

KAYNE ANDERSON MIDSTREAM/ENERGY FUND, INC.

Form N-30B-2

October 28, 2016

Table of Contents

Midstream/Energy Fund

KMF Quarterly Report

August 31, 2016

Table of Contents**CONTENTS**

	Page
<u>Management Discussion</u>	1
<u>Schedule of Investments</u>	6
<u>Statement of Assets and Liabilities</u>	11
<u>Statement of Operations</u>	12
<u>Statement of Changes in Net Assets Applicable to Common Stockholders</u>	13
<u>Statement of Cash Flows</u>	15
<u>Financial Highlights</u>	16
<u>Notes to Financial Statements</u>	20
<u>Glossary of Key Terms</u>	41
<u>Information Regarding Changes and Clarifications to Investment Policy</u>	42
<u>Repurchase Disclosure</u>	42

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.

Table of Contents**KAYNE ANDERSON MIDSTREAM/ENERGY FUND, INC.****MANAGEMENT DISCUSSION****(UNAUDITED)****Fund Overview**

Kayne Anderson Midstream/Energy Fund, Inc. is a non-diversified, closed-end fund. We commenced operations on November 24, 2010. Our shares of common stock are listed on the New York Stock Exchange under the symbol KMF.

Our investment objective is to provide a high level of total return with an emphasis on making quarterly cash distributions to our stockholders. We seek to achieve that investment objective by investing at least 80% of our total assets in the securities of companies in the Midstream/Energy Sector, consisting of (a) Midstream MLPs, (b) Midstream Companies, (c) Other MLPs and (d) Other Energy Companies. We anticipate that the majority of our investments will consist of investments in Midstream MLPs and Midstream Companies. Please see the Glossary of Key Terms for a description of these investment categories and for the meaning of capitalized terms not otherwise defined herein.

As of August 31, 2016, we had total assets of \$496 million, net assets applicable to our common stock of \$349 million (net asset value of \$15.86 per share), and 22.0 million shares of common stock outstanding. As of August 31, 2016, we held \$407 million in equity investments, \$72 million in debt investments and \$3 million of cash and cash equivalents (including short-term investments).

Our Top Ten Portfolio Investments

Listed below are our top ten portfolio investments by issuer as of August 31, 2016.

	Holding	Category⁽¹⁾	Amount (\$ millions)	Percent of Long-Term Investments
1.	Enbridge Energy Management, L.L.C.	Midstream MLP	\$ 39.4	8.2%
2.	Plains GP Holdings, L.P. ⁽²⁾⁽³⁾	Midstream Company	37.9	7.9
3.	ONEOK, Inc.	Midstream Company	33.1	6.9
4.	Targa Resources Corp.	Midstream Company	25.6	5.4
5.	Dynagas LNG Partners LP	Midstream Company	19.0	4.0
6.	KNOT Offshore Partners LP	Midstream Company	14.9	3.1
7.	Energy Transfer Partners, L.P.	Midstream MLP	14.9	3.1
8.	Golar LNG Partners LP	Midstream Company	14.6	3.0
9.	GasLog Partners LP	Midstream Company	14.5	3.0
10.	Spectra Energy Corp. ⁽⁴⁾	Midstream Company	14.5	3.0
			\$ 228.4	47.6%

(1) See Glossary of Key Terms for definitions.

(2) On July 11, 2016, Plains All American Pipeline, L.P. (PAA) announced it had entered into a definitive agreement with Plains AAP, L.P. (PAA GP) to permanently eliminate PAA's incentive distribution rights and the economic rights associated with PAA's 2% general partner

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

interest in exchange for newly issued PAA common units and the assumption of all of PAA GP's outstanding debt. Under the terms of the agreement, PAA is issuing 245.5 million PAA common units to PAA GP.

- (3) We hold an interest in PAA GP, which controls the general partner of PAA. Plains GP Holdings, L.P. (Plains GP) also holds an equity interest in PAA GP. Our ownership of PAA GP is exchangeable into shares of Plains GP on a one-for-one basis at our option. The amounts shown in the table include our current holdings of Plains GP as well as our interest in PAA GP.
- (4) On September 6, 2016, Enbridge Inc. (ENB) and Spectra Energy Corp. (SE) announced an agreement to combine in a stock-for-stock merger transaction. Under the terms of the agreement, each holder of SE will receive 0.984 shares of ENB for each share of SE they own.

Table of Contents

KAYNE ANDERSON MIDSTREAM/ENERGY FUND, INC.

MANAGEMENT DISCUSSION

(UNAUDITED)

Results of Operations For the Three Months Ended August 31, 2016

Investment Income. Investment income totaled \$5.4 million for the quarter and consisted primarily of net dividends and distributions and interest income on our investments. We received \$7.4 million of dividends and distributions, of which \$4.1 million was treated as return of capital. Interest income was \$2.1 million. We also received \$1.0 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 \$3.3 million, including \$1.5 million of investment management fees, \$1.0 million of interest expense, \$0.4 million of preferred stock distributions and \$0.4 million of other operating expenses. Interest expense includes \$0.1 million of non-cash amortization of debt issuance costs. Preferred stock distributions include less than \$0.1 million of non-cash amortization of offering costs.

Net Investment Income. Our net investment income totaled \$2.1 million.

Net Realized Gains. We had net realized gains of \$6.5 million, which included \$0.3 million of net realized gains from option activity.

Net Change in Unrealized Losses. We had a net decrease in unrealized losses of \$29.5 million. The net decrease consisted of \$29.2 million of unrealized gains from investments and \$0.3 million of net unrealized gains from option activity.

Net Increase in Net Assets Resulting from Operations. We had an increase in net assets resulting from operations of \$38.1 million. This increase was comprised of net investment income of \$2.1 million, net realized gains of \$6.5 million and a net decrease in unrealized losses of \$29.5 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 (Kafa), (b) other expenses (mostly comprised of fees paid to other service providers), (c) accrual for estimated excise taxes (if any) 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 August 31, 2016
Distributions and Other Income from Investments	
Dividends ⁽¹⁾	\$ 7.4
Paid-In-Kind Dividends ⁽¹⁾	1.0
Interest Income	2.3
Net Premiums Received from Call Options Written	0.4
Total Distributions and Other Income from Investments	11.1
Expenses	
Investment Management Fee	(1.5)
Other Expenses	(0.4)
Interest Expense	(0.9)
Preferred Stock Distributions	(0.4)
Net Distributable Income (NDI)	\$ 7.9
Weighted Shares Outstanding	22.0
NDI per Weighted Share Outstanding	\$ 0.36
Adjusted NDI per Weighted Share Outstanding⁽²⁾	\$ 0.36
Distributions paid per Common Share⁽³⁾	\$ 0.35

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

(2) Adjusted NDI includes \$0.1 million of consideration received in the MarkWest Energy Partners, L.P. and MPLX LP merger that was intended to offset lower quarterly distributions as a result of the transaction. Because the acquiring entity has deemed part of the merger consideration to be compensation to help offset the lower quarterly distribution that unitholders of the acquired entity would receive after closing, we believe it to be appropriate to include this amount in Adjusted NDI. This merger consideration is not included in investment income for GAAP purposes, but rather is treated as additional consideration when calculating the realized or unrealized gain (loss) that results from the merger transaction.

(3) The distribution of \$0.35 per share for the third quarter was paid on October 14, 2016.

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. Because our quarterly distributions are funded primarily by NDI generated from our portfolio investments, the Board of Directors, in determining our quarterly distribution to common stockholders, gives a significant amount of consideration to the NDI and Adjusted NDI generated in the current quarter, as well as the NDI that our portfolio is expected to generate over the next twelve months. The Board of Directors also considers other factors, including but not limited to, realized and unrealized gains generated by the portfolio.

Table of Contents

KAYNE ANDERSON MIDSTREAM/ENERGY FUND, INC.

MANAGEMENT DISCUSSION

(UNAUDITED)

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.

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 stock (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 exclude excise tax that is unrelated to the current fiscal period.

Liquidity and Capital Resources

At August 31, 2016, we had total leverage outstanding of \$143 million, which represented 29% of total assets and was comprised of \$91 million of Notes, \$17 million of borrowings outstanding under our unsecured

Table of Contents

KAYNE ANDERSON MIDSTREAM/ENERGY FUND, INC.

MANAGEMENT DISCUSSION

(UNAUDITED)

revolving credit facility (the Credit Facility) and \$35 million of MRP Shares. At August 31, 2016, we did not have any borrowings outstanding under our unsecured revolving term loan (the Term Loan), and we had \$3 million of cash and cash equivalents (including short-term investments). As of October 24, 2016, we had \$27 million borrowed under our Credit Facility, we had no borrowings outstanding under our Term Loan and we had \$2 million of cash and cash equivalents.

Our Credit Facility has a total commitment of \$105 million and matures on November 21, 2016. We are in active discussions with our lenders and expect to renew this facility prior to its maturity date. 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. We pay a fee of 0.25% per annum on any unused amounts of the Credit Facility.

On July 19, 2016, we amended the terms of our Term Loan, resetting the minimum net asset threshold to \$172 million, which is equal to 50% of our net asset value as of July 18, 2016 and reducing the commitment from \$50 million to \$35 million. In conjunction with this amendment, the interest rate for borrowings under the Term Loan was increased from LIBOR plus 1.30% to LIBOR plus 1.50%. As a result of this amendment, we are now able to borrow on the Term Loan because our net asset value is above the minimum net asset threshold. We pay a fee of 0.25% per annum on any unused amount of the Term Loan. The Term Loan is scheduled to mature on July 25, 2019.

At August 31, 2016, we had \$91 million of Notes outstanding that mature between 2021 and 2023 and we had \$35 million of MRP Shares outstanding that are subject to mandatory redemption in 2021.

At August 31, 2016, our asset coverage ratios under the Investment Company Act of 1940, as amended (the 1940 Act), were 456% for debt and 344% for total leverage (debt plus preferred stock). Our target asset coverage ratio with respect to our debt is 430%. At times we may be above or below our target depending on market conditions as well as certain other factors, including our target total leverage asset coverage ratio of 320% and the basic maintenance amount as stated in our rating agency guidelines.

As of August 31, 2016, our total leverage consisted of both fixed rate (88%) and floating rate (12%) obligations. At such date, the weighted average interest/dividend rate on our total leverage was 3.67%.

Table of Contents**KAYNE ANDERSON MIDSTREAM/ENERGY FUND, INC.****SCHEDULE OF INVESTMENTS****AUGUST 31, 2016****(amounts in 000 s, except number of option contracts)****(UNAUDITED)**

Description	No. of Shares/Units	Value
Long-Term Investments 137.1%		
Equity Investments⁽¹⁾ 116.4%		
United States 114.4%		
Midstream Company⁽²⁾ 64.9%		
Capital Product Partners L.P. Class B Units ⁽³⁾⁽⁴⁾⁽⁵⁾⁽⁶⁾	606	\$ 4,406
Dynagas LNG Partners LP ⁽³⁾	1,296	19,019
EnLink Midstream, LLC	5	85
GasLog Partners LP ⁽³⁾	730	14,483
Golar LNG Partners LP ⁽³⁾	752	14,594
Höegh LNG Partners LP ⁽³⁾	316	5,893
Kinder Morgan, Inc. ⁽⁷⁾	178	3,883
KNOT Offshore Partners LP ⁽³⁾	802	14,927
ONEOK, Inc. ⁽⁷⁾⁽⁸⁾	706	33,082
Plains GP Holdings, L.P. ⁽³⁾⁽⁸⁾⁽⁹⁾	1,493	16,995
Plains GP Holdings, L.P. Plains AAP, L.P. ⁽²⁾⁽⁵⁾⁽⁸⁾⁽⁹⁾⁽¹⁰⁾	1,836	20,897
SemGroup Corporation	244	7,596
Spectra Energy Corp. ⁽¹¹⁾	406	14,465
Tallgrass Energy GP, LP ⁽³⁾	388	9,022
Targa Resources Corp. ⁽⁷⁾	588	25,639
The Williams Companies, Inc.	460	12,852
VTTI Energy Partners LP ⁽³⁾	471	9,064
		226,902
Midstream MLP⁽²⁾⁽¹²⁾ 44.9%		
Arc Logistics Partners LP	437	6,441
Buckeye Partners, L.P.	101	7,064
Crestwood Equity Partners LP	195	4,060
DCP Midstream Partners, LP ⁽⁷⁾	326	10,668
Enbridge Energy Management, L.L.C. ⁽¹³⁾⁽¹⁴⁾	1,729	39,355
Energy Transfer Partners, L.P.	373	14,880
EnLink Midstream Partners, LP	182	3,219
Enterprise Products Partners L.P.	309	8,146
EQT Midstream Partners, LP	34	2,673
Global Partners LP	240	3,640
Magellan Midstream Partners, L.P. ⁽⁷⁾	24	1,660
MPLX LP	237	7,858
NuStar Energy L.P.	40	1,920
ONEOK Partners, L.P. ⁽⁸⁾	277	10,749
PBF Logistics LP	27	548
Phillips 66 Partners LP	36	1,781
Spectra Energy Partners, LP	50	2,282

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

Sunoco Logistics Partners L.P.	282	8,332
Sunoco LP	54	1,615
TC PipeLines, LP	2	121
Tesoro Logistics LP	140	6,710
Western Gas Partners, LP	113	5,709
Williams Partners L.P.	197	7,494
		156,925

See accompanying notes to financial statements.

Table of Contents**KAYNE ANDERSON MIDSTREAM/ENERGY FUND, INC.****SCHEDULE OF INVESTMENTS****AUGUST 31, 2016****(amounts in 000 s, except number of option contracts)****(UNAUDITED)**

Description	No. of Shares/Units	Value
Other Energy Company 4.5%		
Anadarko Petroleum Corporation 7.50% Tangible Equity Units ⁽⁴⁵⁾	145	\$ 5,554
Macquarie Infrastructure Corporation ⁽⁷⁾	114	9,137
NRG Yield, Inc. Class A	69	1,113
		15,804
Total United States (Cost \$379,566)		399,631
Canada 2.0%		
Midstream Company⁽²⁾ 2.0%		
Enbridge Inc. ⁽¹¹⁾	60	2,369
TransCanada Corporation	100	4,522