

KAYNE ANDERSON MIDSTREAM/ENERGY FUND, INC.

Form N-30B-2

April 29, 2015

Table of Contents

Midstream/Energy Fund

KMF Quarterly Report

February 28, 2015

Table of Contents

CONTENTS

	Page
<u>Management Discussion</u>	1
<u>Schedule of Investments</u>	6
<u>Statement of Assets and Liabilities</u>	12
<u>Statement of Operations</u>	13
<u>Statement of Changes in Net Assets Applicable to Common Stockholders</u>	14
<u>Statement of Cash Flows</u>	15
<u>Financial Highlights</u>	16
<u>Notes to Financial Statements</u>	19
<u>Glossary of Key Terms</u>	37
<u>Repurchase Disclosure</u>	38

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS: This report of Kayne Anderson Midstream/Energy Fund, Inc. (the Fund) contains forward-looking statements as defined under the U.S. federal securities laws. Generally, the words believe, expect, intend, estimate, anticipate, project, will and similar expressions identify forward-looking statements, which generally are not historical in nature. Forward-looking statements are subject to certain risks and uncertainties that could cause actual results to materially differ from the Fund's historical experience and its present expectations or projections indicated in any forward-looking statement. These risks include, but are not limited to, changes in economic and political conditions; regulatory and legal changes; MLP industry risk; leverage risk; valuation risk; interest rate risk; tax risk; and other risks discussed in the Fund's filings with the Securities and Exchange Commission (SEC). You should not place undue reliance on forward-looking statements, which speak only as of the date they are made. The Fund undertakes no obligation to publicly update or revise any forward-looking statements made herein. There is no assurance that the Fund's investment objectives will be attained.

Edgar Filing: KAYNE ANDERSON MIDSTREAM/ENERGY FUND, INC. - Form N-30B-2

We hold an interest in Plains AAP, L.P. (PAA GP), which controls the general partner of Plains All American, L.P. Our ownership of PAA GP is exchangeable into shares of Plains GP Holdings, L.P. (Plains GP which trades on the NYSE under the ticker PAGP). The amounts shown in the table include our current holding of shares of Plains GP as well as our interest in PAA GP.

- (4) On January 26, 2015, Regency Energy Partners LP entered into a definitive merger agreement with Energy Transfer Partners, L.P. The merger is expected to close in the second quarter of 2015.

Results of Operations For the Three Months Ended February 28, 2015

Investment Income. Investment income totaled \$10.1 million for the quarter and consisted primarily of net dividends and distributions and interest income on our investments. We received \$13.0 million of dividends and distributions, of which \$5.7 million was treated as return of capital. Interest and other income was \$2.8 million. We

Table of Contents

KAYNE ANDERSON MIDSTREAM/ENERGY FUND, INC.

MANAGEMENT DISCUSSION

(UNAUDITED)

received \$1.5 million of paid-in-kind dividends during the quarter, which are not included in investment income, but are reflected as an unrealized gain.

Operating Expenses. Operating expenses totaled \$10.2 million, including \$3.6 million of investment management fees, \$2.7 million of interest expense (including non-cash amortization of debt issuance costs of \$0.2 million), \$2.3 million of excise taxes, \$1.3 million of preferred stock distributions (including non-cash amortization of offering costs of \$0.1 million) and \$0.4 million of other operating expenses.

Net Investment Loss. Our net investment loss totaled \$0.1 million.

Net Realized Loss. We had a net realized loss of \$6.2 million, which included \$1.2 million of net realized gains from option activity.

Net Change in Unrealized Gains. We had a net decrease in unrealized gains of \$41.3 million. The net decrease consisted of \$39.9 million of net unrealized losses from investments and \$1.4 million of net unrealized losses from option activity.

Net Decrease in Net Assets Resulting from Operations. We had a decrease in net assets resulting from operations of \$47.6 million. This decrease was comprised of net investment loss of \$0.1 million, net realized loss of \$6.2 million and a net decrease in unrealized gains of \$41.3 million, as noted above.

Distributions to Common Stockholders

We pay quarterly distributions to our common stockholders, funded generally by net distributable income (*NDI*) generated from our portfolio investments. *NDI* is the amount of income received by us from our portfolio investments less operating expenses, subject to certain adjustments as described below. *NDI* is not a financial measure under the accounting principles generally accepted in the United States of America (*GAAP*). Refer to the *Reconciliation of NDI to GAAP* section below for a reconciliation of this measure to our results reported under *GAAP*.

Income from portfolio investments includes (a) cash dividends and distributions, (b) paid-in-kind dividends received (*i.e.*, stock dividends), (c) interest income from debt securities and commitment fees from private investments in public equity (*PIPE investments*) and (d) net premiums received from the sale of covered calls.

Operating expenses include (a) investment management fees paid to our investment adviser, (b) other expenses (mostly comprised of fees paid to other service providers), (c) accrual for estimated excise taxes and (d) interest expense and preferred stock distributions.

Table of Contents**KAYNE ANDERSON MIDSTREAM/ENERGY FUND, INC.****MANAGEMENT DISCUSSION****(UNAUDITED)****Net Distributable Income (NDI)**

(amounts in millions, except for per share amounts)

	Three Months Ended February 28, 2015
Distributions and Other Income from Investments	
Dividends ⁽¹⁾	\$ 13.0
Paid-In-Kind Dividends and Distributions ⁽¹⁾	1.5
Interest and Other Income	2.8
Net Premiums Received from Call Options Written	2.2
Total Distributions and Other Income from Investments	19.5
Expenses	
Investment Management Fee	(3.6)
Other Expenses	(0.4)
Excise Taxes ⁽²⁾	(2.3)
Interest Expense	(2.5)
Preferred Stock Distributions	(1.2)
Net Distributable Income (NDI)	\$ 9.5
Weighted Shares Outstanding	21.6
NDI per Weighted Share Outstanding	\$ 0.439
Adjusted NDI per Weighted Share Outstanding⁽³⁾	\$ 0.545
Distributions paid per Common Share⁽⁴⁾	\$ 0.5025

(1) See Note 2 (Investment Income) to the Financial Statements for additional information regarding paid-in-kind and non-cash dividends and distributions.

(2) As of November 30, 2014, we intended to declare a special distribution prior to the end of calendar 2014 to avoid the excise tax and, as a result, we did not accrue any excise tax for fiscal 2014 as the liability was not probable and estimable. Due to unfavorable market conditions after our fiscal year end, we determined in early December 2014 not to make a special distribution of income in order to avoid excise tax. As a result, an excise tax accrual of \$2.3 million was recorded in the first quarter of fiscal 2015. See Note 6 Taxes.

Edgar Filing: KAYNE ANDERSON MIDSTREAM/ENERGY FUND, INC. - Form N-30B-2

(3) Although \$2.3 million of excise taxes were recorded in the first quarter of fiscal 2015, the tax primarily related to cumulative undistributed income as of November 30, 2014. As a result, we have adjusted the NDI per weighted share outstanding for the first quarter of fiscal 2015 by removing the \$2.3 million of excise tax. Unadjusted NDI per weighted share outstanding for the fiscal year ended November 30, 2014 was \$2.046. Adjusted for the \$2.3 million of excise tax, NDI per weighted share outstanding for fiscal 2014 would have been \$1.941.

(4) The distribution of \$0.5025 per share for the first quarter of fiscal 2015 was paid on April 24, 2015. Payment of future distributions is subject to Board of Directors approval, as well as meeting the covenants of our debt agreements and terms of our preferred stock. In determining our quarterly distribution to common stockholders, our Board of Directors considers a number of factors that include, but are not limited to:

NDI and adjusted NDI generated in the current quarter;

Expected NDI over the next twelve months; and

Realized and unrealized gains generated by the portfolio.

Table of Contents

KAYNE ANDERSON MIDSTREAM/ENERGY FUND, INC.

MANAGEMENT DISCUSSION

(UNAUDITED)

On April 1, 2015, we declared a quarterly distribution of \$0.5025 per common share for the first quarter of fiscal 2015 (a total distribution of \$10.9 million). The distribution represents an increase of 1.5% from the prior quarter's distribution and an increase of 6.3% from the distribution for the quarter ended February 28, 2014.

As a regulated investment company (RIC), we are required to distribute all of our income to avoid paying federal income taxes. See Note 2 Significant Accounting Policies and Note 6 Taxes. At November 30, 2014, we had a total of \$69.4 million of undistributed ordinary income and long-term capital gains (collectively, Undistributed Income) on a tax basis. We plan to make a special distribution to common stockholders during fiscal 2015 to avoid paying income taxes on this Undistributed Income. This special distribution is subject to approval by the Board of Directors, and, if approved, would be declared prior to August 15, 2015. We estimate that this special distribution will be at least \$35 million (or approximately \$1.60 per share), but it could be a larger amount based on a variety of factors, including our Undistributed Income at such time.

Reconciliation of NDI to GAAP

The difference between distributions and other income from investments in the NDI calculation and total investment income as reported in our Statement of Operations is reconciled as follows:

GAAP recognizes that a significant portion of the cash distributions received from MLPs is characterized as a return of capital and therefore excluded from investment income, whereas the NDI calculation includes the return of capital portion of such distributions.

NDI includes the value of paid-in-kind dividends and distributions whereas such amounts are not included as investment income for GAAP purposes, but rather are recorded as unrealized gains upon receipt.

NDI includes commitment fees from PIPE investments, whereas such amounts are generally not included in investment income for GAAP purposes, but rather are recorded as a reduction to the cost of the investment.

Certain of our investments in debt securities were purchased at a discount or premium to the par value of such security. When making such investments, we consider the security's yield to maturity, which factors in the impact of such discount (or premium). Interest income reported under GAAP includes the non-cash accretion of the discount (or amortization of the premium) based on the effective interest method. When we calculate interest income for purposes of determining NDI, in order to better reflect the yield to maturity, the accretion of the discount (or amortization of the premium) is calculated on a straight-line basis to the earlier of the expected call date or the maturity date of the debt security.

We may sell covered call option contracts to generate income or to reduce our ownership of certain securities that we hold. In some cases, we are able to repurchase these call option contracts at a price less than the call premium that we received, thereby generating a profit. The premium we receive from selling call options, less (i) the amount that we pay to repurchase such call option contracts and (ii) the amount by which the market price of an underlying security is above the strike price at the time a new call option is written (if any), is included in NDI. For GAAP purposes, premiums received from call option contracts sold are not included in investment income. See Note 2 Significant Accounting Policies for a full discussion of the GAAP treatment of option contracts.

The treatment of expenses included in NDI also differs from what is reported in the Statement of Operations as follows:

The non-cash amortization or write-offs of capitalized debt issuance costs and preferred stock offering costs related to our financings is included in interest expense and distributions on preferred stock for GAAP purposes, but is excluded from our calculation of NDI.

Table of Contents

KAYNE ANDERSON MIDSTREAM/ENERGY FUND, INC.

MANAGEMENT DISCUSSION

(UNAUDITED)

NDI also includes recurring payments (or receipts) on interest rate swap contracts or the amortization of termination payments on interest rate swap contracts entered into in anticipation of an offering of unsecured notes (Notes) or mandatory redeemable preferred shares (MRP Shares). The termination payments on interest rate swap contracts are amortized over the term of the Notes or MRP Shares issued. For GAAP purposes, these amounts are included in the realized gains/losses section of the Statement of Operations.

Under GAAP, excise taxes are accrued when probable and estimable. For NDI, we have adjusted the first quarter of fiscal 2015 by removing the \$2.3 million of excise tax as this related to tax on undistributed income accumulated prior to fiscal 2015. See Note 6 Taxes.

Liquidity and Capital Resources

Total leverage outstanding at February 28, 2015 of \$355 million was comprised of \$235 million of Notes, \$15 million outstanding under our unsecured revolving term loan (Term Loan) and \$105 million of MRP Shares. At February 28, 2015, we did not have any borrowings outstanding under our unsecured revolving credit facility (the Credit Facility). Total leverage represented 30% of total assets at February 28, 2015. As of April 24, 2015, we had \$27 million borrowed under our Term Loan and we had \$1.0 million of cash. As of April 24, 2015, we did not have any borrowings outstanding under our Credit Facility.

Our Credit Facility has a total commitment of \$105 million and matures on November 21, 2016. The interest rate on outstanding loan balances may vary between LIBOR plus 1.50% and LIBOR plus 2.15%, depending on our asset coverage ratios. Outstanding loan balances accrue interest daily at a rate equal to LIBOR plus 1.50% based on current asset coverage ratios. We pay a fee of 0.25% per annum on any unused amounts of the Credit Facility.

Our Term Loan has a total commitment of \$50 million and matures on July 25, 2019. Borrowings under the Term Loan accrue interest at a rate of LIBOR plus 1.30%. We pay a fee of 0.25% per annum on any unused amount of the Term Loan.

At February 28, 2015, we had \$235 million of Notes outstanding that mature between 2016 and 2023, and we had \$105 million of MRP Shares outstanding, that are subject to mandatory redemption in 2018, 2020 and 2021.

At February 28, 2015, our asset coverage ratios under the Investment Company Act of 1940, as amended (the 1940 Act), were 461% for debt and 325% for total leverage (debt plus preferred stock). Our long-term target asset coverage ratio with respect to our debt is 400%, but at times we may be above or below our target depending on market conditions.

As of February 28, 2015, our total leverage consisted of both fixed rate (96%) and floating rate (4%) obligations. At such date, the weighted average interest/dividend rate on our total leverage was 4.10%.

We plan to make a special distribution to common stockholders during fiscal 2015. This special distribution is subject to approval by the Board of Directors, and, if approved, would be declared prior to August 15, 2015. We estimate that this special distribution will be at least \$35 million, but it could be a larger amount based on a variety of factors, including our Undistributed Income at such time.

Table of Contents**KAYNE ANDERSON MIDSTREAM/ENERGY FUND, INC.****SCHEDULE OF INVESTMENTS****FEBRUARY 28, 2015****(amounts in 000 s, except numbers of option contracts)****(UNAUDITED)**

Description	No. of Shares/Units	Value
Long-Term Investments 145.2%		
Equity Investments⁽¹⁾ 129.7%		
United States 121.9%		
Midstream Company⁽²⁾ 64.1%		
Capital Product Partners L.P. ⁽³⁾	721	\$ 6,703
Capital Products Partners L.P. Class B Units ⁽³⁾⁽⁴⁾⁽⁵⁾	606	6,188
CenterPoint Energy, Inc.	235	4,886
Dynagas LNG Partners LP ⁽³⁾	1,296	25,903
EnLink Midstream, LLC	108	3,603
GasLog Partners LP ⁽³⁾	56	1,432
Golar LNG Partners LP ⁽³⁾	1,005	26,243
Höegh LNG Partners LP ⁽³⁾	319	7,155
Kinder Morgan, Inc. ⁽⁶⁾	3,413	139,967
Kirby Corporation ⁽⁶⁾⁽⁷⁾	25	1,927
KNOT Offshore Partners LP ⁽³⁾	839	18,835
NiSource Inc. ⁽⁶⁾	50	2,145
ONEOK, Inc.	819	36,232
Plains GP Holdings, L.P. ⁽³⁾⁽⁸⁾	614	17,596
Plains GP Holdings, L.P. ⁽³⁾⁽⁸⁾⁽⁹⁾	1,836	52,591
SemGroup Corporation ⁽⁶⁾	77	5,953
Spectra Energy Corp. ⁽⁶⁾	473	16,797
Targa Resources Corp. ⁽⁶⁾	111	11,004
Teekay Corporation ⁽⁶⁾	70	3,097
Teekay Offshore Partners L.P. ⁽³⁾	602	13,216
VTTI Energy Partners LP ⁽³⁾	326	8,438
The Williams Companies, Inc. ⁽⁶⁾	2,063	101,190
		511,101
Midstream MLP⁽²⁾⁽¹⁰⁾ 47.5%		
Antero Midstream Partners LP	131	3,411
Arc Logistics Partners LP	82	1,519
Buckeye Partners, L.P. ⁽⁶⁾	135	10,491
Columbia Pipeline Partners LP ⁽¹¹⁾	61	1,700
CONE Midstream Partners LP	17	365
Crestwood Midstream Partners LP	1,067	15,978
CSI Compressco LP	47	809
DCP Midstream Partners, LP	384	15,288
Enbridge Energy Management, L.L.C. ⁽⁶⁾⁽¹²⁾⁽¹³⁾	2,721	101,443
Energy Transfer Equity, L.P.	89	5,704
Energy Transfer Partners, L.P. ⁽¹⁴⁾⁽¹⁵⁾	456	27,100
EnLink Midstream Partners, LP	409	10,995

Edgar Filing: KAYNE ANDERSON MIDSTREAM/ENERGY FUND, INC. - Form N-30B-2

Enterprise Products Partners L.P. ⁽¹⁴⁾	498	16,589
Exterran Partners, L.P.	291	6,804
Global Partners LP	266	10,581
Holly Energy Partners, L.P.	144	4,775
MarkWest Energy Partners, L.P. ⁽⁶⁾⁽⁸⁾	304	19,720
Midcoast Energy Partners, L.P.	142	2,186
ONEOK Partners, L.P.	479	20,032

See accompanying notes to financial statements.

Table of Contents

KAYNE ANDERSON MIDSTREAM/ENERGY FUND, INC.

SCHEDULE OF INVESTMENTS

FEBRUARY 28, 2015

(amounts in 000 s, except numbers of option contracts)

(UNAUDITED)

Description	No. of Shares/Units	Value
Midstream MLP⁽²⁾⁽¹⁰⁾ (continued)		
Plains All American Pipeline, L.P. ⁽⁸⁾	459	\$ 22,895
QEP Midstream Partners, LP	38	616
Regency Energy Partners LP ⁽¹⁵⁾	1,340	32,690
Shell Midstream Partners, L.P.	105	4,113
Sprague Resources LP	24	580
Summit Midstream Partners, LP	79	2,846
Targa Resources Partners LP	103	