

Salient Midstream & MLP Fund  
Form N-CSR  
February 09, 2015

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, DC 20549**

**FORM N-CSR**

**CERTIFIED SHAREHOLDER REPORT OF REGISTERED**  
**MANAGEMENT INVESTMENT COMPANY**  
**Investment Company Act file number 811-22626**

**Salient Midstream & MLP Fund**  
**(Exact name of registrant as specified in charter)**

**4265 SAN FELIPE, 8<sup>TH</sup> FLOOR, HOUSTON, TX 77027**  
**(Address of principal executive offices) (Zip code)**

*With a copy to:*

**Gregory A. Reid**  
**Salient Midstream & MLP Fund**  
**4265 San Felipe, 8<sup>th</sup> Floor**  
**Houston, TX 77027**  
(Name and address of agent for service)

**George J. Zornada**  
**K & L Gates LLP**  
**State Street Financial Center**  
**One Lincoln St.**  
**Boston, MA 02111-2950**  
**(617) 261-3231**

**Registrant's telephone number, including area code: 713-993-4675**

**Date of fiscal year end: November 30, 2014**

**Date of reporting period: November 30, 2014**

**Item 1. Reports to Stockholders.**

**Annual Report to Shareholders**

**November 30, 2014**

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**Management Discussion of Fund Performance (Unaudited)**

**Letter to Shareholders**

Dear Fellow Shareholders:<sup>1</sup>

We are pleased to provide the annual report of the Salient Midstream & MLP Fund (the Fund) (NYSE: SMM) which contains updated data as of November 30, 2014.

As of November 30, 2014, the Fund had total consolidated assets of \$757.5 million, net assets applicable to our common shares of \$492.7 million (net asset value of \$27.80 per share) and 17.7 million common shares outstanding. The Fund's price per share was \$26.20, which represents a 5.8% discount to its net asset value (NAV<sup>2</sup>).

On November 17, 2014, the Fund announced its successful completion of the approved reorganization (Reorganization) involving SMM and Salient MLP & Energy Infrastructure Fund (NYSE: SMF). The Reorganization was completed as of the close of business November 14, 2014, in which 8,222,798 additional shares of SMM were issued to SMF shareholders at the conversion ratio of 1.14 shares of SMM for every share of SMF. We believe the anticipated benefits of the Reorganization include portfolio management efficiencies, economies of scale on other expenses, enhanced common shares liquidity and a larger market capitalization for the Fund.

The Fund's investments allocation is shown in the pie chart below:

<sup>1</sup> **Certain statements in this letter are forward-looking statements.** The forward-looking statements and other views expressed herein are those of the portfolio managers and the Fund as of the date of this letter. Actual future results or occurrences may differ significantly from those anticipated in any forward-looking statements, and there is no guarantee that any predictions will come to pass. The views expressed herein are subject to change at any time, due to numerous market and other factors. The Fund disclaims any obligation to update publicly or revise any forward-looking statements or views expressed herein. There can be no assurance that the Fund will achieve its investment objectives. The value of the Fund will fluctuate with the value of the underlying securities. Historically, closed-end funds often trade at a discount to their net asset value.

<sup>2</sup> Past performance is not predictive of future results. Current performance may be higher or lower than the data shown. The data shown are unaudited. Returns do not reflect the deduction of taxes that shareholders may have to pay on Fund distributions or upon the sale of Fund shares.

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The Fund's Top 10 consolidated holdings are shown below, as of November 30, 2014<sup>3</sup>:

| Company Name                         | Sector            | % of<br>Gross<br>Assets |
|--------------------------------------|-------------------|-------------------------|
| Enterprise Products Partners, L.P.*  | MLP               | 8.7%                    |
| Kinder Morgan, Inc.                  | Midstream Company | 8.2%                    |
| The Williams Companies, Inc.         | Midstream Company | 6.6%                    |
| Energy Transfer Equity, L.P.*        | MLP               | 6.2%                    |
| Plains All American Pipeline, L.P.*  | MLP               | 4.8%                    |
| Magellan Midstream Partners, L.P.*   | MLP               | 3.6%                    |
| NGL Energy Partners LP**             | MLP               | 3.5%                    |
| Macquarie Infrastructure Company LLC | Other             | 3.2%                    |
| Targa Resources Corp.                | Midstream Company | 3.2%                    |
| Enbridge Energy Management L.L.C.    | MLP Affiliate     | 3.0%                    |
| Total                                |                   | 51.0%                   |

For illustrative purposes only.

\* Held indirectly through the wholly owned C-Corporation, Salient Midstream & MLP Fund, Inc.

\*\* Includes both restricted and unrestricted units

Current and future holdings are subject to change and risk.

Source: Salient Capital Advisors, LLC, November 2014.

During fiscal 2014 (December 2013 – November 2014), the Fund's NAV and market price total return were +20.7% and +21.3%, respectively, compared to +12.87% for the Alerian MLP Index (AMZ), during the same period.<sup>4</sup> Some of the top contributing investments held by the Fund in 2014, include Energy Transfer Equity, L.P. (ETE), Enterprise Products Partners, L.P. (EPD), Targa Resources Corp. (TRGP), Magellan Midstream Partners, L.P. (MMP), and Rose Rock Midstream Partners, L.P. (RRMS). Some of the bottom detractors from performance include Seadrill Partners LLC (SDLP), Memorial Production Partners L.P. (MEMP), Navios Maritime Partners L.P. (NMM), HollyFrontier Corporation (HFC), and Transocean Partners LLC (RIGP).

The Fund recognized losses of \$11,921,442 from its hedging strategy, which utilizes total return swaps and futures contracts and losses of \$566,135 on its covered call option strategy.

### Market Review

The recent rout in crude oil prices continued through November culminating in OPEC's Thanksgiving Day announcement that it would maintain its production quota at 30 mmbbl/d.<sup>5,6</sup> Crude oil plummeted 10% the following day, ending the month at a five-year low of \$66.15/bbl down nearly 40% from its June high. Investors, fearing sizable cuts to Exploration & Production (E&P) capital expenditure budgets due to low commodity prices, indiscriminately dumped Master Limited Partnerships (MLP) and the AMZ fell 5.3% on the final day of November and an additional 4.4% the following Monday, December 1<sup>st</sup>, to mark a third consecutive negative month for MLPs.

<sup>3</sup> Fund shares do not represent a deposit or obligation of, and are not guaranteed or endorsed by, any bank or other insured depository institution, and are not federally insured by the Federal Deposit Insurance Corporation, the Federal Reserve Board or any other government agency. Data are based on total market value of Fund investments unless otherwise indicated. The data provided are for informational purposes only and are not intended for trading purposes.

<sup>4</sup> Alerian Capital Management, November 2014.

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<sup>5</sup> Organization of the Petroleum Exporting Countries. OPEC 166<sup>th</sup> Meeting Concludes [Press Release]. Retrieved from:

[http://www.opec.org/opec\\_web/en/press\\_room/2938.htm](http://www.opec.org/opec_web/en/press_room/2938.htm)

<sup>6</sup> mmbbl/d = millions of barrels per day



Ironically, we believe that at least some of the MLP underperformance of the last few months can be attributed to the increased maturity of the asset class. The Salient MLP investable universe had grown to an aggregate of \$850 billion by the end of August up from just over \$100 billion in 2009.<sup>7</sup> As the space has matured, we believe that many investment firms now manage MLPs as a component of their overall energy portfolios rather than as an alternative investment vehicle. As such, with commodity prices continuing to decline, we believe many energy portfolio managers were given orders to reduce overall energy exposure and several MLPs were sold despite having little to zero exposure to crude oil or even natural gas liquids (NGL) prices for that matter.

In retrospect, what began as a “sell your winners” scenario in October when crude oil prices first dipped under \$90/bbl and many individual MLPs were up >40% YTD on the heels of 2013’s 27.6% gains for the AMZ, morphed into semi-panic selling by the end of November and early December as the slide in crude oil prices showed no signs of abating.

**Performance Snapshot**

as of November 30, 2014 (unaudited)

| Price Per Share        | 1-Year<br>Total Return* | Since<br>Inception*<br>(Annualized) |
|------------------------|-------------------------|-------------------------------------|
| \$27.80 (NAV)          | 20.7%                   | 20.8%                               |
| \$26.20 (Market Price) | 21.3%                   | 18.0%                               |

Source: Salient Capital Advisors, LLC, November 2014.

For illustrative purposes only. All figures represent past performance and are not a guarantee of future results.

\* Total returns are based on changes in NAV or market price, respectively. Returns reflect the deduction of all Fund expenses, including management fees, operating expenses, and other Fund expenses. Returns do not reflect the deduction of brokerage commissions or taxes that investors may pay on distributions or the sale of shares. Total return assumes the reinvestment of all distributions. Inception date of the Fund was May 25, 2012.

**Summary**

Our long-term investment philosophy remains focused on MLPs and MLP-related companies that have the potential to achieve above average distribution growth which, we believe, leads to potentially higher long-term returns for investors. However, we believe that we are entering a period of heightened volatility where investors will likely place a premium on safety and predictability rather than focusing mainly on dividend growth potential. Fortunately, we do not believe that the two characteristics are mutually exclusive. It is our opinion that successful MLPs achieve above average distribution growth in no small part because their operations allow them to outperform in both rising and falling macro commodity price environments. Being disciplined and sticking to our focus on choosing quality names using our bottom up stock selection approach will be more important than ever as the recent broad-based sell-off in MLPs has potentially created an opportunity to build positions in names that are well positioned to weather the current volatility and emerge even stronger going forward.

Please visit our website at [www.salientfunds.com](http://www.salientfunds.com) for the latest updates and sign up to receive email alerts on future press releases by the Fund.

<sup>7</sup> Bloomberg, Salient Capital Advisors, LLC, August 2014. The investable universe incorporates energy MLPs, midstream companies (including general partners), marine midstream companies, yield cos and MLP affiliates.

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Please note that this letter, including the financial information herein, is made available to shareholders of the Fund for their information. It is not a prospectus, circular or representation intended for use in the purchase or sale of shares of the Fund or of any securities mentioned in this letter.

Sincerely,

Gregory A. Reid

President and Chief Executive Officer

MLP Business, Salient Capital Advisors, LLC

**Key Financial Data (unaudited)**

We supplement the reporting of our financial information determined under United States generally accepted accounting principles ( GAAP ) with certain non-GAAP financial measures: distributable cash flow and distributable cash flow coverage ratio. We believe these non-GAAP measures provide meaningful information to assist shareholders in understanding our financial results and assessing our performance. We pay distributions to our shareholders, funded in part by distributable cash flow generated from our portfolio investments. Distributable cash flow is the amount of income received by us from our portfolio investments less operating expenses, subject to certain adjustments as described below. Other companies with similar measures may calculate these measures differently, and as a result, it may not be possible to compare these financial measures with other companies' non-GAAP financial measures having the same or similar names. These adjusted financial measures should not be considered in isolation or as a substitute for reported net investment income. These non-GAAP financial measures reflect an additional way of viewing an aspect of our operations that, when viewed with our GAAP results and the below reconciliation to the corresponding GAAP financial measures, provide a more complete understanding of our Fund. We strongly encourage shareholders to review our financial statements in their entirety and not rely on any single financial measure.

The table below reconciles the non-GAAP financial measures, distributable cash flow and distributable cash flow coverage ratio, by starting with the most directly comparable GAAP financial measure, net investment income (loss).

|   | <b>Year Ended<br/>November 30, 2014</b> |
|---|---|
| Net investment loss, before income taxes                          | \$ (1,995,791)                          |
| Reconciling items:  |   |
| Return of capital of distributions (a)                            | 12,781,929                              |
| Dividends paid in stock (b)                                       | 2,964,423                               |
| Option premium earnings (c)                                       | (566,135)                               |
| Distributable cash flow (non-GAAP)                                | \$ 13,184,426                           |
| Distributions paid on common stock                                | \$ 13,537,003                           |
| Distributable cash flow coverage ratio (non-GAAP)                 | 0.97                                    |
| Distributable cash flow coverage ratio since inception (non-GAAP) | 0.97                                    |

**Reconciliation of distributable cash flow to GAAP**

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

(b) Distributable cash flow includes the value of dividends paid-in-kind (i.e., stock dividends), whereas such amounts are not included in net investment income for GAAP purposes during the period received, but rather are recorded as unrealized gains upon receipt.

(c) 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 fee that we received, thereby generating a profit. The amount we receive from selling call option contracts, less the amount that we pay to repurchase such call option contracts is included in distributable cash flow. For GAAP purposes, income from call option contracts sold is not included in net investment income (loss). See Note 2 Summary of Significant Accounting Policies and Practices for a full discussion of the GAAP treatment of call option contracts.

**SALIENT MIDSTREAM & MLP FUND**

**Report of Independent Registered Public Accounting Firm**

The Shareholders and Board of Trustees of

Salient Midstream & MLP Fund:

We have audited the accompanying consolidated statement of assets, liabilities and shareholders' equity of Salient Midstream & MLP Fund and Subsidiary (the Fund), including the consolidated schedule of investments, as of November 30, 2014, and the related consolidated statements of operations and cash flows for the year then ended, the consolidated statements of changes in net assets for each of the years in the two-year period then ended, and the consolidated financial highlights for each of the years in the two-year period then ended and the period from May 24, 2012 (commencement of operations) through November 30, 2012. These consolidated financial statements and consolidated financial highlights are the responsibility of the Fund's management. Our responsibility is to express an opinion on these consolidated financial statements and consolidated financial highlights based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements and consolidated financial highlights are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. Our procedures included confirmation of securities owned as of November 30, 2014, by correspondence with the custodian and brokers or by other appropriate auditing procedures. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements and consolidated financial highlights referred to above present fairly, in all material respects, the financial position of Salient Midstream & MLP Fund and Subsidiary as of November 30, 2014, the results of their operations and cash flows for the year then ended, the changes in their net assets for each of the years in the two-year period then ended, and the financial highlights for each of the years in the two-year period then ended and the period from May 24, 2012 through November 30, 2012 in conformity with U.S. generally accepted accounting principles.

/s/ KPMG LLP

Columbus, Ohio

February 5, 2015

## SALIENT MIDSTREAM &amp; MLP FUND

## Consolidated Schedule of Investments

November 30, 2014

|   | Shares/Units | Fair Value    |
|---|--------------|---------------|
| <b>Master Limited Partnerships and Related Companies 147.1%</b> |              |               |
| <b>Coal 2.8%</b>  |              |               |
| <b>United States 2.8%</b>                                       |              |               |
| Alliance Holdings GP, L.P. <sup>(1)(2)(3)</sup>                 | 202,907      | \$ 13,600,856 |
|   |              | 13,600,856    |
| <b>Crude/Natural Gas Production 3.5%</b>                        |              |               |
| <b>United States 3.5%</b>                                       |              |               |
| Legacy Reserves LP <sup>(3)</sup>                               | 74,092       | 1,321,060     |
| Memorial Production Partners L.P. <sup>(1)(2)(3)</sup>          | 456,938      | 6,287,467     |
| Western Gas Equity Partners, L.P. <sup>(2)(3)</sup>             | 150,106      | 9,426,657     |
|   |              | 17,035,184    |
| <b>Crude/Refined Products Pipelines 44.4%</b>                   |              |               |
| <b>United States 44.4%</b>                                      |              |               |
| American Midstream Partners, LP <sup>(3)</sup>                  | 575,126      | 12,836,812    |
| Arc Logistics Partners LP <sup>(2)(3)</sup>                     | 275,479      | 6,060,538     |
| Calumet Specialty Products Partners, L.P. <sup>(2)(3)</sup>     | 65,000       | 1,703,000     |
| Enbridge Energy Management, L.L.C. <sup>(2)(3)(4)</sup>         | 619,643      | 22,555,020    |
| Kinder Morgan, Inc. <sup>(2)</sup>                              | 1,485,366    | 61,419,871    |
| Magellan Midstream Partners, L.P. <sup>(1)(2)(3)</sup>          | 326,350      | 27,051,152    |
| Plains All American Pipeline, L.P. <sup>(1)(2)(3)</sup>         | 697,720      | 35,897,694    |
| Plains GP Holdings L.P., Class A <sup>(2)(3)</sup>              | 759,876      | 19,741,578    |
| Rose Rock Midstream, L.P. <sup>(2)(3)</sup>                     | 319,423      | 17,146,627    |
| Summit Midstream Partners, LP <sup>(2)(3)</sup>                 | 312,114      | 14,169,976    |
|   |              | 218,582,268   |
| <b>Electric Utilities 2.9%</b>                                  |              |               |
| <b>United States 2.9%</b>                                       |              |               |
| NRG Yield, Inc., Class A <sup>(2)</sup>                         | 305,345      | 14,470,300    |
|   |              | 14,470,300    |
| <b>Natural Gas Gathering/Processing 38.9%</b>                   |              |               |
| <b>United States 38.9%</b>                                      |              |               |
| CONE Midstream Partners LP <sup>(2)(3)</sup>                    | 51,385       | 1,411,032     |
| CorEnergy Infrastructure Trust, Inc.                            | 2,000,000    | 13,340,000    |
| DCP Midstream Partners, LP <sup>(2)(3)</sup>                    | 95,444       | 4,572,722     |
| EMG Utica I Offshore Co Investment, LP <sup>(5)(6)(7)(8)</sup>  | 16,000,000   | 20,120,000    |
| EnLink Midstream LLC <sup>(2)</sup>                             | 480,026      | 17,362,540    |
| EnLink Midstream Partners, LP <sup>(2)(3)</sup>                 | 210,700      | 5,876,423     |
| MarkWest Energy Partners, L.P. <sup>(2)(3)</sup>                | 137,805      | 9,792,423     |
| NGL Energy Partners LP <sup>(2)(3)(5)(6)</sup>                  | 54,500       | 1,841,555     |
| NGL Energy Partners LP <sup>(1)(3)</sup>                        | 699,628      | 24,417,018    |
| Targa Resources Corp. <sup>(2)</sup>                            | 207,594      | 23,694,779    |
| Targa Resources Partners LP <sup>(2)(3)</sup>                   | 362,616      | 19,882,235    |

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The Williams Companies, Inc.<sup>(2)</sup>

955,880

49,466,791

191,777,518

See accompanying Notes to Consolidated Financial Statements.

## SALIENT MIDSTREAM &amp; MLP FUND

## Consolidated Schedule of Investments, continued

November 30, 2014

|  | Shares/Units | Fair Value   |
|--|--------------|--------------|
| <b>Natural Gas/Natural Gas Liquids Pipelines 33.9%</b> |              |              |
| <b>United Kingdom 1.8%</b>                             |              |              |
| VTTI Energy Partners LP <sup>(2)(3)</sup>              | 360,007      | \$ 8,802,171 |
| <b>United States 32.1%</b>                             |              |              |
| Buckeye Partners, L.P. <sup>(2)(3)</sup>               | 94,640       | 7,274,977    |
| Energy Transfer Equity, L.P. <sup>(1)(2)(3)</sup>      | 778,420      | 46,230,364   |
| Enterprise Products Partners L.P. <sup>(1)(2)(3)</sup> | 1,728,894    | 64,556,901   |
| EQT Midstream Partners, L.P. <sup>(2)(3)</sup>         | 102,488      | 8,572,096    |
| Exterran Partners, LP <sup>(2)(3)</sup>                | 183,715      | 4,541,435    |
| ONEOK, Inc. <sup>(2)</sup>                             | 379,230      | 20,539,097   |
| Spectra Energy Corp. <sup>(2)</sup>                    | 175,476      | 6,647,031    |
|  |              | 167,164,072  |
| <b>Oil &amp; Gas Drilling 0.1%</b>                     |              |              |
| <b>United Kingdom 0.1%</b>                             |              |              |
| Transocean Partners LLC <sup>(2)(3)</sup>              | 45,435       | 712,421      |
|  |              | 712,421      |
| <b>Oil, Gas &amp; Consumable Fuels 2.2%</b>            |              |              |
| <b>United States 2.2%</b>                              |              |              |
| Antero Midstream Partners LP <sup>(1)(3)</sup>         | 54,133       | 1,498,943    |
| HollyFrontier Corporation <sup>(2)</sup>               | 165,680      | 6,763,057    |
| Shell Midstream Partners, L.P. <sup>(3)</sup>          | 70,513       | 2,575,135    |
|  |              | 10,837,135   |
| <b>Shipping 10.5%</b>                                  |              |              |
| <b>Bermuda 4.0%</b>                                    |              |              |
| Golar LNG Partners L.P. <sup>(2)(3)</sup>              | 597,059      | 19,643,241   |
| <b>Republic of the Marshall Islands 4.2%</b>           |              |              |
| Dynagas LNG Partners LP <sup>(2)(3)</sup>              | 383,000      | 6,859,530    |
| Navios Maritime Partners L.P. <sup>(2)(3)</sup>        | 530,836      | 6,879,635    |
| Seadrill Partners LLC <sup>(2)(3)</sup>                | 410,852      | 6,951,615    |
| <b>United States 2.3%</b>                              |              |              |
| Capital Product Partners L.P. <sup>(2)(3)</sup>        | 1,425,033    | 11,143,758   |
|  |              | 51,477,779   |
| <b>Transportation Infrastructure 7.9%</b>              |              |              |
| <b>Bermuda 3.1%</b>                                    |              |              |
| Teekay Offshore Partners L.P. <sup>(5)(6)</sup>        | 584,461      | 15,254,432   |
|  |              | 15,254,432   |

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**United States 4.8%**

|   |         |                       |
|---|---------|-----------------------|
| Macquarie Infrastructure Company LLC <sup>(2)</sup>                                     | 337,486 | 23,725,266            |
|   |         | 23,725,266            |
|   |         | 38,979,698            |
| <b>Total Master Limited Partnerships and Related Companies<br/>(Cost \$498,240,935)</b> |         | <b>\$ 724,637,231</b> |

See accompanying Notes to Consolidated Financial Statements.



## SALIENT MIDSTREAM &amp; MLP FUND

## Consolidated Schedule of Investments, continued

November 30, 2014

|  | Shares/Units | Fair Value            |
|--|--------------|-----------------------|
| <b>Convertible Bond 0.4%</b>                                     |              |                       |
| <b>Natural Gas Gathering/Processing 0.4%</b>                     |              |                       |
| <b>United States 0.4%</b>  |              |                       |
| American Energy Utica, 3.50%, 03/01/2029 <sup>(1)</sup>          | 2,000,000    | \$ 1,835,000          |
|  |              | 1,835,000             |
| Total Convertible Bond (Cost \$2,000,000)                        |              | 1,835,000             |
| <b>Total Investments 147.5% (Cost \$500,240,935)</b>             |              | <b>726,472,231</b>    |
| <b>Credit Facility (42.5)%<sup>(2)</sup></b>                     |              | <b>(209,300,000)</b>  |
| <b>Other Assets and Liabilities (5.0)%</b>                       |              | <b>(24,502,217)</b>   |
| <b>Total Net Assets Applicable to Common Shareholders 100.0%</b> |              | <b>\$ 492,670,014</b> |

All percentages disclosed are calculated by dividing the indicated amounts by net assets applicable to common shareholders.

- (1) All or a portion of these securities are held by Salient Midstream & MLP Fund, Inc. (the "Subsidiary").
- (2) All or a portion of these securities are held as collateral for the line of credit agreements. As of November 30, 2014 the total fair value of securities held as collateral for the line of credit agreements is \$562,627,154.
- (3) Non-income producing security.
- (4) Distributions are paid-in-kind.
- (5) Restricted securities are exempt from registration under the Securities Act of 1933. The security may be resold in transactions exempt from registration, normally to qualified institutional buyers. See footnote 2(g) in the notes to consolidated financial statements for further information.
- (6) Securities have been fair valued in good faith using fair value procedures approved by the Board of Trustees and represent 7.6% of net assets applicable to common shareholders. See notes to consolidated financial statements for further information.
- (7) Security has been deemed illiquid by the Adviser based on procedures approved by the Board of Trustees and represents 4.1% of net assets applicable to common shareholders. See footnote 2(g) in the notes to consolidated financial statements for further information.
- (8) Affiliated investment for which ownership exceeds 25% of underlying fund's partners' capital. See footnote 2(h) in the notes to consolidated financial statements for further information.
- (9) Security exempt from registration under Rule 144A of the Securities Act of 1933. This security may be sold in transactions exempt from registration, normally to qualified institutional buyers. At November 30, 2014, the value of this security was \$1,835,000, representing 0.4% of net assets. This security has been deemed liquid based on procedures approved by the Board of Trustees.
- (10) A portion of this credit facility is maintained in the Subsidiary. See footnote 4 in the notes to consolidated financial statements for further information.

See accompanying Notes to Consolidated Financial Statements.

**SALIENT MIDSTREAM & MLP FUND**

**Consolidated Schedule of Investments, continued**

**November 30, 2014**

Salient Midstream & MLP Fund invested in the following industries as of November 30, 2014:

|   | <b>Value</b>          | <b>% of<br/>Total<br/>Investments</b> |
|---|-----------------------|---------------------------------------|
| Coal                                      | \$ 13,600,856         | 1.9%                                  |
| Crude/Natural Gas Production              | 17,035,184            | 2.3%                                  |
| Crude/Refined Products Pipelines          | 218,582,268           | 30.1%                                 |
| Electric Utilities                        | 14,470,300            | 2.0%                                  |
| Natural Gas Gathering/Processing          | 193,612,518           | 26.7%                                 |
| Natural Gas/Natural Gas Liquids Pipelines | 167,164,072           | 23.0%                                 |
| Oil & Gas Drilling                        | 712,421               | 0.1%                                  |
| Oil, Gas & Consumable Fuels               | 10,837,135            | 1.5%                                  |
| Shipping                                  | 51,477,779            | 7.0%                                  |
| Transportation Infrastructure             | 38,979,698            | 5.4%                                  |
| <b>Total</b>                              | <b>\$ 726,472,231</b> | <b>100.0%</b>                         |

Salient Midstream & MLP Fund invested in securities with exposure to the following countries as of November 30, 2014:

|                                  | <b>Value</b>          | <b>% of<br/>Total<br/>Investments</b> |
|----------------------------------|-----------------------|---------------------------------------|
| Bermuda                          | \$ 34,897,673         | 4.8%                                  |
| Republic of the Marshall Islands | 20,690,780            | 2.8%                                  |
| United Kingdom                   | 9,514,592             | 1.3%                                  |
| United States                    | 661,369,186           | 91.1%                                 |
| <b>Total</b>                     | <b>\$ 726,472,231</b> | <b>100.0%</b>                         |

See accompanying Notes to Consolidated Financial Statements.

## SALIENT MIDSTREAM &amp; MLP FUND

## Consolidated Statement of Assets, Liabilities and Shareholders Equity

November 30, 2014

|  |                       |
|--|-----------------------|
| <b>Assets:</b>   |                       |
| Investments at fair value (cost \$500,240,935)   | \$ 726,472,231        |
| Cash and cash equivalents  | 15,275,209            |
| Dividends and interest receivable  | 281,769               |
| Deferred tax asset   | 12,315,829            |
| Receivable from investments sold   | 2,956,095             |
| Variation margin on futures contracts  | 113,120               |
| Prepays and other assets   | 42,531                |
| <b>Total assets</b>  | <b>757,456,784</b>    |
| <b>Liabilities:</b>  |                       |
| Credit facility  | 209,300,000           |
| Payable for investments purchased  | 16,530,717            |
| Payable to Adviser   | 699,920               |
| Interest payable   | 68,969                |
| Trustee fees payable   | 4,629                 |
| Line of credit fees payable  | 1,316                 |
| Accounts payable and accrued expenses  | 598,190               |
| Deferred tax liability   | 37,583,029            |
| <b>Total liabilities</b>   | <b>264,786,770</b>    |
| Net assets applicable to common shareholders   | \$ 492,670,014        |
| <b>Net Assets Applicable to Common Shareholders:</b>   |                       |
| Capital Stock, \$0.01 par value; 17,722,449 shares issued and outstanding<br>(unlimited shares authorized) | \$ 177,224            |
| Paid-in capital  | 307,945,535           |
| Accumulated net investment loss  | (2,317,996)           |
| Accumulated net realized loss  | (1,783,016)           |
| Net unrealized appreciation on investments   | 188,648,267           |
| <b>Net assets applicable to common shareholders</b>  | <b>\$ 492,670,014</b> |
| <b>Net Asset Value:</b>  |                       |
| Net assets applicable to common shareholders   | \$ 492,670,014        |
| Common shares outstanding  | 17,722,449            |
| <b>Net asset value per common share outstanding</b>  | <b>\$ 27.80</b>       |

See accompanying Notes to Consolidated Financial Statements.

## SALIENT MIDSTREAM &amp; MLP FUND

## Consolidated Statement of Operations

Year Ended November 30, 2014

|  |                    |
|--|--------------------|
| <b>Investment Income:</b>  |                    |
| Distributions from master limited partnerships   | \$ 13,409,585      |
| Less return of capital on distributions  | (12,781,929)       |
| Net distributions from master limited partnerships   | 627,656            |
| Dividends from master limited partnership related companies  | 4,215,485          |
| Interest income  | 15,364             |
| <b>Total Investment Income</b>   | <b>4,858,505</b>   |
| <b>Operating Expenses:</b>   |                    |
| Investment management fees   | 5,009,459          |
| Administration fees  | 162,343            |
| Custodian fees   | 25,716             |
| Interest expense   | 1,118,203          |
| Line of credit commitment fees   | 12,947             |
| Professional fees  | 325,450            |
| Trustees fees  | 120,409            |
| Other expenses   | 453,482            |
| <b>Total Expenses</b>  | <b>7,228,009</b>   |
| Less expenses reimbursed by the Adviser  | (373,713)          |
| <b>Net Expenses</b>  | <b>6,854,296</b>   |
| <b>Net Investment Loss, before Income Taxes</b>  | <b>(1,995,791)</b> |
| Deferred tax benefit   | (140,385)          |
| <b>Net Investment Loss</b>   | <b>(1,855,406)</b> |
| <b>Realized and Unrealized Gain (Loss):</b>  |                    |
| Net realized gain on investments   | 9,369,820          |
| Net realized loss on written options contracts   | (566,135)          |
| Net realized loss on futures contracts   | (2,411,496)        |
| Net realized loss on swap agreements   | (9,509,946)        |
| Net realized loss, before income taxes   | (3,117,757)        |
| Deferred tax benefit   | (4,846,492)        |
| Net realized gain, net of income taxes   | 1,728,735          |
| Change in unrealized appreciation/depreciation from investments, written options contracts, futures contracts and swap agreements, before income taxes | 50,245,719         |
| Deferred tax expense   | 7,149,507          |
| Change in unrealized appreciation/depreciation from investments, written options contracts, futures contracts and swap agreements, net of income taxes | 43,096,212         |

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|  |                      |
|--|----------------------|
| <b>Net Realized and Unrealized Gain from Investments, Written Options Contracts, Futures Contracts and Swap Agreements</b> | 44,824,947           |
| <b>Net Increase in Net Assets Applicable to Common Shareholders Resulting from Operations</b>                              | <b>\$ 42,969,541</b> |

See accompanying Notes to Consolidated Financial Statements.

## SALIENT MIDSTREAM &amp; MLP FUND

## Consolidated Statements of Changes in Net Assets

|  | Year Ended<br>November 30, 2014 | Year Ended<br>November 30, 2013 |
|--|---------------------------------|---------------------------------|
| <b>Operations:</b>   |                                 |                                 |
| Net investment loss, net of income taxes   | \$ (1,855,406)                  | \$ (1,005,904)                  |
| Net realized gain, net of income taxes   | 1,728,735                       | 8,880,958                       |
| Change in unrealized appreciation/depreciation, net of income taxes  | 43,096,212                      | 51,549,869                      |
| <b>Net increase in net assets applicable to common shareholders resulting from operations</b>                  | <b>42,969,541</b>               | <b>59,424,923</b>               |
| <b>Distributions:</b>  |                                 |                                 |
| In excess of net investment income   | (13,327,520) <sup>(1)</sup>     | (8,150,649)                     |
| Return of capital  | (3,620,853)                     | (4,825,706)                     |
| <b>Total distributions to common shareholders</b>  | <b>(16,948,373)</b>             | <b>(12,976,355)</b>             |
| <b>Capital Shares Transactions:</b>  |                                 |                                 |
| Issuance of 8,222,798 and 0 common shares from merger (Note 11), respectively                                  | 235,891,358                     |                                 |
| Issuance of 0 and 29,119 common shares from reinvestment of distributions to common shareholders, respectively |                                 | 624,121                         |
| <b>Net increase in net assets applicable to common shareholders from capital transactions</b>                  | <b>235,891,358</b>              | <b>624,121</b>                  |
| <b>Total increase in net assets applicable to common shareholders</b>  | <b>261,912,526</b>              | <b>47,072,689</b>               |
| <b>Net Assets:</b>   |                                 |                                 |
| Beginning of period  | 230,757,488                     | 183,684,799                     |
| <b>End of period</b>   | <b>\$ 492,670,014</b>           | <b>\$ 230,757,488</b>           |
| Accumulated net investment loss  | \$ (2,317,996)                  | \$ (194,149)                    |

- (1) Distributions include \$3.4 million in distributions to Salient MLP & Energy Infrastructure Fund shareholders of record as of November 13, 2014.

See accompanying Notes to Consolidated Financial Statements.

## SALIENT MIDSTREAM &amp; MLP FUND

## Consolidated Statement of Cash Flows

Year Ended November 30, 2014

|   |                |
|---|----------------|
| <b>Cash flows from operating activities:</b>  |                |
| Net increase in net assets resulting from operations  | \$ 42,969,541  |
| Adjustments to reconcile net increase in net assets resulting from operations to net cash provided by operating activities: |                |
| Purchases of investments  | (194,378,870)  |
| Proceeds from disposition of investments  | 199,404,546    |
| Return of capital on distributions from master limited partnerships   | 12,781,929     |
| Cash proceeds from merger   | 2,916,958      |
| Premiums from written call options  | 1,812,926      |
| Proceeds paid to cover written call options   | (2,251,949)    |
| Premiums paid on exercised written call options   | (127,112)      |
| Net realized gain on investments  | (9,369,820)    |
| Net realized loss on written options contracts  | 566,135        |
| Change in unrealized appreciation/depreciation from investments   | (50,245,719)   |
| Change in operating assets and liabilities:   |                |
| Dividends and interest receivable   | 266,895        |
| Deferred tax asset  | (11,307,415)   |
| Receivable from investments sold  | 5,176,505      |
| Variation margin on futures contracts   | (113,120)      |
| Prepays and other assets  | 26,350         |
| Payable for investments purchased   | 13,267,552     |
| Line of credit fees payable   | 73             |
| Payable to Adviser  | 423,554        |
| Trustee fees payable  | 4,629          |
| Interest payable  | (16,220)       |
| Accounts payable and accrued expenses   | (286,979)      |
| Deferred tax liability  | 13,470,046     |
| Net cash provided by operating activities   | 24,990,435     |
| <b>Cash flows from financing activities:</b>  |                |
| Advances from credit facility   | 362,600,000    |
| Repayments on credit facility   | (357,700,000)  |
| Distributions paid to common shareholders, net of reinvestments   | (16,948,373)   |
| Net cash used in financing activities   | (12,048,373)   |
| Net increase in cash and cash equivalents   | 12,942,062     |
| Cash and cash equivalents at beginning of year  | 2,333,147      |
| Cash and cash equivalents at end of year  | \$ 15,275,209  |
| <b>Supplemental schedule of cash activity:</b>  |                |
| Cash paid for interest during the year  | \$ 1,134,423   |
| Cash paid for non-use fees during the year  | 12,874         |
| <b>Supplemental schedule of non-cash activity:</b>  |                |
| Non-cash proceeds from common shares issued in merger (Note 11)   | \$ 232,974,400 |
| Distributions received in-kind  | 2,964,423      |

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See accompanying Notes to Consolidated Financial Statements.



## SALIENT MIDSTREAM &amp; MLP FUND

## Consolidated Financial Highlights

|   | Year Ended<br>November 30, 2014 | Year Ended<br>November 30, 2013 | Period from<br>May 24, 2012 <sup>(1)</sup><br>through<br>November 30, 2012 |
|---|---------------------------------|---------------------------------|--|
| <b>Per Common Share Data:<sup>(2)</sup></b>   |                                 |                                 |  |
| Net Asset Value, beginning of period  | \$ 24.29                        | \$ 19.40                        | \$ 20.00   |
| <b>Income from Investment Operations:</b>   |                                 |                                 |  |
| Net investment income (loss) <sup>(3)</sup>   | (0.19)                          | (0.11)                          | 0.01   |
| Net realized and unrealized gain from investments                                     | 5.15                            | 6.37                            | 1.00   |
| Net increase resulting from operations  | 4.96                            | 6.26                            | 1.01   |
| <b>Distributions paid from:</b>   |                                 |                                 |  |
| In excess of net investment income  | (1.14)                          | (0.86)                          |  |
| Return of capital   | (0.31)                          | (0.51)                          | (0.66)   |
| Underwriting discounts and offering costs on issuance of common shares <sup>(4)</sup> |                                 |                                 | (0.95)   |
| Net Asset Value, end of period  | \$ 27.80                        | \$ 24.29                        | \$ 19.40   |
| Per common share market value, end of period  | \$ 26.20                        | \$ 22.78                        | \$ 19.54   |
| Total Investment Return Based on Market Value <sup>(5)(6)</sup>                       | 21.30%                          | 23.79%                          | 1.13%  |
| <b>Ratios to Average Net Assets:<sup>(7)</sup></b>                                    |                                 |                                 |  |
| Net investment income (loss)  | (0.66)%                         | (0.47)%                         | 0.11%  |
| Gross operating expenses  | 3.34%                           | 5.44%                           | 4.94%  |
| Net operating expenses <sup>(8)</sup>   | 3.21%                           | 5.14%                           | 4.69%  |
| Net operating expenses (excluding deferred income tax benefit/expense) <sup>(8)</sup> | 2.44%                           | 2.25%                           | 2.22%  |
| <b>Supplemental Data:</b>   |                                 |                                 |  |
| Net assets applicable to common shareholders, end of period (000s)                    | \$ 492,670                      | \$ 230,757                      | \$ 183,685   |
| Average net assets (000s)   | \$ 280,809                      | \$ 214,892                      | \$ 184,441   |
| Portfolio turnover <sup>(5)</sup>   | 46.39% <sup>(9)</sup>           | 74.87%                          | 47.73%   |
| Asset coverage per \$1,000 unit of senior indebtedness <sup>(10)</sup>                | 3,354                           | 3,187                           | 3,443  |
| Short-term borrowings, end of period (000s)   | \$ 209,300                      | \$ 105,500                      | \$ 75,200  |

(1) Commencement of operations.

(2) Information presented relates to a common share outstanding for periods indicated.

(3) Per share net investment income (loss) has been calculated using the average daily shares method.

(4) Represents the dilution per common share from underwriting and other offering costs for the period.

(5) Not annualized for periods less than one year.

(6) Total investment return is calculated assuming a purchase of common shares at the current market price on the first day of the period and a sale at the closing market price on the last day of the period reported (excluding brokerage commissions). Dividends and distributions are assumed for the purpose of this calculation to be reinvested at prices obtained under the DRIP.

(7) Annualized for periods less than one year.

(8) The amount includes an investment adviser waiver representing 0.13%, 0.30% and 0.25% for the periods ended November 30, 2014, November 30, 2013 and November 30, 2012, respectively, to the expense ratios. Without this waiver, the expense ratios would be

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higher.

- (9) In connection with the reorganization of the Salient MLP & Energy Infrastructure Fund into the Salient Midstream & MLP Fund, no purchases or sales occurred in an effort to realign the combined fund's portfolio after the merger, and therefore none have been excluded from the portfolio turnover calculation. The value of investments acquired in the reorganization, which have been excluded from purchases in the portfolio turnover calculation, is \$337,519,725.
- (10) Calculated by subtracting the Fund's total liabilities (not including borrowings) from the Fund's total assets and dividing by the total number of senior indebtedness units, where one unit equals \$1,000 of senior indebtedness.

See accompanying Notes to Consolidated Financial Statements.

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**SALIENT MIDSTREAM & MLP FUND**

**Notes to Consolidated Financial Statements**

**November 30, 2014**

**(1) ORGANIZATION**

Salient Midstream & MLP Fund (the Fund), a Delaware statutory trust registered under the Investment Company Act of 1940, as amended (the 1940 Act), commenced operations on May 24, 2012 as a non-diversified, closed-end management investment company. The Fund is authorized to issue an unlimited number of common shares of beneficial interest ( Common Shares ), which may be issued in more than one class or series. The Fund's Common Shares are listed on the New York Stock Exchange ( NYSE ) under the symbol SMM .

The Fund's objective is to provide a high level of total return with an emphasis on making quarterly cash distributions to its common shareholders. The Fund seeks to achieve its investment objective by investing at least 80% of its total assets in securities of midstream companies and master limited partnerships ( MLPs ).

The board of trustees (each member thereof a Trustee and, collectively the Board) is authorized to engage an investment adviser, and pursuant to an investment management agreement (the Investment Management Agreement), it has selected Salient Capital Advisors, LLC (the Adviser) to manage the Fund's portfolio and operations. The Adviser is a Texas limited liability company that is registered as an investment adviser under the Investment Advisers Act of 1940, as amended. Under the Investment Management Agreement, the Adviser is responsible for the establishment of an investment committee (the Investment Committee), which is responsible for developing, implementing, and supervising the Fund's investment program subject to the ultimate supervision of the Board.

Under the Fund's organizational documents, the Fund's Trustees and officers are indemnified against certain liabilities arising out of the performance of their duties to the Fund. In the normal course of business, the Fund enters into contracts with service providers, which also provide for indemnifications by the Fund. The Fund's maximum exposure under these arrangements is unknown as this would involve any future potential claims that may be made against the Fund. However, based on experience, management expects that risk of loss to be remote.

The Fund may invest up to 25% of its total assets in Salient Midstream & MLP Fund, Inc., a wholly owned subsidiary (the Subsidiary). The Subsidiary, which is organized under the laws of the state of Delaware, is controlled by the Fund, and is therefore consolidated in the Fund's consolidated financial statements. The Fund invests in the Subsidiary in order to gain additional exposure to the investment returns of the MLP markets, within the limitations of the federal tax law requirements applicable to regulated investment companies ( RIC ). Where the context requires, the Fund includes both the Fund and the Subsidiary.

**(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND PRACTICES**

**(a) BASIS OF ACCOUNTING**

The consolidated financial statements have been prepared in conformity with generally accepted accounting principles in the United States of America ( U.S. GAAP ). The accompanying consolidated financial statements reflect the financial position of the Fund and its Subsidiary and the results of their operations on a consolidated basis. All intercompany accounts and transactions have been eliminated in consolidation. The Fund is an investment company and follows the investment company accounting and reporting guidance under Financial Accounting Standards Board ( FASB ) Accounting Standards Codification ( ASC ) Topic 946, Financial Services-Investment Companies .

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**SALIENT MIDSTREAM & MLP FUND**

**Notes to Consolidated Financial Statements, continued**

**November 30, 2014**

***(b) CASH EQUIVALENTS***

The Fund considers all unpledged temporary cash investments with a maturity date at the time of purchase of three months or less to be cash equivalents.

***(c) PORTFOLIO SECURITIES TRANSACTIONS***

Security transactions are accounted for on a trade date basis. Realized gains and losses are reported using the specific identification cost basis.

***(d) INVESTMENT VALUATION***

The valuation of the Fund's investments is determined each day based on the most recent close of regular session trading on the NYSE and reported by Citi Fund Services Ohio, Inc., the Fund's independent administrator ( Administrator ).

The Board has formed a valuation committee (the Board Valuation Committee ) that is responsible for overseeing the Fund's valuation policies, making recommendations to the Board on valuation-related matters, and overseeing implementation by the Adviser of the Fund's valuation policies.

The Board has authorized the Adviser to establish a valuation committee of the Adviser ( Adviser Valuation Committee ). The Adviser Valuation Committee's function, subject to oversight of the Board Valuation Committee and the Board, is generally to review the Fund's valuation methodologies, valuation determinations, and any information provided to the Adviser Valuation Committee by the Adviser or the Administrator.

To the extent that the price of a security cannot be determined applying the methods described below, the Adviser Valuation Committee in conjunction with the Administrator will determine the price of the security pursuant to the fair value procedures approved by the Board.

Investments held by the Fund are valued as follows:

**SECURITIES LISTED ON A SECURITIES EXCHANGE OR OVER-THE-COUNTER EXCHANGES** In general, the Fund values those securities at their last sales price on the exchange or over-the-counter market on the valuation date. If the security is listed on more than one exchange, the Fund uses the price from the exchange that it considers to be the principal exchange on which the security is traded. If there have been no sales for that day on the exchange where the security is principally traded, then the price of the security will be valued at the mean between the closing bid and ask prices on the valuation date. Securities listed on the NASDAQ National Market System ( NASDAQ ) will be valued at the NASDAQ Official Closing Price on the valuation date, which may not necessarily represent the last sale price.

**PUBLICLY-TRADED EQUITY SECURITIES ACQUIRED IN A DIRECT PLACEMENT TRANSACTION** Such securities may be subject to restrictions on resale that can affect the security's liquidity and fair value. Such securities that are convertible or otherwise will become freely tradable will be valued based on the market value of the freely tradable security less an applicable restriction discount. Generally, the discount will initially be equal to the discount at which the Fund purchased the securities and thereafter will be periodically reassessed and likely reduced over the anticipated restricted period. Equity securities are typically categorized as Level 1 or Level 2 in the fair value hierarchy, based upon inputs utilized in determining the value of such securities.

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**SALIENT MIDSTREAM & MLP FUND**

**Notes to Consolidated Financial Statements, continued**

**November 30, 2014**

**DERIVATIVES** Exchange traded futures contracts are valued using quoted final settlement prices from the national exchange on which they are principally traded and are typically categorized as Level 1 in the fair value hierarchy. If no such price is reported by such exchange on the valuation date, the Adviser Valuation Committee will determine the fair value in good faith using information that is available at such time. Such fair valued investments are typically categorized as Level 2 or Level 3 in the fair value hierarchy, based upon the inputs used to value the investments.

Options that are listed on a securities exchange are generally valued at the midpoint of closing bid and ask prices for options held long and short, respectively on the valuation date and are typically categorized as Level 1 in the fair value hierarchy. If no such bid or ask price is reported, the positions are valued at the last sales price on the valuation date. If no such sales price is reported by such exchange on the valuation date, the Adviser Valuation Committee in conjunction with the Administrator will determine the fair value in good faith using information that is available at such time. Such fair valued investments are typically categorized as Level 2 or Level 3 in the fair value hierarchy, based upon the inputs used to value the investments.

Options traded on an over-the-counter market are generally valued using the midpoint of the closing bid and ask prices provided by an independent pricing service. If a quotation is not available from the independent pricing service, the price is obtained from a broker (typically the counterparty to the option) on the valuation date. If no such price is available on the valuation date, the Adviser Valuation Committee in conjunction with the Administrator will determine the fair value of such options in good faith using information that is available at such time. Such fair valued options are typically categorized as Level 2 or Level 3 in the fair value hierarchy, based upon the inputs used to value the investments.

Non exchange-traded derivatives, such as swap agreements, are valued based on procedures approved by the Board and are typically categorized as Level 2 in the fair value hierarchy. Credit default swaps and total return swaps are generally fair valued using evaluated quotes provided by an independent pricing service. If a quotation is not available from the independent pricing service, the price is obtained from a broker (typically the counterparty to the swap agreement) on the valuation date.

**SECURITIES NOT ACTIVELY TRADED** The value of securities, derivatives or synthetic securities that are not actively traded on an exchange are determined by obtaining quotes from brokers that normally deal in such securities or by an unaffiliated pricing service that may use actual trade data or procedures using market indices, matrices, yield curves, specific trading characteristics of certain groups of securities, pricing models or a combination of these procedures. In each of these situations, valuations are typically categorized as Level 2 in the fair value hierarchy. Securities for which independent pricing services are not available are valued pursuant to the valuation procedures approved by the Board and are typically categorized as Level 2 or Level 3 in the fair value hierarchy, based upon the inputs used to value the investments.

**INVESTMENT FUNDS** Investments in investment limited partnerships and shares in unregistered investment funds ( Investment Funds ) for which a market value is not available will generally be valued using the partners' capital or net asset value (the NAV ) as a practical expedient, as reported by the Investment Fund managers or the administrators of such Investment Funds. These Investment Funds value their underlying investments in accordance with policies established by such Investment Funds. Prior to investing in any Investment Fund, the Adviser Valuation Committee, as part of the due diligence process, conducts a review of the valuation

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**SALIENT MIDSTREAM & MLP FUND**

**Notes to Consolidated Financial Statements, continued**

**November 30, 2014**

methodologies employed by the Investment Fund to determine whether such methods are appropriate for the asset types. The Adviser Valuation Committee will consider whether it is appropriate, in light of the relevant circumstances, to value shares at NAV as reported by an Investment Fund for valuation purposes, or whether to adjust such reported value to reflect an adjusted fair value. Because of the inherent uncertainty of valuation, fair value may differ significantly from the value that would have been used had readily available markets for the investments in Investment Funds existed. The Fund's investments in Investment Funds are subject to the terms and conditions of the respective operating agreements and offering memoranda of such Investment Funds. Investment Funds are typically categorized as Level 2 or Level 3 in the fair value hierarchy based upon liquidity.

**OTHER** Investments in private placement securities and other securities for which market quotations are not readily available will be valued in good faith by using fair value procedures approved by the Board. Such fair value procedures may consider among other factors discounts to publicly traded issues, time until conversion date, securities with similar yields, quality, type of issue, coupon, duration and rating, and an analysis of the issuer's financial statements and reports. If events occur that affect the value of the Fund's securities before the net asset value has been calculated, the securities so affected will generally be priced using fair value procedures. Such investments are typically categorized as Level 2 or Level 3 in the fair value hierarchy, based upon the inputs used to value the investments.

***(e) FOREIGN CURRENCY***

The accounting records of the Fund are maintained in U.S. dollars. Foreign currency amounts and investments denominated in a foreign currency, if any, are translated into U.S. dollar amounts at current exchange rates on the valuation date. Purchases and sales of investments denominated in foreign currencies are translated into U.S. dollar amounts at the exchange rate on the respective dates of such transactions. The Fund does not isolate the portion of the results of operations resulting from changes in foreign exchange rates on investments from fluctuations arising from changes in market prices of securities held. Such fluctuations are included with the net realized gain on investments.

***(f) MASTER LIMITED PARTNERSHIPS***

Entities commonly referred to as MLPs are generally organized under state law as limited partnerships or limited liability companies. The Fund and Subsidiary invest in MLPs receiving partnership taxation treatment under the Internal Revenue Code of 1986, as amended (the "Code"), and whose interests or units are traded on securities exchanges like shares of corporate stock. To be treated as a partnership for U.S. federal income tax purposes, an MLP whose units are traded on a securities exchange must receive at least 90% of its income from qualifying sources such as interest, dividends, real property rents, gains on dispositions of real property, income and gains from mineral or natural resources activities, income and gains from the transportation or storage of certain fuels, and, in certain circumstances, income and gains from commodities or futures, forwards and options on commodities. Mineral or natural resources activities include exploration, development, production, processing, mining, refining, marketing and transportation (including pipelines) of oil and gas, minerals, geothermal energy, fertilizer, timber or industrial source carbon dioxide. An MLP consists of a general partner and limited partners (or in the case of MLPs organized as limited liability companies, a managing member and members).

The general partner or managing member typically controls the operations and management of the MLP and has an ownership stake in the partnership or limited liability company. The limited partners or members, through

## SALIENT MIDSTREAM &amp; MLP FUND

## Notes to Consolidated Financial Statements, continued

November 30, 2014

their ownership of limited partner or member interests, provide capital to the entity, are intended to have no role in the operation and management of the entity and receive cash distributions. The Fund's investments in MLPs consist only of limited partner or member interests ownership. The MLPs themselves generally do not pay U.S. federal income taxes. Thus, unlike investors in corporate securities, direct MLP investors are generally not subject to double taxation (i.e., corporate level tax and tax on corporate dividends). Currently, most MLPs operate in the energy and/or natural resources sector.

**(g) RESTRICTED AND ILLIQUID SECURITIES**

The Fund may invest up to 30% of its total assets in unregistered or otherwise restricted securities of which up to 10% may be in securities of privately held companies. A restricted security is a security which has been purchased through a private offering and cannot be resold to the general public without prior registration under the Securities Act of 1933 (the "1933 Act") or pursuant to the resale limitations provided by Rule 144 under the 1933 Act, or an exemption from the registration requirements of the 1933 Act. Illiquid securities are securities that cannot be sold or disposed of within a reasonable amount of time in the ordinary course of business. Certain restricted securities may be resold in transactions exempt from registration, normally to qualified institutional buyers, and may be deemed liquid by the Adviser based on procedures approved by the Board. Therefore, not all restricted securities are considered illiquid.

The restricted securities held at November 30, 2014 are identified below and are also presented in the Fund's Consolidated Schedule of Investments.

| Security                                | % of<br>Net Assets | Acquisition<br>Date | Total Cost    | Shares/<br>Units | Fair Value    |
|---|--------------------|---------------------|---------------|------------------|---------------|
| EMG Utica I Offshore Co-Investment, LP* | 2.3%               | 2/22/13             | \$ 9,000,000  | 9,000,000        | \$ 11,317,500 |
| EMG Utica I Offshore Co-Investment, LP* | 1.8%               | 2/22/13             | 7,000,000     | 7,000,000        | 8,802,500     |
| NGL Energy Partners LP**                | 0.3%               | 6/12/14             | 1,473,000     | 37,500           | 1,267,125     |
| NGL Energy Partners LP**                | 0.1%               | 6/13/14             | 667,760       | 17,000           | 574,430       |
| Teekay Offshore Partners L.P.**         | 3.1%               | 11/24/14            | 15,254,432    | 584,461          | 15,254,432    |
| Total                                   | 7.6%               |                     | \$ 33,395,192 | \$ 16,638,961    | \$ 37,215,987 |

\* Security has been deemed illiquid by the Adviser based on procedures approved by the Board.

\*\* Securities have been deemed liquid by the Adviser based on procedures approved by the Board.

**(h) AFFILIATED INVESTMENT FUNDS**

The 1940 Act defines affiliates as those issuers in which a fund holds 5% or more of the outstanding voting securities, but the fund does not own enough of the outstanding voting securities of the issuer to have control (as defined by the 1940 Act) of that issuer. The following is a summary of the investments in other affiliates for the year ended November 30, 2014:

| Security                                 | Balance<br>November 30,<br>2013 | Gross<br>Purchases | Proceeds<br>from Sales | Net Realized<br>Gain (Loss) on<br>Investments | Change in<br>Unrealized<br>Appreciation/<br>Depreciation | Balance<br>November 30,<br>2014 |
|--|---------------------------------|--------------------|------------------------|---|--|---------------------------------|
| EMG Utica I Offshore Co-Investment, L.P. | \$ 9,538,200                    | \$ 8,771,000       | \$                     | \$  | \$ 1,810,800   | \$ 20,120,000                   |





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**SALIENT MIDSTREAM & MLP FUND**

**Notes to Consolidated Financial Statements, continued**

**November 30, 2014**

As of the effective date of the Fund's acquisition of SMF (see note 11), the Fund owns 100% of EMG Utica I Offshore Co-Investment, L.P. (EMG Utica). EMG Utica holds a non-controlling underlying interest in MarkWest Utica EMG, L.L.C., which is a joint venture between MarkWest Energy Partners, L.P. (MarkWest) and The Energy and Minerals Group (EMG). MarkWest is a U.S. domiciled publicly traded master limited partnership in the natural gas gathering, processing and transportation business. EMG is a private investment firm that targets equity investments in the energy and minerals sector. The Fund has included EMG Utica as an investment at fair value in its Consolidated Statement of Assets, Liabilities and Shareholders' Equity (see note 3) and has not consolidated operations of EMG Utica for the 16 days in which the Fund owned 100% of EMG Utica. EMG Utica's investments are recorded at fair value by primarily utilizing a discounted cash flow model as well as market comparable companies and transactions. These methodologies utilize unobservable inputs and as such are considered Level 3 in the fair value hierarchy.

**(i) INVESTMENT INCOME**

Interest income is recognized on the accrual basis. Distributions are recorded on the ex-dividend date. Distributions received from the Fund's investments in MLPs generally are composed of ordinary income, capital gains and return of capital from the MLPs.

**(j) USE OF ESTIMATES**

The consolidated financial statements have been prepared in conformity with U.S. GAAP, which requires management to make estimates and assumptions relating to the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of income and expenses during the reporting period. Actual results may differ from those estimates and such differences may be significant.

**(k) DERIVATIVE INSTRUMENTS**

The Fund may invest in derivatives in order to meet its investment objectives. The risk in using derivatives varies depending upon the structure of the instruments. All open derivative positions at period end, if any, are presented in the Fund's Consolidated Schedule of Investments. The following is a description of the derivative instruments that the Fund has utilized as part of its investment strategy, including the primary underlying risk exposures related to each instrument type.

**OPTIONS** The Fund may write equity call options with the purpose of generating realized gains from premiums as a means to enhance distributions to the Fund's common shareholders. Options are secured by investments, as detailed in the Fund's Consolidated Schedule of Investments. A call option on a security is a contract that gives the holder of such call option the right to buy the security underlying the call option from the writer of such call option at a specified price at any time during the term of the option. At the time the call option is sold, the writer of a call option receives a premium from the buyer of such call option. If the Fund writes a call option, it will have the obligation upon exercise of such call option to deliver the underlying security upon payment of the exercise price. As the writer of a covered call option, during the option's life, the Fund gives up the opportunity to profit from increases in the market value of the security covering the call option above the sum of the premium and the strike price of the call, but the Fund retains the risk of loss should the price of the underlying security decline.

## SALIENT MIDSTREAM &amp; MLP FUND

## Notes to Consolidated Financial Statements, continued

November 30, 2014

The Fund had the following transactions in written call options during the year ended November 30, 2014:

|  | Number of<br>Contracts | Premiums    |
|--|------------------------|-------------|
| Written options outstanding at November 30, 2013 |                        | \$          |
| Options written                                  | 24,241                 | 1,812,926   |
| Options exercised                                | (5,371)                | (127,112)   |
| Options expired                                  | (1,085)                | (67,260)    |
| Options closed                                   | (17,785)               | (1,618,554) |
| Written options outstanding at November 30, 2014 |                        | \$          |

**FUTURES CONTRACTS** The Fund may invest in futures contracts as a part of its hedging strategy to manage exposure to interest rate, equity and market price movements, and commodity prices. A futures contract represents a commitment for the future purchase or sale of an asset at a specified price on a specified date. The underlying asset is not physically delivered. Futures contracts are valued at their quoted daily settlement prices. Upon entering into a futures contract, the Fund is required to segregate liquid assets in accordance with the initial margin requirements of the clearinghouse to secure the Fund's performance. The clearinghouse also requires daily settlement of variation margin representing changes in the value of each contract. Fluctuations in the value of the contracts are recorded as unrealized appreciation (depreciation) until the contracts are closed, when they are recorded as net realized gain (loss) on futures contracts. The primary risks associated with the use of futures contracts are imperfect correlation between changes in fair values of the underlying assets and the prices of futures contracts, and the possibility of an illiquid market. Counterparty risk involving futures is mitigated because a regulated clearinghouse is the counterparty.

**SWAP AGREEMENTS** The Fund may invest in swap agreements, primarily total return swap agreements, in connection with its hedging strategy to manage market risks.

A total return swap agreement is a bilateral financial contract agreement where one party (the payer) agrees to pay the other (the receiver) the total return on a specified asset or index in exchange for a fixed or floating rate of return. A total return swap agreement allows the receiver or payer to derive the economic benefit of owning or having short exposure to an asset without owning or shorting the underlying asset directly. The receiver is entitled to the amount, if any, by which the notional amount of the total return swap agreement would have increased in value had it been invested in the particular instruments, plus an amount equal to any dividends or interest that would have been received on those instruments. In return, the payer is entitled to an amount equal to a fixed or floating rate of interest (e.g., a LIBOR based rate) on the notional amount of the swap agreement plus the amount, if any, by which the notional amount would have decreased in value had it been invested in such instruments, less any dividends or interest. The amounts to which each party is entitled are normally netted against each other at periodic settlement dates, resulting in a single amount that is either due to or from each party.

A credit default swap agreement gives one party (the buyer) the right to recoup the economic value of a decline in the value of debt securities of the reference issuer if a credit event (a downgrade, bankruptcy or default) occurs. This value is obtained by delivering a debt security of the reference issuer to the party in return for a previously agreed upon payment from the other party (frequently, the par value of the debt security) or receive a net amount equal to the par value of the defaulted reference entity less its recovery value. The Fund is usually a net buyer of credit default swap agreements.

## SALIENT MIDSTREAM &amp; MLP FUND

## Notes to Consolidated Financial Statements, continued

November 30, 2014

The Fund as a buyer of a credit default swap agreement would have the right to deliver a referenced debt obligation and receive the par (or other agreed-upon) value of such debt obligation from the counterparty in the event of a default or other credit event by the reference issuer with respect to its debt obligations. In return, the Fund would pay the counterparty a periodic stream of payments over the term of the agreement provided that no event of default or other credit event has occurred. If no default or other credit event occurs, the counterparty would keep the stream of payments and would have no further obligations to the Fund.

In addition to being exposed to the credit risk of the underlying reference entity, swap agreements are subject to counterparty risk, market risk and interest rate risk. Swap agreements utilized by the Fund may not perform as expected. Risks may arise as a result of the failure of the counterparty to perform under the agreement. The loss incurred by the failure of a counterparty is generally limited to the market value and premium amounts recorded. The Fund considers the creditworthiness of each counterparty to a swap agreement in evaluating potential credit risk, and will not enter into any swap agreement unless the Adviser believes the counterparty to the transaction is creditworthy. Additionally, risks may arise from the unanticipated movements in interest rates or in the value of the underlying reference assets. The Fund may use various techniques to minimize credit risk including early termination or reset and payment. Collateral, in the form of cash, is held in broker segregated accounts for swap agreements.

As of November 30, 2014, the Fund held no investments in derivative instruments.

The following is a summary of the effect of derivative instruments on the Consolidated Statement of Operations for the year ended November 30, 2014.

|                                 | Net Realized<br>Gain (Loss)<br>on Derivatives |
|---------------------------------|---|
| <b>Equity Risk Exposure:</b>    |   |
| Futures Contracts               | \$ (1,949,339)                                |
| Swap Agreements                 | (9,509,946)                                   |
| Written Call Options Contracts  | (566,135)                                     |
| <b>Commodity Risk Exposure:</b> |   |
| Futures Contracts               | (462,157)                                     |

The following is a summary of the average monthly notional value of written options, futures contracts and swap agreements during the year ended November 30, 2014.

|                              | Average Monthly<br>Notional Value | Notional Value<br>Outstanding at<br>November 30, 2014 |
|------------------------------|-----------------------------------|---|
| Written call options         | \$ 85,092                         | \$  |
| Futures contracts sold       | 26,342,850                        |   |
| Total return swap agreements | 16,609,467                        |   |

**(I) DISTRIBUTIONS TO SHAREHOLDERS**

The Fund intends to continue to comply with the requirements under Subchapter M of the Internal Revenue Code (the Code) in order to continue to qualify as a RIC. If so qualified, the Fund will not be subject to federal income tax to the extent it distributes substantially all of its net investment income and net capital gains to its shareholders.



**SALIENT MIDSTREAM & MLP FUND**