, the 2010 Credit Facility). The 2010 Credit Facility also provides for one or more additional term loans up to an aggregate \$50.0 million, subject to lender and administrative agent approval.

As of June 30, 2010, \$72.0 million was outstanding under the 2010 Term Loan A, \$148.1 million was outstanding under the 2010 Term Loan B and \$40 million was outstanding under the 2010 Revolver Loan. As discussed in Note 4, the Company partially funded the purchase price of the Alltel Acquisition with the \$150 million 2010 Term Loan B and borrowed \$40 million under the 2010 Revolver Loan.

The 2010 Term Loan A and the 2010 Term Loan B each mature on September 30, 2014, with certain quarterly repayment obligations described below, unless accelerated pursuant to an event of default, as described below. The 2010 Revolver Loan matures on September 10, 2014, unless accelerated pursuant to an event of default, as described below. Amounts borrowed under the 2010 Term Loan A, 2010 Term Loan B and the 2010 Revolver Loan bear interest at a rate equal to, at the Company's option, either (i) the London Interbank Offered Rate (LIBOR) plus an applicable margin ranging between 3.50% to 4.75% or (ii) a base rate plus an applicable margin ranging from 2.50% to 3.75%. The Company is not required to apply a minimum LIBOR percentage for any loans bearing interest at the LIBOR rate. The base rate is equal to the higher of either (i) 1.50% plus the higher of (x) the one-week LIBOR and (y) the one-month LIBOR and (ii) the prime rate (as defined in the credit agreement). The applicable margin is determined based on the ratio of the Company's indebtedness (as defined in the credit agreement) to its EBITDA (as defined in the credit agreement). Borrowings as of June 30, 2010, including the interest rate swap agreement as described in Note 7, were bearing a weighted average interest rate of 5.95%.

All amounts outstanding under the 2010 Revolver Loan will be due and payable upon the earlier of the maturity date or the acceleration of the loan upon an event of default. Amounts outstanding under the 2010 Term Loan A and the 2010 Term Loan B became due and payable commencing on March 31, 2010 and June 30, 2010, respectively, in quarterly payments equal to 1.25% of the initial principal amount outstanding under each loan, increasing to 2.50% of the initial principal amount outstanding commencing on March 31, 2012. Remaining balances will be due and payable upon maturity, unless the loans are accelerated upon an event of default.

Certain of our subsidiaries, including our principal wholly-owned domestic operating subsidiaries, are guarantors of our obligations under the 2010 CoBank Credit Agreement. Further, our obligations are secured by (i) a first priority, perfected lien on substantially all of our property and assets and that of the guarantor subsidiaries, and (ii) a pledge of 100% of the Company's equity interests in certain domestic subsidiaries and up to 65% of the equity interests outstanding of certain foreign subsidiaries, in each case, including the Company's principal operating subsidiaries.

The 2010 CoBank Credit Agreement contains customary representations, warranties and covenants, including covenants by the Company limiting additional indebtedness, liens, guaranties, mergers and consolidations, substantial asset sales, investments and loans, sale and leasebacks, transactions with affiliates and fundamental changes. In addition, the 2010 CoBank Credit Agreement contains financial covenants by the Company that (i) impose a maximum ratio of indebtedness (as defined in the credit agreement) to EBITDA (as defined in the credit agreement), (ii) require a minimum ratio of EBITDA to cash interest expense, (iii) require a minimum ratio of equity to consolidated assets and (iv) require a minimum ratio of EBITDA to fixed charges (as defined in the credit agreement). As of June 30, 2010, the Company was in compliance with all of the financial covenants of the 2010 CoBank Credit Agreement.

The 2010 CoBank Agreement provides for events of default customary for credit facilities of this type, including but not limited to non-payment, defaults on other debt, misrepresentation, breach of covenants, representations and warranties, insolvency and bankruptcy. After the occurrence of an event of default and for so long as it continues, the administrative agent or the requisite lenders (as defined in the credit agreement) may increase the interest rate then in effect on all outstanding obligations by 2.0%. Upon an event of default relating to insolvency, bankruptcy or receivership, the amounts outstanding under the 2010 Credit Facility will become immediately due and payable and the lender commitments will be automatically terminated. Upon the occurrence and continuation of any other event of default, the administrative agent and/or the requisite lenders (as defined in the credit agreement) may accelerate payment of all obligations and terminate the lenders' commitments under the 2010 CoBank Agreement.

7. DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

As required by the FASB's authoritative guidance on accounting for derivative instruments and hedging activities, the Company records all derivatives on the balance sheet at fair value. The accounting for changes in the fair value of derivatives depends on the intended use of the derivative, whether the Company has elected to designate a derivative in a hedging relationship and apply hedge accounting and whether the hedging relationship has satisfied the criteria necessary to apply hedge accounting. Derivatives

Table of Contents

designated and qualifying as a hedge of the exposure to changes in the fair value of an asset, liability, or firm commitment attributable to a particular risk, such as interest rate risk, are considered fair value hedges. Derivatives designated and qualifying as a hedge of the exposure to variability in expected future cash flows, or other types of forecasted transactions, are considered cash flow hedges. Hedge accounting generally provides for the matching of the timing of gain or loss recognition on the hedging instrument with the recognition of the changes in the fair value of the hedged asset or liability that are attributable to the hedged risk in a fair value hedge or the earnings effect of the hedged forecasted transactions in a cash flow hedge. The Company may enter into derivative contracts that are intended to economically hedge certain of its risk, even though hedge accounting does not apply or the Company elects not to apply hedge accounting.

Risk Management Objective of Using Derivatives

The Company is exposed to certain risks arising from both its business operations and economic conditions. The Company principally manages its exposures to a wide variety of business and operational risks through management of its core business activities. The Company manages economic risks related to interest rates primarily by managing the amount, sources, and duration of its debt funding and the use of derivative financial instruments. Specifically, the Company entered into derivative financial instruments to manage exposures that arise from business activities that result in the payment of future known and uncertain cash amounts, the value of which are determined by interest rates. The Company's derivative financial instruments are used to manage differences in the amount, timing, and duration of its known or expected cash payments principally related to the Company's borrowings.

Cash Flow Hedge of Interest Rate Risk

The Company's objectives in using interest rate derivatives are to add stability to interest expense and to manage its exposure to interest rate movements. To accomplish this objective, the Company primarily uses an interest rate swap as part of its interest rate risk management strategy. Interest rate swaps designated as cash flow hedges involve the receipt of variable-rate amounts from a counterparty in exchange for the Company making fixed-rate payments over the life of the agreements without exchange of the underlying notional amount.

The effective portion of changes in the fair value of interest rate swaps designated and that qualify as cash flow hedges is recorded in Accumulated Other Comprehensive Income and is subsequently reclassified into earnings in the period that the hedged forecasted transaction affects earnings. The Company uses a derivative to hedge the variable cash flows associated with existing variable-rate debt. The ineffective portion of the change in fair value of the derivative is recognized directly in earnings. No hedge ineffectiveness was recognized during either the three months ended June 30, 2009 or 2010.

As of December 31, 2009 and June 30, 2010, the Company's sole derivative instrument was an interest rate swap with a notional amount of \$68 million that was designated as a cash flow hedge of interest rate risk.

Amounts reported in accumulated other comprehensive income related to the interest rate swap will be reclassified to interest expense as interest payments are made on the Company's variable-rate debt. Through June 30, 2011, the Company estimates that an additional \$2.6 million will be reclassified as an increase to interest expense due to the interest rate swaps since the hedge interest rate exceeds the variable interest rate on the debt.

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The table below presents the fair value of the Company's derivative financial instrument as well as its classification on the consolidated balance sheet as of December 31, 2009 and June 30, 2010 (in thousands):

	Balance Sheet Location	Liability Derivatives	
		December 31, 2009	Fair Value as of June 30, 2010
Derivatives designated as hedging instruments:			
Interest Rate Swap	Other liabilities	\$ 5,096	\$ 8,262
Total derivatives designated as hedging instruments		\$ 5,096	\$ 8,262

Table of Contents

The table below presents the effect of the Company's derivative financial instrument on the consolidated income statements for the three months ended June 30, 2009 and 2010 (in thousands):

Three Months Ended June 30,	Derivative in Cash Flow Hedging Relationships	Amount of Gain or (Loss) Recognized in OCI on Derivative (Effective Portion)	Location of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Amount of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)
2009	Interest Rate Swap	\$ 2,411	Interest expense	\$ 690
2010	Interest Rate Swap	(2,263)	Interest expense	709

The table below presents the effect of the Company's derivative financial instrument on the consolidated income statements for the six months ended June 30, 2009 and 2010 (in thousands):

Six Months Ended June 30,	Derivative in Cash Flow Hedging Relationships	Amount of Gain or (Loss) Recognized in OCI on Derivative (Effective Portion)	Location of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Amount of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)
2009	Interest Rate Swap	\$ 3,091	Interest expense	\$ 1,349
2010	Interest Rate Swap	(3,083)	Interest expense	1,422

Credit-risk-related Contingent Features

The Company has an agreement with its derivative counterparty that contains a provision where if the Company defaults on any of its indebtedness, including default where repayment of the indebtedness has not been accelerated by the lender, then the Company could also be declared in default on its derivative obligations.

As of June 30, 2010, the fair value of the interest rate swap liability position, related to this agreement was \$8.3 million. As of June 30, 2010, the Company has not posted any collateral related to this agreement. If the Company had breached any of these provisions at June 30, 2010, it would have been required to settle its obligation under the agreement at its termination value of \$8.3 million.

Table of Contents**8. RECONCILIATION OF TOTAL EQUITY**

Total equity was as follows (in thousands):

	Six Months Ended June 30,					
	Atlantic Tele- Network, Inc.	2009 Non-Controlling Interests	Total Equity	Atlantic Tele- Network, Inc.	2010 Non-Controlling Interests	Total Equity
Equity, beginning of period	\$ 228,873	\$ 32,787	\$ 261,660	\$ 255,745	\$ 26,687	\$ 282,432
Stock based compensation	656		656	981		981
Comprehensive income:						
Net income	18,438	543	18,981	28,809	90	28,899
Other comprehensive income(loss)- Gain(loss) on interest rate swap (net of tax)	1,897		1,897	(1,900)		(1,900)
Total comprehensive income	20,335	543	20,878	26,909	90	26,999
Issuance of common stock upon exercise of stock options	74		74	677		677
Dividends on common stock	(5,483)	(5,118)	(10,601)	(6,123)		(6,123)
Non-controlling interests of acquired business					16,000	16,000
Distributions to non-controlling interests					(860)	(860)
Investments made by minority shareholders		200	200		225	225
Purchase of common shares	(23)		(23)			
Equity, end of period	\$ 244,432	\$ 28,412	\$ 272,844	\$ 278,189	\$ 42,142	\$ 320,331

9. NET INCOME PER SHARE

For the three and six months ended June 30, 2009 and 2010, outstanding stock options were the only potentially dilutive securities.

The reconciliation from basic to diluted weighted average common shares outstanding is as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2010	2009	2010
	15,232	15,300	15,231	15,280

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Basic weighted average common shares outstanding				
Stock options	50	178	36	183
Diluted weighted average common shares outstanding	15,282	15,478	15,267	15,463

The above calculations for the three months ended June 30, 2009 and 2010 do not include 323,000 and 114,000 shares, respectively, related to certain stock options because the effects of such were anti-dilutive. For the six months ended June 30, 2009 and 2010, the calculation does not include 349,000 and 87,000 shares, respectively, related to certain stock options because the effect of such options were anti-dilutive.

10. SEGMENT REPORTING

Upon the completion of the Alltel Acquisition, the Company restructured how it manages its business, and accordingly, modified its reportable segments. The previously reported Rural Wireless segment has been combined with the operating results of Alltel and is now being reported as the U.S. Wireless segment, which generates all of its revenue and has all of its assets located in the United States. In addition, the previously reported Wireless Data segment has been merged into the Island Wireless segment which generates its revenue, and has its assets, in Bermuda, Turks and Caicos, and the U.S. Virgin Islands. Integrated Telephony International has been renamed International Integrated

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Table of Contents

Telephony and has its assets located in Guyana. Integrated Telephony Domestic has been renamed U.S. Wireline, and has its assets located in the United States. The operating segments are managed separately because each offers different services and serves different markets. Reconciling items refer to corporate overhead matters.

The following tables provide information for each operating segment (in thousands). Previously reported periods have been restated, showing the effects of the new segment structure:

For the Three Months Ended June 30, 2009						
	U.S. Wireless	International Integrated Telephony	Island Wireless	U.S. Wireline	Reconciling Items	Consolidated
Revenue						
U.S. Wireless:						
Retail	\$	\$	\$	\$	\$	\$
Wholesale	25,800					25,800
International Wireless		5,184	6,207			11,391
Wireline		17,512		4,728		22,240
Equipment and Other			990			990
Total Revenue	25,800	22,696	7,197	4,728		60,421
Depreciation and amortization	3,614	4,197	1,229	680	74	9,794
Non-cash stock-based compensation				32	323	355
Operating income (loss)	13,463	8,762	(937)	(234)	(2,942)	18,112

For the Three Months Ended June 30, 2010						
	U.S. Wireless	International Integrated Telephony	Island Wireless	U.S. Wireline	Reconciling Items	Consolidated
Revenue						
U.S. Wireless:						
Retail	\$	\$	\$	\$	\$	\$
Wholesale	81,507					81,507
International Wireless	39,545	6,311	6,219			12,530
Wireline	81	18,154		4,995		23,230
Equipment and Other	7,077		535			7,612
Total Revenue	128,210	24,465	6,754	4,995		164,424
Depreciation and amortization	12,527	4,245	965	727	78	18,542
Non-cash stock-based compensation					625	625
Operating income (loss)	16,834	7,899	(586)	3	(16,376)	7,774

Table of Contents

	For the Six Months Ended June 30, 2009					
	U.S. Wireless	International Integrated Telephony	Island Wireless	U.S. Wireline	Reconciling Items	Consolidated
Revenue						
U.S. Wireless:						
Retail	\$	\$	\$	\$	\$	\$
Wholesale	47,439					47,439
International Wireless		10,103	11,927			22,030
Wireline		35,328		9,338		44,666
Equipment and Other			2,380			2,380
Total Revenue	47,439	45,431	14,307	9,338		116,515
Depreciation and amortization	6,849	8,380	2,218	1,399	148	18,994
Non-cash stock-based compensation				63	593	656
Operating income (loss)	21,817	15,476	(1,830)	(1,035)	461	34,889

Table of Contents

For the Six Months Ended June 30, 2010

	U.S. Wireless	International Integrated Telephony	Island Wireless	U.S. Wireline	Reconciling Items	Consolidated
Revenue						
U.S. Wireless:						
Retail	\$ 81,507	\$	\$	\$	\$	\$ 81,507
Wholesale	62,481					62,481
International Wireless		11,875	11,574			23,449
Wireline	81	33,750		9,920		43,751
Equipment and Other	7,077		994			8,071
Total Revenue	151,146	45,625	12,568	9,920		219,259
Depreciation and amortization	16,597	8,528	1,941	1,426	119	28,611
Non-cash stock-based compensation				11	970	981
Operating income (loss)	26,784	15,355	(1,584)	(112)	(25,247)	15,196

Segment Assets

	U.S. Wireless	International Integrated Telephony	Island Wireless	U.S. Wireline	Reconciling Items	Consolidated
December 31, 2009:						
Net fixed assets	\$ 68,560	\$ 117,931	\$ 20,749	\$ 8,829	\$ 946	\$ 217,015
Goodwill	32,148		722	7,491		40,361
Total assets	147,639	152,936	49,734	24,898	71,347	446,554
June 30, 2010:						
Net fixed assets	\$ 262,552	\$ 123,359	21,549	8,554	3,509	419,523
Goodwill	32,148		722	7,491		40,361
Total assets	533,743	154,276	47,992	22,238	25,136	783,385

Capital Expenditures

	US Wireless	International Integrated Telephony	Island Wireless	US Wireline	Reconciling Items	Consolidated
Six Months Ended June 30,						
2009	\$ 11,329	\$ 10,951	\$ 4,791	\$ 463	\$ 7	\$ 27,541
2010	25,456	13,538	9,413	904	2,684	51,995

11. COMMITMENTS AND CONTINGENCIES**Regulatory and Litigation Matters**

The Company and its subsidiaries are subject to certain regulatory and legal proceedings and other claims arising in the ordinary course of business, some of which involve claims for damages and taxes that are substantial in amount. The Company believes that, except for the items discussed below and those discussed in our Annual Report on Form 10-K for the year ended December 31, 2009, for which the Company is currently unable to predict the final outcome, the disposition of proceedings currently pending will not have a material adverse effect on the Company's financial position or results of operations.

Regulatory

The Company's wireless and wireline operations in the United States and in the U.S. Virgin Islands are governed by the Communications Act of 1934, as amended, the implementing regulations adopted thereunder by the Federal Communications Commission, judicial and regulatory decisions and other federal and state statutes. In addition, certain of the Company's subsidiaries are subject to additional regulation in the United States in connection with their acceptance of stimulus award grants pursuant to the American Recovery and Reinvestment Act of 2009. The Company's Bermuda operations are subject to Bermuda's Telecommunications Act of 1986.

Table of Contents

The Company is subject to regulation in Guyana under the provisions of our licenses to provide telecommunications services in Guyana and under the Guyana Public Utilities Commission Act of 1999 and the Guyana Telecommunications Act of 1990. The Company also has certain significant rights and obligations pursuant to the agreement with the Government of Guyana by which the Company acquired its interest in GT&T in 1991. Finally, because of the large volume of traffic that our Guyana operations have with the United States, they can also be significantly affected by orders of U.S. regulatory agencies.

Currently, the Company holds an exclusive license to provide domestic wireline local and international voice and data services in Guyana, which the Company renewed for an additional twenty year term in November of 2009. Since 2001, the Government of Guyana has stated its intention to introduce additional competition into Guyana's telecommunications sector. Since that time, the Company has met with the Government of Guyana to discuss potential modifications of its exclusivity rights, however, no additional steps towards the introduction of competition for international voice and data services have occurred. The Company has been informed that draft legislation liberalizing the telecommunications sector in Guyana may be available during 2010, however, the Company does not know whether or how any draft legislation will address the Company's exclusive license, and if so, whether it would be pursuant to a mutual agreement with the Government. In exercising the Company's option to renew its licenses, it reiterated to the Government that the Company would be willing to voluntarily relinquish the exclusivity aspect of our licenses, but only as part of an overall settlement agreement with the Government. Although the Company believe that we would be entitled to damages for any involuntary termination of that exclusive license, the Company cannot guarantee that the Company would prevail in any court or arbitration proceeding or that our actions would effectively halt any unilateral action by the Government.

Litigation

We are involved in several legal claims regarding our tax filings with the Guyana Inland Revenue dating back to 1991 regarding the deductibility of intercompany advisory fees as well as other tax assessments. Should we be held liable for any of the disputed tax assessments, totaling \$36.8 million (including an assessment for \$13.3 million that we received in July 2010), we believe that the government of Guyana would then be obligated to reimburse us for any amounts that would reduce our return on investment to less than 15% per annum for the relevant periods.

In addition, we are currently involved in several legal challenges to our exclusive license under Guyana's constitution, which have remained pending for anywhere from one to ten years. We believe that any legal challenge to our exclusive license granted in 1990, including lawsuits filed in 2000 by Inet Communications, Inc., in 2002 by an individual and in 2009 by Digicel, are without merit, and we have and will continue to vigorously defend against such legal challenges.

For all of the above regulatory, litigation, or related matters, we believe some adverse outcome is probable and have accordingly accrued \$5.0 million as of June 30, 2010.

Other

The Company is currently disputing certain invoices received during the three months ended June 30, 2010 relating to acquisition-related charges. A portion of these disputed invoices is included in the accompanying statements of operations for the three and six months ended June 30, 2010.

12. SUBSEQUENT EVENTS

On July 7, 2010, in partnership with the Vermont Telecommunications Authority (the VTA), we were awarded a \$33.4 million federal stimulus grant by the National Telecommunications and Information Administration of the U.S. Department of Commerce (NTIA). The grant, along with partial matching funds to be contributed by us (through a Vermont subsidiary) and the VTA, will be invested in fiber-optic middle mile network in Vermont to provide broadband and wireless services to community schools, colleges, libraries and state-owned buildings in the area. The funding of this project is not scheduled to occur until later in 2010, once the necessary environmental site work is completed. Accordingly, we did not recognize any of the granted funds during the three or six months ended June 30, 2010. The results of our U.S. wireline business are included in the Company s U.S. Wireline segment as reported in Note 10.

On July 26, 2010, the Company executed an additional interest rate swap with a notional amount of \$30 million that was also designated as a cash flow hedge of interest rate risk.

There were no other subsequent events required to be recognized or disclosed in the financial statements.

Table of Contents

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The discussion and analysis of our financial condition and results of operations that follows are based upon our condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of our financial statements requires us to make estimates and judgments that affect the reported amounts of assets and liabilities, revenues and expenses, and the related disclosure of contingent assets and liabilities at the date of our financial statements. Actual results may differ significantly from these estimates under different assumptions or conditions. This discussion should be read in conjunction with our condensed consolidated financial statements herein and the accompanying notes thereto, and our Annual Report on Form 10-K for the year ended December 31, 2009, in particular, the information set forth therein under Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations .

Overview

We provide the following wireless and wireline telecommunications services, through our operating subsidiaries, in North America and the Caribbean:

- **Wireless.** In the United States, we offer wireless voice and data services to retail customers under the Alltel name in rural markets located principally in the Southeast and Midwest. Additionally, we offer wholesale wireless voice and data roaming services to national, regional and local wireless carriers in rural markets located principally in the Southwest and Midwest United States. We also offer wireless voice and data services to retail customers in Guyana under the Cellink name, in Bermuda under the CellularOne name, in Turks and Caicos under the Islandcom name and in the U.S. Virgin Islands under the Choice name.
- **Wireline.** Our local telephone and data services include our operations in Guyana under the GT&T name and in the United States under the Sovernet and ION names. In Guyana, we are the exclusive provider of domestic wireline local and long distance telephone services and also provide international voice and data services. We offer facilities-based integrated voice and data communications services to residential and business customers in New England, primarily in Vermont, and wholesale transport services in New York State. We are also a leading internet access service provider in the U.S. Virgin Islands.

ATN was incorporated in Delaware in 1987, and since that time, has engaged in strategic acquisitions to grow the Company's operations. From 1998 through 2005, a significant majority of our revenue was derived from our wireless and wireline operations in Guyana, in which we have owned an 80% interest since 1991. In addition, the Company has been a provider of fixed and portable wireless broadband data and dial-up internet services through our U.S. Virgin Islands subsidiary, acquired in 1999. In the past five years, we have added substantially to the diversity of our business and reduced our historical dependence on our Guyana operations for our financial results. We entered the U.S. telecommunications market through the 2005 acquisition of an operator of a wholesale wireless network in rural portions of the Southwest and Midwest and we continued our U.S. expansion with the 2006 acquisition of a wireline voice, broadband data and dial-up service provider in New England. In 2008, we increased our previously non-controlling investment in a Bermudian wireless voice and data services provider to a controlling 58% interest and entered into new U.S. and Caribbean markets with investments in two early stage businesses providing wholesale transport services in New York State and wireless voice and data services in Turks and Caicos. In addition to the diversification of our business through acquisition, we have further accentuated our focus on our U.S. operations with increased capital investment in and growth of our wholesale wireless business, which was the single largest contributor to our revenue and operating income in 2009.

In the second quarter of 2010, we completed the acquisition of our retail wireless business, which provides wireless voice and data services in rural markets of the United States under the Alltel brand name (the Alltel Acquisition). Also during the quarter, we completed an investment in a wireless telecommunications provider in Aruba, in which we hold a controlling interest. With the completion of the Alltel asset acquisition, we continued our trend towards growth in U.S.-sourced revenue, with the U.S. wireless portion of our business now constituting a significant majority of the Company's consolidated revenue. Of course, we continue to actively evaluate additional investment and acquisition opportunities in the United States and the Caribbean that meet our return-on-investment and other acquisition criteria.

Table of Contents

The following chart summarizes the operating activities of our principal subsidiaries, the segments in which we report their revenue and the markets they serve as of June 30, 2010:

Services	Segment	Markets
Wireless	U.S. Wireless	United States (rural markets)
	International Integrated Telephony	Guyana
	Island Wireless	Bermuda, Turks and Caicos, U.S. Virgin Islands
Wireline	International Integrated Telephony	Guyana
	U.S. Wireline	United States (New England and New York State)

We provide management, technical, financial, regulatory, and marketing services to our subsidiaries and typically receive a management fee equal to approximately 3% to 5% of their respective revenue. Management fees from consolidated subsidiaries are eliminated in consolidation. For information about our business segments and geographical information about our revenue, operating income and long-lived assets, see Note 10 to the Consolidated Financial Statements included in this Report.

As discussed above, we have historically been dependent on our wholesale U.S. wireless business and International Integrated Telephony operations for a majority of our revenue and profits. The addition of our retail U.S. wireless business following our Alltel Acquisition has shifted our reliance substantially to our U.S. Wireless segment, which now includes both our wholesale and retail U.S. wireless businesses. For the three months ended June 30, 2010, approximately 78% of our consolidated revenue was generated by our U.S. Wireless segment, while only 15% was generated by our International Integrated Telephony segment. In comparison, for the three months ended June 30, 2009, approximately 43% of our consolidated revenue was generated by our U.S. Wireless segment (then our Rural Wireless segment), while 38% was generated by our International Integrated Telephony segment. All of our consolidated operating income was generated by these two operating segments for the three and six months ended June 30, 2009 and 2010.

As of June 30, 2010, our U.S. retail wireless services was offered in six states to approximately 807,000 customers under the Alltel brand name. Our wireless licenses provide mobile data and voice coverage to a network footprint covering a population of approximately six million people as of June 30, 2010. As a result of Verizon's required divestiture of Alltel assets, we acquired a regional, non-contiguous wireless network that we anticipate will require network expansion and improvements as well as roaming support to ensure ongoing nationwide coverage. Our Alltel service offerings provide rate plans which include local and nationwide voice and data services on either a postpaid or prepaid basis. We offer several rate plans designed for customers to choose the flexibility that they desire for their calling preferences, and believe that the ability to offer nationwide calling to our customers is a key factor in our ability to remain competitive in the telecommunications market.

The revenue of our U.S. retail wireless business is primarily driven by the number of wireless subscribers acquired in the Alltel Acquisition and their related voice and data usage. The number of our retail subscribers and their usage volumes and patterns also has a major impact on the profitability of our U.S. retail wireless operations. Our customer activity may be influenced by traditional retail selling periods, which may be seasonal in nature, and other factors that arise in connection with our rural customer base. We expect to initially experience a greater degree of customer turnover due to the recent acquisition, including some net reduction in total subscribers, but generally expect that this turnover, or churn, will gradually improve during the next two years as we are able to refine our service offerings and transition the assets from the legacy Alltel information technology systems and platforms to our own. During this time, we also expect to experience higher economic-related churn as we eliminate certain sales and credit practices implemented by the management of the trust that operated the assets from 2009 through the completion of the acquisition in April 2010. During this time, we may engage in sales and promotional activities designed to retain or increase our customer base, but may be affected by other factors, including general economic conditions, the roaming and usage of our existing customer

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base and actions by our competitors, which may reduce or outweigh the success of our marketing or promotional efforts. The mix of our customers and their patterns of usage, particularly usage outside our network footprint, will have a significant impact on the level of profits for our U.S. retail wireless business. In general, we compete with national and regional wireless providers that offer both prepaid and postpaid services; whose scale, resources and U.S. network footprint are significantly greater than ours. Our ability to remain competitive and to maintain reasonable profit margins will depend, in part, on our ability to remain attractive to customers who prefer a rural-based service provider, to provide competitive pricing for our customers, to provide the latest mobile voice and data services in all of the areas they wish to access those services and to anticipate and respond to various competitive factors.

In addition, the revenue and profits of our U.S. wholesale wireless business contribute to our overall U.S. Wireless revenue and are primarily driven by the number of sites and base stations we operate, the amount of voice and data traffic that each of these

Table of Contents

sites generates, and the rate we get paid from our carrier customers on that traffic. We also provide roaming services in a number of areas in the U.S. (mainly in the western United States) where we do not operate a retail wireless business. With the Alltel Acquisition, our reported wholesale wireless revenue also includes roaming revenue generation in areas in which we have retail wireless operations. Historically, the growth in same site voice and data volumes and the number of operated sites has outpaced the decline in rates. However, in the first half of 2010, a significant decrease in the data rates almost offset overall voice and data traffic growth. The growth of this revenue has historically been driven mainly by the rate at which we expand the number of base stations we operate. We compete with other wireless service providers that operate networks in their markets and offer wholesale roaming services as well.

However, the most significant competitive factor we face in our U.S. wholesale wireless business is the extent to which our carrier customers elect to build or acquire their own infrastructure (including networks that we built out pursuant to certain roaming agreements) in a market in which they operate, reducing or eliminating their need for our services in that market. For example, the 2009 acquisition by Verizon Wireless of Alltel Corporation assets and subsequent 2010 acquisition of divested Alltel assets by AT&T, will result in our wholesale customers having their own infrastructure in certain markets where they are currently served by us. This has already resulted in some loss, and is expected to continue to result in a significant loss, of wireless wholesale revenue and operating income in future periods, which, if not offset by growth in other wholesale revenue generated or other sources, could materially reduce our overall operating profits. While we are not able to forecast the extent of this revenue impact precisely at this time, we expect that at the very least we will begin to experience lost revenue from those overlapping areas in late 2010 or early 2011, which may more than offset any growth in U.S. wholesale wireless revenue during these periods.

For more information regarding this segment, see the discussion of U.S. Wireless in Note 10 to our Consolidated Financial Statements included in this Report.

Acquisition of Alltel Assets

On April 26, 2010, we completed our previously-announced acquisition of wireless assets from Cellco Partnership d/b/a Verizon Wireless pursuant to the Purchase Agreement, dated June 9, 2009, by and between the Company and Verizon. Pursuant to the Alltel Acquisition, Verizon contributed certain licenses, network assets, tower and other leases and other assets and certain related liabilities to a wholly-owned subsidiary limited liability company, whose membership interests were acquired by AWCC, our wholly-owned subsidiary. In connection with the acquisition, the Company and Verizon entered into roaming and transition services arrangements and we obtained the rights to use the Alltel brand and related service marks for up to twenty eight years in connection with the continuing operation of the acquired assets. The purchase price of the acquisition was \$200 million, plus approximately \$21 million in connection with a customary net working capital adjustment.

Stimulus Grants

In 2009 and 2010, we filed several applications for stimulus funds made available by the U.S. Government under provisions of the American Recovery and Reinvestment Act of 2009 intended to stimulate the deployment of broadband infrastructure and services to rural, unserved and underserved areas.

In December 2009, we were named to receive a \$39.7 million federal stimulus grant to fund our ION Upstate New York Rural Broadband Initiative, which involves building ten new segments of fiber-optic, middle-mile broadband infrastructure, serving more than 70 rural

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communities in upstate New York and parts of Pennsylvania and Vermont. The new project will be undertaken through our public-private partnership with the Development Authority of the North Country (DANC), a New York State public benefit corporation that owns and operates 750 miles of fiber optic network and provides wholesale telecommunications transport services to voice, video, data and wireless service providers. The \$39.7 million grant, awarded to us by the National Telecommunications and Information Administration of the U.S. Department of Commerce (NTIA), under its Broadband Technology Opportunities Program, will be paid over the course of the three-year project period as expenses are incurred. An additional \$9.9 million will be invested in the project by us and by DANC. The funding of the new ION project is scheduled to begin in the third quarter of 2010. Accordingly, the Company did not recognize any of the granted funds during the three or six months ended June 2010. The results of our U.S. fiber optic transport business are included in the Company's U.S. Wireline segment as reported in Note 10 to our Consolidated Financial Statements included in this Report.

On March 25, 2010 the NTIA awarded the Navajo Tribal Utility Authority (NTUA) a \$32.1 million federal stimulus grant. The grant, along with partial matching funds, will provide broadband infrastructure access to the Navajo Nation across Arizona, New Mexico and Utah. As part of the project, we are proposing to partner with NTUA to provide last mile services through a 4G LTE network to be constructed as a part of this project. This network will allow NTUA to supply both fixed and mobile customers with high-speed broadband access. The funding of this project is not scheduled to begin until later in 2010, once the necessary environmental site work is completed. Accordingly, we did not recognize any of the granted funds during the three or six months ended June 30, 2010. The results of our wholesale U.S. wireless

Table of Contents

business are included in the Company's U.S. Wireless segment as reported in Note 10 to our Consolidated Financial Statements included in this Report.

On July 7, 2010, in partnership with the Vermont Telecommunications Authority (the VTA), we were awarded a \$33.4 million federal stimulus grant by the NTIA. The grant, along with partial matching funds to be contributed by us (through a Vermont subsidiary) and the VTA, will be invested in fiber-optic middle mile network in Vermont to provide broadband and wireless services to community schools, colleges, libraries and state-owned buildings in the area. The funding of this project is not scheduled to occur until later in 2010, once the necessary environmental site work is completed. Accordingly, we did not recognize any of the granted funds during the three or six months ended June 30, 2010. The results of our U.S. wireline business are included in the Company's U.S. Wireline segment as reported in Note 10 to our Consolidated Financial Statements included in this Report.

Aruba Investment

In June 2010, we entered into a joint venture to purchase a controlling interest in a wireless telecommunications enterprise in bankruptcy proceedings and operating on the island of Aruba. The joint venture is conducted through a newly-created company named Caribbean Telecom Partners, LLC (CTP), in which we invested \$3.1 million in exchange for a 51% controlling interest. CTP is governed by a three-member board of directors, which consists of two members designated by us and one member designated by a member of our Board, Brian A. Schuchman, who, through a company wholly-owned by him, owns the remaining 49% interest. Mr. Schuchman oversees the day-to-day management of CTP and, through CTP, the day-to-day management of the underlying Aruba telecommunications business. The Audit Committee of our Board approved the above-described arrangement with Mr. Schuchman after review in accordance with our Related Person Transaction policy.

Table of Contents**Results of Operations***Three Months Ended June 30, 2010 and 2009*

	Three Months Ended June 30,		Amount of Increase (Decrease)	Percent Increase (Decrease)		
	2009	2010				
(In thousands)						
REVENUE:						
US Wireless:						
Retail	\$	\$	81,507	\$ 81,507	%	
Wholesale			25,800	39,545	53.3	
International Wireless			11,391	12,530	10.0	
Wireline			22,240	23,230	4.4	
Equipment and Other			990	7,612	668.9	
Total revenue			60,421	164,424	172.1	
OPERATING EXPENSES:						
Termination and access fees			11,436	41,104	259.4	
Engineering and operations			7,511	18,127	141.3	
Sales, Marketing and customer services			3,274	31,054	848.5	
Equipment Expense			533	10,139	1,802.3	
General and administrative			9,403	26,643	183.3	
Acquisition-related charges			358	11,041	2,984.1	
Depreciation and amortization			9,794	18,542	89.3	
Total operating expenses			42,309	156,650	270.3	
Income from operations			18,112	7,774	(10,338)	(57.1)
OTHER INCOME (EXPENSE):						
Interest expense			(1,197)	(2,387)	(1,190)	99.4
Interest income			369	84	(285)	(77.2)
Gain on acquisition, net of tax				27,024	27,024	
Other income (expense), net			10	225	215	2,150.0
Other income, net			(818)	24,946	25,764	3,149.6
INCOME BEFORE INCOME TAXES			17,294	32,720	15,426	89.2
Income taxes			7,342	7,968	626	8.5
INCOME BEFORE EQUITY IN EARNINGS OF UNCONSOLIDATED AFFILIATE			9,952	24,752	14,800	148.7
Equity in earnings of unconsolidated affiliate				290	290	100.0
NET INCOME			9,952	25,042	15,090	151.6
Net income attributable to non-controlling interests			(315)	(238)	77	24.4
NET INCOME ATTRIBUTABLE TO ATLANTIC TELE-NETWORK, INC. STOCKHOLDERS	\$	\$	9,637	24,804	\$ 15,167	157.4%

U.S. Wireless revenue. Wireless revenue includes voice and data services revenue from our prepaid and postpaid retail operations as well as our wholesale roaming operations. Retail revenue is derived from access by our retail customers to and usage of our networks and facilities, including airtime, roaming and long distance as well as enhanced services such as caller identification, call waiting, voice mail and other features. Wholesale revenue is generated from providing mobile voice or data services to the customers of other wireless carriers and also includes revenue from other, related, wholesale services such as the provision of network switching services and certain wholesale transport services.

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The retail portion of our U.S. Wireless revenue was \$81.5 million for the three months ended June 30, 2010 as a result of our April 26, 2010 Alltel Acquisition. Our U.S. Wireless prepaid subscriber base was 230,000 and our post-paid subscriber base was 577,000 at June 30, 2010.

We expect wireless revenue from our U.S. retail operations to remain fairly consistent in future periods noting that the revenue for the quarter ending June 30, 2010 represents revenue only since our acquisition of Alltel on April 26, 2010.

Table of Contents

The wholesale portion of our U.S. Wireless revenue increased to \$39.5 million for the three months ended June 30, 2010 from \$25.8 million for the three months ended June 30, 2009, an increase of \$13.7 million. The increase in wireless wholesale revenue was entirely due to the roaming revenue generated by the networks we acquired in the Alltel Acquisition. Base stations in our rural U.S. network increased from 537 as of June 30, 2009 to 598 as of June 30, 2010. The roaming traffic generated in the Alltel network footprint contributed approximately \$13.7 million in wireless wholesale revenue for the second quarter of 2010.

Verizon's acquisition of Alltel in 2009 has caused some loss of wireless wholesale revenue and contributed to our lack of growth this quarter as certain network assets acquired by Verizon overlap geographically with a substantial number of areas of our rural U.S. network in which we formerly provided wholesale roaming services to Verizon. Similarly, we expect that the AT&T acquisition of certain Alltel assets, which was completed in June 2010, may also contribute to additional decreases in wireless wholesale revenue as we had previously provided wholesale roaming services to AT&T in a substantial number of areas that they acquired. In addition, we expect the AT&T acquisition to result in a significant additional loss in wireless wholesale revenue during the last half of 2010 and in 2011 when AT&T completes its previously announced GSM network build in those areas. This loss in wireless wholesale revenue could have a significant negative impact on our revenue and operating income if it is not offset or replaced by increased revenue in other areas of our U.S. rural wireless business or from other sources (including increased revenue in connection with our Alltel Acquisition).

While we expect to see some increase in wireless wholesale revenue from our rural U.S. wireless business in geographical areas not impacted by Verizon or AT&T's acquisition of Alltel networks, the pace of that increase in non-Alltel overlap markets may be slower as compared to the growth in previous periods due to a reduction in the number of new sites and base stations added and scheduled reductions in roaming rates. We also expect to receive a portion of the \$32.1 million grant from the NTIA to build on the Navajo Nation during 2010 but do not expect the network buildout, which will occur as a result of that grant, to significantly impact revenue during 2010.

International Wireless revenue. International Wireless revenue includes retail and wholesale voice and data wireless revenue from international operations in Guyana, Bermuda, Turks and Caicos and the U.S Virgin Islands.

International Wireless revenue increased by \$1.1 million to \$12.5 million for the three months ended June 30, 2010, from \$11.4 million for the three months ended June 30, 2009. Wireless subscribers in Guyana increased 9%, from approximately 266,000 subscribers as of June 30, 2009 to approximately 290,000 subscribers as of June 30, 2010. Wireless subscribers in Bermuda increased moderately to 20,800 for the three months ended June 30, 2010 from 20,200 for the three months ended June 30, 2009, respectively.

While we have experienced recent subscriber growth in Guyana, competition remains intense, and the largely pre-paid subscriber base means that subscribers and revenue could shift relatively quickly in future periods. In addition, the overall number of our wireless subscribers in Guyana could be reduced as a result of recent regulations imposed on Guyana telecommunications carriers, including our Guyana operations, to collect proof of address and photographic identification for all new and existing customers.

Wireline revenue. Wireline revenue is generated by our wireline operations in Guyana, including international telephone calls into and out of Guyana, our integrated voice and data operations in New England and our wholesale transport operations in New York State and in the western United States. This revenue includes basic service fees, measured service revenue, and internet access fees, as well as installation charges for new lines, monthly line rental charges, long distance or toll charges, maintenance and equipment sales.

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Wireline revenue increased by \$1.0 million to \$23.2 million for the three months ended June 30, 2010 from \$22.2 million for the three months ended June 30, 2009. The increase is attributable to local telephone and data revenue in our Guyana markets partially offset by a decrease in international long distance revenue. Our access lines in Guyana grew from approximately 142,000 lines as of June 30, 2009 to approximately 149,000 lines as of June 30, 2010 (an increase of 5%). Revenue from the growth in access lines has been partially offset by a decrease in usage that is likely due to wireless service alternatives.

For the quarter, we experienced a decrease in international long distance revenue at our Guyana operations. We believe this decrease is a result of continued and considerable illegal bypass activities resulting in lost revenue opportunities, as well as an overall reduction in call volume into Guyana attributable to the current difficult global economic environment. In the U.S., we saw increased revenue from our upstate New York network transport service business. We continue to add business customers for our voice and data services; however, the overall revenue increase is partially offset by the decline in the residential data business, particularly dial-up internet services.

Table of Contents

In future periods, we anticipate that wireline revenue from our international long distance business in Guyana may continue to decrease, but may be offset by increased revenue from local telephone and voice services in Guyana, as well as high-speed data sales in New York. While we expect to expand our network in New York and receive a portion of the \$39.7 million stimulus grant during 2010, we do not expect the network buildout to be completed during 2010 and thus we are not expecting that grant to significantly impact revenue for 2010.

Equipment and Other revenue. Equipment revenue represents revenue from wireless equipment sales and other miscellaneous revenue items.

Equipment and Other revenue increased by \$6.6 million to \$7.6 million for the three months ended June 30, 2010, from \$1.0 million for the three months ended June 30, 2009. The increase is due to equipment sales from our recent Alltel acquisition.

Termination and access fee expenses. Termination and access fee expenses are charges that we pay for voice and data transport circuits (in particular, the circuits between our wireless sites and our switches), internet capacity and other access fees we pay to terminate our calls. Termination and access fees increased by \$29.7 million from \$11.4 million for the three months ended June 30, 2009 to \$41.1 million for the three months ended June 30, 2010, as a result of the Alltel Acquisition.

Termination and access fees are expected to increase in future periods, but remain fairly proportionate to their related revenue as our networks expand.

Engineering and operations expenses. Engineering and operations expenses include the expenses associated with developing, operating, supporting and expanding our networks, including the salaries and benefits paid to employees directly involved in the development and operation of our networks. Engineering and operations expenses increased by \$10.6 million from \$7.5 million for the three months ended June 30, 2009 to \$18.1 million for the three months ended June 30, 2010 as a result of the Alltel Acquisition. We expect that engineering and operations expenses will increase in the future as our networks expand and require additional support and as we transition the network that we recently acquired as part of the Alltel Acquisition.

Sales marketing and customer service expenses. Sales and marketing expenses include salaries and benefits we pay to sales personnel, customer service expenses, sales commissions and the costs associated with the development and implementation of our promotion and marketing campaigns.

Sales and marketing expenses increased by \$27.8 million from \$3.3 million for the three months ended June 30, 2009 to \$31.1 million for the three months ended June 30, 2010. The majority of this increase is the result of the Alltel Acquisition.

Due to our Alltel Acquisition, we expect that sales and marketing expenses will increase substantially in future periods.

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Equipment expenses. Equipment expenses include the costs of our handset and customer resale equipment at our retail wireless businesses.

Equipment Expenses increased from \$0.5 million for the three months ended June 30, 2010 to \$10.1 million for the three months ended June 30, 2009. We expect that with respect to the equipment acquired as part of the Alltel Acquisition, these expenses will increase in future periods with our expanded operations, but to remain proportionate to our equipment revenue.

General and administrative expenses. General and administrative expenses include salaries, benefits and related costs for general corporate functions, including executive management, finance and administration, legal and regulatory, facilities, information technology and human resources. General and administrative expenses also include internal costs associated with our pending or completed acquisitions.

General and administrative expenses increased by \$17.2 million from \$9.4 million for the three months ended June 30, 2009 to \$26.6 million for the three months ended June 30, 2010. This increase resulted from the Alltel Acquisition as well as increased overhead to support our growth and internal costs associated with the acquisition.

We expect overall general and administrative expenses to increase both in order to aid our transition efforts in relation to the Alltel Acquisition and to support our growth in our new U.S. retail wireless business. We expect that these increased expenses will continue to overlap during the next three to four quarters, and afterwards we expect that the expenses, as a percentage of revenue, will decrease.

Acquisition-related charges. Acquisition-related charges include the external costs, such as legal, accounting, and consulting fees directly associated with acquisition related activities, which are expensed as incurred. Acquisition-related charges do not include internal costs,

Table of Contents

such as employee salary and travel-related expenses, which we incurred during the three months ended June 30, 2010 in connection with the Alltel Acquisition.

For the three months ended June 30, 2010, acquisition-related charges for legal, banking, consulting and accounting fees were \$11.0 million (including, in part, invoiced amounts disputed but not yet resolved by the Company), all of which were attributable to closing the April 2010 Alltel Acquisition, as compared to \$0.4 million for the three months ended June 30, 2009. As the Company continues to explore any additional acquisition opportunities that arise and may meet our investment objectives, we expect that acquisition-related expenses will continue to be incurred.

Depreciation and amortization expenses. Depreciation and amortization expenses represent the depreciation and amortization charges we record on our property and equipment and on our intangible assets.

Depreciation and amortization expenses increased by \$8.7 million from \$9.8 million for the three months ended June 30, 2009 to \$18.5 million for the three months ended June 30, 2010. The increase is primarily due to the addition of the Alltel tangible and intangible assets as well as additional fixed assets from our network expansion in our U.S. Wireless business.

We expect depreciation expense on our tangible assets to continue to increase as a result of a future network expansion in the U.S. and elsewhere. Such increase, however, will be partially offset by a future decrease in the amortization of our intangible assets which are being amortized using an accelerated amortization method.

Interest expense. Interest expense represents interest incurred on our outstanding credit facilities.

Interest expense increased from \$1.2 million for the three months ended June 30, 2009 to \$2.4 million for the three months ended June 30, 2010, due to the amendment of our 2008 Credit Facility and our increased debt under the 2010 Credit Facility. On January 20, 2010, the Company entered into the 2010 Credit Facility, which increased both the amounts available for borrowings by the Company and the applicable interest rates on such borrowings. As of June 30, 2010, we had \$72.0 million outstanding under our 2010 Term Loan A facility, and \$148.1 million outstanding under our 2010 Term Loan B facility. We also had \$40 million in outstanding borrowings under our 2010 Revolver Loan as of June 30, 2010. For a discussion of the Company's 2010 Credit Facility, see Note 6 to the Consolidated Financial Statements and Liquidity and Capital Resources.

Interest income. Interest income represents interest earned on our cash, cash equivalents and short term investments.

Interest income decreased to \$0.1 million from \$0.4 million for the three months ended June 30, 2010 and 2009, respectively. This decrease is a result of a decrease in our cash balances as well as the interest rates and subsequent amounts earned on our cash and investments.

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Bargain purchase gain, net of tax. Bargain purchase gain, net of tax, represents the gain the Company recognized on the Alltel Acquisition. This gain was a result of a bargain purchase generated by the forced divestiture of the assets that was required to be completed by Verizon within a registered timeframe to a limited class of potential buyers.

Other income (expense). Other income (expense) represents miscellaneous non-operational income we earned or expenses we incurred. Other income was \$0.2 million for the three months ended June 30, 2010.

Income taxes. Income tax expense includes federal and state income taxes at their respective statutory rates as well as foreign income taxes in excess of the statutory U.S. income tax rates. Since we operate in jurisdictions that have a wide range of statutory tax rates, our consolidated effective tax rate is impacted by the mix of income generated in those jurisdictions as well as the receipt of dividends from our foreign subsidiaries. Our effective tax rate was 42% for the three months ended June 30, 2009 and 24% for the three months ending June 30, 2010. For 2010, the effective tax rate was reduced by the bargain purchase gain which is shown net of tax on our statements of operations. Partially offsetting this reduction was a \$5.2 million expense related to an increase in valuation allowance against the Company's foreign tax credit carryforward. As part of its acquisition of assets from Alltel and the associated levels of future debt and interest service, the Company re-examined its projected mix of foreign source and US-source earnings and concluded it is more likely than not that it will not generate enough foreign source income to utilize its existing foreign tax credits prior to their expiration date. As a result, the Company has placed a full valuation allowance against those credits.

Equity in earnings of unconsolidated affiliates. Equity in earnings of unconsolidated affiliates included our share of the earnings of an unconsolidated affiliate of our U.S. Wireless segment. Equity in earnings of unconsolidated affiliates was \$0.3 million for the three months ended June 30, 2010.

Net Income Attributable to Non-Controlling Interests. Net income attributable to non-controlling interests includes minority shareholders' share of net income in our less than wholly owned subsidiaries.

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Table of Contents

Net income attributable to non-controlling interests decreased from \$0.3 million for the three months ended June 30, 2009 to a \$0.2 million for the three months ended June 30, 2010. This decrease was a result of the allocation of non-controlling shareholders' share of losses at our early stage businesses.

Net income attributable to Atlantic Tele-Network, Inc. Stockholders. As a result of the above factors, net income increased to \$24.8 million for the three months ended June 30, 2010 from \$9.6 million for the three months ended June 30, 2009. On a per share basis, net income increased from \$0.63 per basic and diluted share to \$1.62 per basic and \$1.60 per diluted share for the three months ended June 30, 2009 to 2010, respectively.

Segment results. We currently have four material operating segments, which we manage and evaluate separately: (1) U.S. Wireless; (2) International Integrated Telephony; (3) Island Wireless; and (4) U.S. Wireline. Segment results are set forth in Note 10 to the Consolidated Financial Statements included in this Report.

Six Months Ended June 30, 2010 and 2009

	Six Months Ended June 30,		Amount of Increase (Decrease)	Percent Increase (Decrease)
	2009	2010		
	(In thousands)			
REVENUE:				
US Wireless:				
Retail	\$	\$ 81,507	\$ 81,507	%
Wholesale	47,439	62,481	15,042	31.7
International Wireless	22,030	23,449	1,419	6.4
Wireline	44,666	43,751	(915)	2.0
Equipment and Other	2,380	8,071	5,691	239.1
Total revenue	116,515	219,259	102,744	88.2
OPERATING EXPENSES:				
Termination and access fees	22,828	52,363	29,535	129.4
Engineering and operations	14,456	24,542	10,086	69.8
Sales, Marketing and Customer Services	6,309	34,448	28,139	446.0
Equipment Expense	1,082	10,852	9,770	903.0
General and administrative	17,599	37,413	19,814	112.6
Acquisition-related charges	358	15,834	15,476	
Depreciation and amortization	18,994	28,611	9,617	50.6
Total operating expenses	81,626	204,063	122,437	150.0
Income from operations	34,889	15,196	(19,693)	(56.4)
OTHER INCOME (EXPENSE):				
Interest expense	(2,354)	(3,654)	(1,300)	(55.2)
Interest income	708	238	(470)	(66.4)
Gain on acquisition, net of tax		27,024	27,024	
Other income (expense), net	36	230	194	538.9
Other income, net	(1,610)	23,838	25,448	1,580.6
INCOME BEFORE INCOME TAXES	33,279	39,034	5,755	17.3
Income taxes	14,298	10,425	(3,873)	(27.1)
INCOME BEFORE EQUITY IN EARNINGS OF UNCONSOLIDATED AFFILIATE	18,981	28,609	9,628	50.7

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Equity in earnings of unconsolidated affiliate		290		290	
NET INCOME	18,981	28,899	9,918	52.2	
Net income attributable to non-controlling interests	(543)	(90)	453	83.4	
NET INCOME ATTRIBUTABLE TO ATLANTIC TELE-NETWORK, INC. STOCKHOLDERS	\$ 18,438	\$ 28,809	\$ 10,371	56.2%	

U.S. Wireless revenue. The retail portion of our U.S. Wireless revenue was \$81.5 million for the six months ended June 30, 2010 as a result of our April 26, 2010 Alltel Acquisition. Our U.S. Wireless prepaid subscriber base was 230,000, and post-paid subscribers were 577,000 at June 30, 2010.

Table of Contents

The wholesale portion of our U.S. Wireless revenue increased to \$62.5 million for the six months ended June 30, 2010 from \$47.4 million for the six months ended June 30, 2009, an increase of \$15.1 million. The increase in wireless wholesale revenue was predominately due to the roaming revenue generated by the networks in our recently completed Alltel Acquisition. Base stations in our rural U.S. network increased from 537 as of June 30, 2009 to 598 as of June 30, 2010. The roaming traffic generated in the Alltel footprint contributed approximately \$13.7 million in wholesale revenue for the six months ended June 30, 2010.

International Wireless revenue. International Wireless revenue increased by \$1.4 million to \$23.4 million for the six months ended June 30, 2010, from \$22.0 million for the six months ended June 30, 2009. Wireless subscribers in Guyana increased 9%, from approximately 266,000 subscribers as of June 30, 2009 to approximately 290,000 subscribers as of June 30, 2010. Wireless subscribers in Bermuda increased moderately to 20,800 for the three months ended June 30, 2010 from 20,200 for the three months ended June 30, 2009, respectively.

Wireline revenue. Wireline revenue decreased by \$0.9 million to \$43.8 million for the six months ended June 30, 2010 from \$44.7 million for the six months ended June 30, 2009. The decrease is attributable to a decrease in international long distance revenue in Guyana. Our access lines in Guyana grew from approximately 142,000 lines as of June 30, 2009 to approximately 149,000 lines as of June 30, 2010 (an increase of 5%). Revenue from the growth in access lines has been partially offset by a decrease in usage that is likely due to wireless service alternatives.

Equipment and Other revenue. Equipment and other revenue increased by \$5.7 million to \$8.1 million for the six months ended June 30, 2010, from \$2.4 million for the six months ended June 30, 2009. The increase is due to equipment sales from our recently acquired U.S. retail wireless operations, offset by a decrease in revenues from our television business in the U.S. Virgin Islands, which we terminated in May of 2009.

Termination and access fee expenses. Termination and access fees increased by \$29.6 million from \$22.8 million for the six months ended June 30, 2009 to \$52.4 million for the six months ended June 30, 2010, as a result of the Alltel Acquisition.

Engineering and operations expenses. Engineering and operations expenses increased by \$10.0 million from \$14.5 million for the six months ended June 30, 2009 to \$24.5 million for the six months ended June 30, 2010 as a result of the Alltel Acquisition.

Sales marketing and customer service expenses. Sales and marketing expenses increased by \$28.1 million from \$6.3 million for the six months ended June 30, 2009 to \$34.4 million for the six months ended June 30, 2010. The majority of this increase is the result of the recently completed Alltel Acquisition.

Equipment expenses. Equipment Expenses increased from \$1.1 million for the six months ended June 30, 2010 to \$10.9 million for the six months ended June 30, 2009 as a result of the Alltel Acquisition.

General and administrative expenses. General and administrative expenses increased by \$19.8 million, or 113%, from \$17.6 million for the six months ended June 30, 2009 to \$37.4 million for the six months ended June 30, 2010. This increase resulted from the recently completed Alltel Acquisition, which was completed in April 2010, as well as increased overhead to support our growth and internal costs associated with the acquisition.

Acquisition-related charges. For the six months ended June 30, 2010, acquisition-related charges for legal, banking, consulting and accounting fees were \$15.8 million (including, in part, invoiced amounts disputed but not yet resolved by the Company), all of which were attributable to closing the April 2010 Alltel Acquisition, as compared to \$0.4 million for the six months ended June 30, 2009.

Depreciation and amortization expenses. Depreciation and amortization expenses increased by \$9.6 million, or 51%, from \$19.0 million for the six months ended June 30, 2009 to \$28.6 million for the six months ended June 30, 2010. The increase is primarily due to the addition of the Alltel tangible and intangible assets as well as additional fixed assets from our network expansion in our U.S. Wireless business.

Interest expense. Interest expense increased from \$2.4 million for the six months ended June 30, 2009 to \$3.7 million for the six months ended June 30, 2010, due to the amendment of our existing credit facility. On January 20, 2010, the Company entered into an amended and restated credit agreement, which increased both the amounts available for borrowings by the Company and the applicable interest rates on such borrowings. As of June 30, 2010, we had \$72.0 million outstanding under our 2010 Term Loan A facility and \$148.1 million outstanding under our 2010 Term Loan B facility. We had \$40 million in outstanding borrowings under our revolving line of credit as of June 30, 2010.

For a discussion of the Company's 2010 Credit Facility, see Note 6 to the Consolidated Financial Statements.

Table of Contents

Interest income. Interest income decreased to \$0.2 million from \$0.7 million for the six months ended June 30, 2010 and 2009, respectively. This decrease is a result of a decrease in our cash balances as well as in the interest rates and subsequent amounts earned on our cash and investments.

Other income (expense). For the six months ended June 30, 2010 Other income was \$0.2 million.

Income taxes. Our effective tax rate was 42% for the six months ended June 30, 2009 and 27% for the six months ending June 30, 2010. For 2010, the effective tax rate was reduced by the bargain purchase gain which is shown net of tax on our statements of operations. Partially offsetting this reduction was a \$5.2 million expense related to an increase in valuation allowance against the Company's foreign tax credit carryforward. As part of its acquisition of assets from Alltel and the associated levels of future debt and interest service, the Company re-examined its projected mix of foreign source and US-source earnings and concluded it is more likely than not that it will not generate enough foreign source income to utilize its existing foreign tax credits prior to their expiration date. As a result, the Company has placed a full valuation allowance against those credits.

Equity in earnings of unconsolidated affiliates. Equity in earnings of unconsolidated affiliates was \$0.3 million for the six months ended June 30, 2010.

Net Income Attributable to Non-Controlling Interests. Net income attributable to non-controlling interests decreased from \$0.5 million for the six months ended June 30, 2009 to \$0.1 million for the six months ended June 30, 2010. This decrease was a result of the allocation of non-controlling shareholders' share of losses at our early stage businesses.

Net income attributable to Atlantic Tele-Network, Inc. Stockholders. As a result of the above factors, net income increased to \$28.8 million for the six months ended June 30, 2010 from \$18.4 million for the six months ended June 30, 2009. On a per share basis, net income increased from \$1.21 per basic and diluted share to \$1.89 per basic and \$1.86 per diluted share for the six months ended June 30, 2009 and 2010, respectively.

Regulatory and Tax Issues

We are involved in a number of regulatory and tax proceedings. See Note 11 to the Consolidated Financial Statements included in this Report. A material and adverse outcome in one or more of these proceedings could have a material adverse impact on our financial condition and future operations.

Liquidity and Capital Resources

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Historically, we have met our operational liquidity needs through a combination of cash on hand and internally generated funds and have funded capital expenditures and acquisitions with a combination of internally generated funds, cash on hand and borrowings under our credit facilities.

Uses of Cash

Capital Expenditures. A significant use of our cash has been for capital expenditures to expand and upgrade our networks.

For the six months ended June 30, 2009 and 2010, we spent approximately \$27.5 million and \$52.0 million on capital expenditures, respectively. Of the 2010 capital expenditures, we spent approximately \$25.5 million in our U.S. Wireless segment, expanding our retail and wholesale networks. Also included in our costs are one-time costs associated with developing our billing, point-of-sale and other OSS and BSS systems, and costs related to network migration following the Alltel closing. In our International Integrated Telephony segment, we spent approximately \$13.5 million on capital expenditures, of which \$9.3 million was related to construction costs on a new fiber optic submarine cable into Guyana which we launched in July 2010, while the remainder of the capital expenditures in this segment was for the expansion of the capacity and coverage of our wireline and wireless network in Guyana. In addition, we invested \$9.4 million in capital expenditures in our Island Wireless segment with \$6.9 million of which related to two wireless network build-outs in the U.S. Virgin Islands, which are expected to launch later in 2010. A majority of the remaining Island Wireless capital expenditures was incurred in Turks and Caicos in connection with our network development and expansion which we launched in June 2010.

We are continuing to invest in expanding our networks in many of our markets and expect to incur capital expenditures between \$130 million and \$140 million in 2010. The majority of these expenditures, and the increase from our previous estimate, relate to our U.S wireless business. Specifically we anticipate expenditures of between \$70 million to \$80 million in our U.S. retail wireless business primarily related to one-time costs for network migration and information technology and system conversion costs in conjunction with our integration of our newly acquired wireless assets. The balance is comprised of several capital projects inherited with our Alltel Acquisition that we intend to complete during 2010. This 2010 estimate also includes approximately \$15 million to \$20 million relating to the construction of the submarine fiber optic cable in Guyana and wireless network build-out in the

Table of Contents

U.S. Virgin Islands, most of which was incurred in the first half of 2010. We expect to fund our current capital expenditures primarily from cash generated from our operations, and borrowings against our new line of credit. We are also seeking to expand our existing credit facility by an additional \$75 million.

Acquisitions and Investments. Historically, we have funded our acquisitions with a combination of cash on hand and borrowings under our credit facilities. In April 2010, we funded the purchase price of the Alltel Acquisition with cash-on-hand and borrowings under our existing credit facility. We drew down a \$150 million term loan under the credit facility and borrowed \$40 million under our previously undrawn \$75 million revolving credit facility. In the third quarter of 2010 we drew down an additional \$4.0 million from our revolving credit facility.

We also continue to explore opportunities to acquire or expand our existing communications properties or licenses in the United States, the Caribbean and elsewhere. Such acquisitions may require external financing. While there can be no assurance as to whether, when or on what terms we will be able to acquire any such businesses or licenses or make such investments, such acquisitions may be accomplished through the issuance of shares of our capital stock, payment of cash or incurrence of additional debt. From time to time, we may raise capital ahead of any definitive use of proceeds to allow us to move more quickly and opportunistically if an attractive investment materializes.

Dividends. We use cash-on-hand to make dividend payments to our common stockholders when declared by our Board of Directors. For the six months ended June 30, 2010, our dividends to our stockholders approximated \$6.1 million, which reflects dividends declared on April 1 and June 18, 2010, and paid on April 19 and July 12, 2010, respectively. We have paid quarterly dividends for the last 47 fiscal quarters.

Stock Repurchase Plan. Our Board of Directors approved a \$5.0 million stock buyback plan in September 2004 pursuant to which we have spent \$2.1 million as of June 30, 2010 repurchasing common stock. We may repurchase shares at any time depending on market conditions, our available cash and our cash needs. We did not repurchase any shares under this plan during the six months ended June 30, 2010.

Sources of Cash

Total Liquidity at June 30, 2010. As of June 30, 2010, we had approximately \$57.6 million in cash and cash equivalents, a decrease of \$32.6 million from the December 31, 2009 balance of \$90.2 million. In addition, we have \$2.4 million in restricted cash escrowed for payment on the undersea cable in Guyana as of June 30, 2010. We are currently seeking to expand our credit facility by \$75 million to allow more flexibility for spending on operating and capital needs, and expect to close on the expanded credit facility by the end of September 2010.

Cash Generated by Operations. Cash provided by operating activities was \$60.7 million for the six months ended June 30, 2010 compared to \$45.9 million for the six months ended June 30, 2009. The increase of \$14.8 million was primarily due to an increase in net income and accrued liabilities for the six months ended June 30, 2010 as compared to June 30, 2009.

Cash Generated by Financing Activities. On January 20, 2010, we amended and restated our 2008 Credit Facility with CoBank as Administrative Agent. (the 2010 CoBank Credit Agreement). The 2010 CoBank Credit Agreement provides for a \$298.9 million credit facility, consisting of a \$73.9 million term loan (the 2010 Term Loan A), a \$150.0 million term loan (the 2010 Term Loan B) and a \$75.0 million

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revolver loan (the 2010 Revolver Loan, and together with the 2010 Term Loan A and 2010 Term Loan B, the 2010 Credit Facility). The 2010 Credit Facility also provides for one or more additional term loans up to an aggregate \$50.0 million, subject to lender and administrative agent approval.

As of June 30, 2010, \$72.0 million was outstanding under the 2010 Term Loan A, an amount equal to the outstanding principal amount under the 2008 Term Loan and \$148.1 million was outstanding under the 2010 Term Loan B. The borrowings under the 2010 Term Loan B and 2010 Revolver Loan were used to fund a portion of the purchase price of the Alltel Acquisition as well as capital expenditures, as discussed above.

The 2010 Term Loan A and the 2010 Term Loan B each mature on September 30, 2014, with certain quarterly repayment obligations described below, unless accelerated pursuant to an event of default, as described below. The 2010 Revolver Loan matures on September 10, 2014, unless accelerated pursuant to an event of default, as described below. Amounts borrowed under the 2010 Term Loan A, 2010 Term Loan B and the 2010 Revolver Loan bear interest at a rate equal to, at our option, either (i) the London Interbank Offered Rate (LIBOR) plus an applicable margin ranging between 3.50% to 4.75% or (ii) a base rate plus an applicable margin ranging from 2.50% to 3.75%. We are not required to apply a minimum LIBOR percentage for any loans bearing interest at the LIBOR rate. The base rate is equal to the higher of either (i) 1.50% plus the higher of (x) the one-week LIBOR and (y) the one-month LIBOR and (ii) the prime rate (as defined in the credit agreement). The applicable margin is determined based on the ratio of our indebtedness (as defined in the credit agreement) to our EBITDA (as defined in the credit agreement).

Table of Contents

All amounts outstanding under the 2010 Revolver Loan will be due and payable upon the earlier of the maturity date or the acceleration of the loan upon an event of default. Amounts outstanding under the 2010 Term Loan A and the 2010 Term Loan B became due and payable commencing on March 31, 2010 and June 30, 2010, respectively, in quarterly payments equal to 1.25% of the initial principal amount outstanding under each loan, increasing to 2.50% of the initial principal amount outstanding commencing on March 31, 2012. Remaining balances will be due and payable upon maturity, unless the loans are accelerated upon an event of default.

Certain subsidiaries, including our principal wholly-owned domestic operating subsidiaries, are guarantors of our obligations under the 2010 CoBank Credit Agreement. Further, our obligations are secured by (i) a first priority, perfected lien on substantially all of our property and assets and the guarantor subsidiaries, and (ii) a pledge of 100% of the Company's equity interests in certain domestic subsidiaries and up to 65% of the equity interests outstanding of certain foreign subsidiaries, in each case, including the Company's principal operating subsidiaries.

The 2010 CoBank Credit Agreement provides for events of default customary for credit facilities of this type, including but not limited to non-payment, defaults on other debt, misrepresentation, breach of covenants, representations and warranties, insolvency and bankruptcy. After the occurrence of an event of default and for so long as it continues, the administrative agent or the requisite lenders (as defined in the credit agreement) may increase the interest rate then in effect on all outstanding obligations by 2.0%. Upon an event of default relating to insolvency, bankruptcy or receivership, the amounts outstanding under the 2010 Credit Facility will become immediately due and payable and the lender commitments will be automatically terminated. Upon the occurrence and continuation of any other event of default, the administrative agent and/or the requisite lenders (as defined in the credit agreement) may accelerate payment of all obligations and terminate the lenders commitments under the 2010 CoBank Credit Agreement.

On September 23, 2008, we executed a forward starting interest rate swap. Our objective in using the derivative is to add stability to interest expense and to manage our exposure to adverse changes in interest rates. The interest rate swap has an initial notional amount of \$68 million, receives 1 month LIBOR, and pays a fixed rate of 4.42%. The interest rate swap agreement effectively converts the variable interest payments on the first \$68 million of our term debt to a fixed rate of 4.42% plus our credit spread, over the life of the agreement. The interest rate swap agreement has a maturity date of September 15, 2015.

On July 26, 2010, we executed an additional interest rate swap with a notional amount of \$30 million that was also designated as a cash flow hedge of interest rate risk. The results of such derivative will be reported in our financial results for the quarter ending September 30, 2010.

Factors Affecting Sources of Liquidity

Internally Generated Funds. The key factors affecting our internally generated funds are demand for our services, competition, regulatory developments, economic conditions in the markets where we operate our businesses and industry trends within the telecommunications industry. For a discussion of tax and regulatory risks in Guyana that could have a material adverse impact on our liquidity, see Risk Factors Risks Relating to Our Wireless and Wireline Services in Guyana, and Business Regulation of Our GT&T Subsidiary in our 2009 Form 10-K and Note 11 to the Condensed Consolidated Financial Statements included in this Report.

Restrictions Under Credit Facility. The 2010 CoBank Credit Agreement contains customary representations, warranties and covenants, including covenants by us limiting additional indebtedness, liens, guaranties, mergers and consolidations, substantial asset sales, investments and

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loans, sale and leasebacks, transactions with affiliates and fundamental changes. In addition, the 2010 Credit Facility contains financial covenants by us that (i) impose a maximum ratio of indebtedness (as defined in the credit agreement) to EBITDA (as defined in the credit agreement), (ii) require a minimum ratio of EBITDA to cash interest expense, (iii) require a minimum ratio of equity to consolidated assets and (iv) require a minimum ratio of EBITDA to fixed charges (as defined in the credit agreement). As of June 30, 2010, we were in compliance with all of the financial covenants of the 2010 CoBank Credit Agreement.

Capital Markets. Our ability to raise funds in the capital markets depends on, among other things, general economic conditions, the conditions of the telecommunications industry, our financial performance, the state of the capital markets and our compliance with Securities and Exchange Commission (SEC) requirements for the offering of securities. On May 13, 2010, the SEC declared effective a new universal shelf registration statement filed by the Company. This filing registered potential future offerings by the Company of the Company s securities.

Table of Contents

Recent Accounting Pronouncements

In January 2010, the FASB issued updated guidance to amend the disclosure requirements related to recurring and nonrecurring fair value measurements. This update requires new disclosures on significant transfers of assets and liabilities in and out of Level 1 and Level 2 of the fair value hierarchy (including the reasons for these transfers) and also requires a reconciliation of recurring Level 3 measurements about purchases, sales, issuances and settlements on a gross basis. In addition to these new disclosure requirements, this update clarifies certain existing disclosure requirements. For example, this update clarifies that reporting entities are required to provide fair value measurement disclosures for each class of assets and liabilities rather than each major category of assets and liabilities. This update also clarifies the requirement for entities to disclose information about both the valuation techniques and inputs used in estimating Level 2 and Level 3 fair value measurements. This update is effective for companies with interim and annual reporting periods after December 15, 2009, except for the requirement to provide the Level 3 activity of purchases, sales, issuances, and settlements on a gross basis, which will become effective for interim and annual reporting periods beginning after December 15, 2010. The Company adopted the updated guidance in the first quarter of 2010 and the adoption did not have an impact on the Company's financial position, results of operations, or cash flows.

In June 2009, the FASB issued new authoritative guidance that amends certain guidance for determining whether an entity is a variable interest entity (VIE). The guidance requires an enterprise to perform an analysis to determine whether the Company's variable interests give it a controlling financial interest in a VIE. A company would be required to assess whether it has an implicit financial responsibility to ensure that a VIE operates as designed when determining whether it has the power to direct the activities of the VIE that most significantly impact the entity's economic performance. In addition, this guidance amends earlier guidance requiring ongoing reassessments of whether an enterprise is the primary beneficiary of a VIE. The guidance is effective for the Company for fiscal year 2010. The adoption of the provisions of this guidance, which was effective January 1, 2010, did not have a material impact on the consolidated financial statements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Foreign Currency Exchange Sensitivity. GT&T's functional currency is the U.S. dollar because a significant portion of GT&T's revenue and expenditures are transacted in U.S. dollars. The results of future operations nevertheless may be affected by changes in the value of the Guyana dollar; however, the Guyanese exchange rate has remained at approximately \$205 Guyana dollars to \$1 U.S. dollar since 2004 so we have not recorded any foreign exchange gains or losses since that date. All of our other foreign subsidiaries operate in jurisdictions where the U.S. dollar is the recognized currency.

Interest Rate Sensitivity. Our exposure to changes in interest rates is limited and relates primarily to our variable interest rate long-term debt. As of June 30, 2010, \$68.0 million of our long term debt has a fixed rate by way of an interest-rate swap that effectively hedges our interest rate risk. The remaining \$192.0 million of long term debt as of June 30, 2010, was subject to interest rate risk. As a result, a 1% increase in the variable borrowing rate associated with our variable rate debt would result in additional annualized interest expense of \$1.9 million. As of July 26, 2010, the Company executed an additional interest rate swap with a notional amount of \$30 million that was also designated as a cash flow hedge of interest rate risk. The results of such derivative will be reported by the Company along with financial results as of September 30, 2010. We continue to evaluate our exposure to interest rate risk, including additional hedging opportunities. If the company decides against any additional hedges, our exposure to fluctuations in interest rates could have a material impact on our financial statements.

ITEM 4. CONTROLS AND PROCEDURES

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Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of June 30, 2010. The term "disclosure controls and procedures," as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), means controls and other procedures of an issuer that are designed to ensure that information required to be disclosed by the issuer in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Exchange Act is accumulated and communicated to the issuer's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on the evaluation of our disclosure controls and procedures as of June 30, 2010, our Chief Executive Officer and Chief Financial Officer concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms and is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer as appropriate to allow timely decisions regarding required disclosure.

Table of Contents

Changes in internal control over financial reporting. Our management, with the participation of our principal executive officer and principal financial officer, is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act, as amended. ATN considers the Alltel Acquisition completed on April 26, 2010 as material to the results of its operations, financial position and cash flows from the date of acquisition through June 30, 2010 and considers the internal controls and procedures relating to the acquired Alltel operations to be reasonably likely to materially affect the ATN's internal control over financial. The Company plans to utilize the scope exception as it relates to the Alltel operations in management's report on internal control over financial reporting for the year-ended December 31, 2010.

PART II OTHER INFORMATION

Item 1. Legal Proceedings

See Note 11 to the Condensed Consolidated Financial Statements included in this Report.

Item 1A. Risk Factors

In addition to the other information set forth in this Report, you should carefully consider the factors discussed in Part I, Item 1A. Risk Factors in our 2009 Annual Report on Form 10-K as filed with the SEC on March 16, 2010, and Part II, Item 1A. Risk Factors in our Quarterly Report on Form 10-Q, for the quarterly period ended March 31, 2010, as filed with the SEC on April 10, 2010, which could materially affect our business, financial condition or future results. The risks described in our 2009 Form 10-K and first quarter 2010 Form 10-Q are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

In September 2004, the Board of Directors authorized the Company to repurchase up to \$5.0 million of common stock. The repurchase authorizations do not have a fixed termination date and the timing of the buyback amounts and exact number of shares purchased will depend on market conditions.

The following table reflects the repurchases by the Company of its common stock during the quarter ended June 30, 2010:

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid per	(c) Total Number of Shares Purchased as Part of Publicly	(d) Maximum Number (or Approximate
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		Share	Announced Plans or Programs	Dollar Value) of Shares that May be Purchased Under the Plans or Programs
April 1, 2010	April 30, 2010	\$		\$ 2,808,173
May 1, 2010	May 31, 2010	\$		\$ 2,808,173
June 1, 2010	June 30, 2010	\$		\$ 2,808,173

Table of Contents

Item 6. Exhibits

- 2.1 Purchase Agreement by and between Atlantic Tele-Network, Inc. and Cellco Partnership d/b/a Verizon Wireless, dated as of June 9, 2009 (incorporated by reference to Exhibit 2.1 of the Company's Current Report on Form 8-K filed on June 15, 2009 (File No. 001-12593)).
- 10.1 Offer Letter by and between Atlantic Tele-Network, Inc. and Leonard Q. Slap, dated May 27, 2010 (incorporated by reference to Exhibit 10.1 of the Company's Current Report on Form 8-K filed on May 27, 2010 (File No. 001-12593)).
- 31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Table of Contents

SIGNATURES

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

Atlantic Tele-Network, Inc.

Date: August 9, 2010

/s/ Michael T. Prior
Michael T. Prior
President and Chief Executive Officer

Date: August 9, 2010

/s/ Justin D. Benincasa
Justin D. Benincasa
Chief Financial Officer and Treasurer

Table of Contents

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