

# FS Credit Opportunities Corp.

## Summary

- Treasury volatility was relatively constrained to start the year before spiking to levels last seen during the global financial crisis upon the emergence of significant stress across regional U.S. and global banks.
- Credit markets turned higher during the quarter as Treasury yields declined across the curve. High yield bonds returned 3.7% and senior secured loans returned 3.1% during the first quarter.<sup>1,2</sup>
- FS Credit Opportunities Corp. (“FSCO” or the “Fund”) returned 2.6% during the quarter, on a net basis, underperforming the liquid high yield bonds and senior secured loans.<sup>1,2,3</sup>
- We expect to reinstate the amended and restated distribution reinvestment plan on May 16 following the listing of the third tranche of shares on the NYSE on May 15.

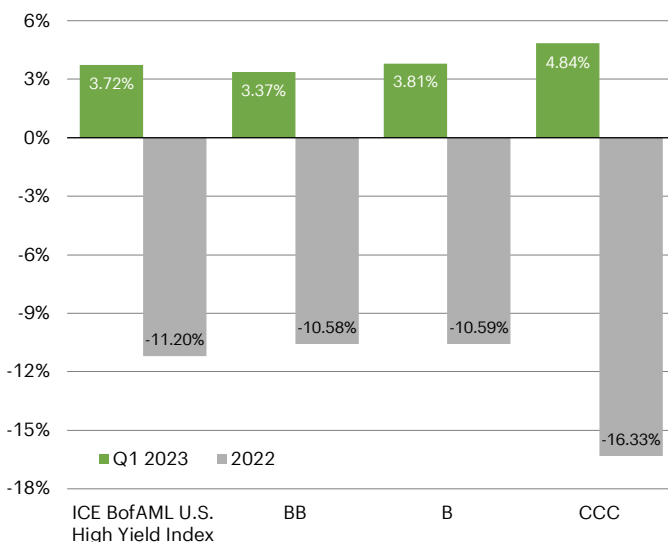
## Market review

Treasury volatility was relatively constrained to start the year before spiking to levels last seen during the global financial crisis upon the emergence of significant stress across regional U.S. and global banks. Despite persistently high inflation data during the quarter, 2-year Treasury yields fell as much as -130 basis points while the 10-year yield declined nearly -70 basis points as investors reset their expectations lower for the terminal Fed funds rate. Despite intra-quarter volatility, loan spreads widened just 15 basis points quarter-over-quarter while high yield spreads tightened over 30 basis points. Against this backdrop, high yield bonds returned 3.7% during the quarter while senior secured loans returned 3.1%.<sup>1,2</sup>

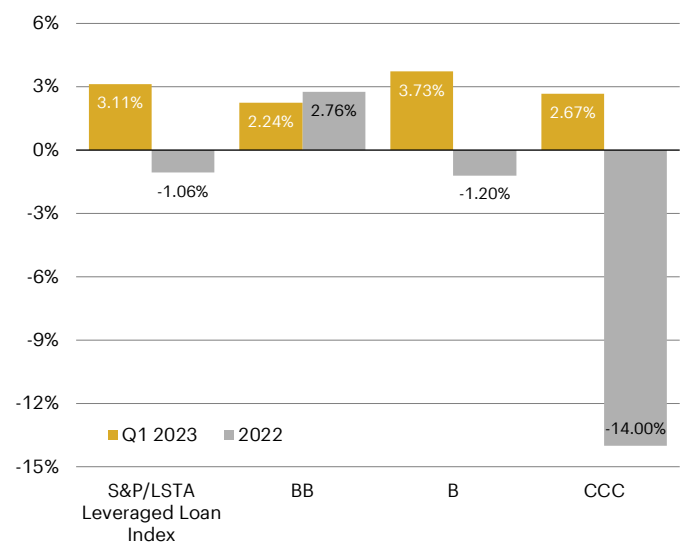
Despite the banking stress in March, lower-rated credit generally outperformed over the quarter as investors adjusted the defensive bias they maintained during much of last year as inflation continued to cool while economic data remained relatively resilient. CCC-rated bonds returned 4.8%, outperforming BB-rated bonds by 147 basis points. The loan market was more mixed as B-rated loans drove returns, outpacing both BB and CCC loans.<sup>5</sup>

## High yield bond and senior secured loan total returns by rating

### Bonds



### Loans



Source: ICE BofAML High Yield Master II Index, S&P/LSTA Leveraged Loan Index, as of March 31, 2023.

An investment in FS Credit Opportunities Corp. involves a high degree of risk and may be considered speculative. Investors are advised to consider the investment objectives, risks, and charges and expenses of the Fund carefully before investing. Investors should read and carefully consider all information found in the Fund’s reports filed with the U.S. Securities and Exchange Commission (the SEC) before investing.

**Since January 2018, the Fund has returned 4.33% on an annualized basis, outperforming the high yield bonds and loans by 160 bps and 65 bps per year, respectively, over the same period.<sup>1,2,3</sup>**

## Performance review

FSCO generated net investment income (NII) of \$0.18 per share during the first quarter of 2023. Consistent with our distribution policy of delivering a fully funded annualized distribution, the Fund's NII exceeded its distributions of \$0.15 per share. NII growth during the quarter was driven by the positive impact of rising interest rates and the continued strong performance of our portfolio. The Fund's net asset value increased approximately 0.2% during the quarter after accounting for distributions paid during the quarter.<sup>6</sup>

More broadly, we believe the steps we have taken since assuming full advisory and portfolio management functions of the Fund in January 2018 have helped diversify the portfolio and generate attractive returns for our investors. Since January 2018, the Fund has returned 4.33% on an annualized basis, outperforming the high yield bonds and loans by 160 bps and 65 bps, respectively, per year over the same period.<sup>1,2,3</sup>

<b>Total returns<sup>1,2,3,4,5</sup></b>	<b>Q1 2023</b>	<b>2022</b>
<b>FSCO*</b>	<b>2.6%</b>	<b>-10.7%</b>
<b>High yield bonds</b>	3.7%	-11.2%
<b>Senior secured loans</b>	3.1%	-1.06%
<b>CCC bonds</b>	4.8%	-16.3%
<b>CCC loans</b>	2.7%	-14.0%

\*FSCO's returns in green above are net of fees and expenses; index returns in black are gross of fees and expenses. All figures may be rounded. Returns shown are historical and based on past performance. **Past performance is not indicative of future results.**

## Investment activity

Net investment activity was nearly flat during the quarter with sales, exits and repayments of approximately \$74 million slightly outpacing purchases. Given the volatility in the broader markets, we selectively rotated out of unsecured debt positions into senior secured debt investments within the capital structures of a few portfolio companies. We also continued to focus on sourcing opportunistic private and public investments with an emphasis on senior secured debt and allocated across the following areas:

- **High quality, defensive investments:** We continue to defensively position the portfolio by adding what we believe are higher-quality investments that have low default risk and limited duration profiles yet pay an attractive level of current income in today's environment.
- **Public credit markets:** Within public credit, our focus is on event driven and opportunistic performing credit, as opposed to highly liquid credits commonly found in high yield funds and CLOs. For example, we have seen large price movements in what we believe are sound companies in out-of-favor sectors and companies in transition. These dislocations have provided us with attractive entry points.
- **Private structured solutions:** In private credit, our focus is on financings to unconventional credit profiles outside of the focus of banks, traditional BDCs, and other conventional lenders. Examples include transitional lending, lending to out of favor industries and companies, and non-sponsored lending. We believe our ability to structure highly customized solutions for our borrowers is differentiated in the marketplace and offers the potential for attractive total returns especially as regulatory restrictions limit bank lending to companies with conventional credit profiles, and private debt strategies become more streamlined with respect to investment terms and structures.

As of March 31, 2023, approximately 82% of the portfolio consisted of senior secured debt, unchanged from the previous quarter. The Fund's allocation to subordinated debt was 4% compared to 5% a quarter earlier. Asset-based finance represented 6% of the Fund as of March 31, 2023, while equity/other investments represented 8%. The portfolio has low average duration of just under one year, with 62% of the portfolio comprised by floating rate assets, compared to 63% as of December 31, 2022.

Heading into the second quarter, leverage and interest coverage for high yield bond and senior secured loan issues have mostly held steady, though margin pressure is evident and default rates have ticked up from historically low levels.

These metrics are inherently backward-looking, however, and the credit worthiness of borrowers will be dictated by future performance, which is hard to predict in uncertain economic environments such as today. As the economic environment evolves, swings in investor sentiment can change quickly, creating market volatility. We remain cautious about the economic outlook and see potential for future volatility and, therefore, are less invested than where we would be in a more benign environment. We think maintaining extra buying power is prudent not only to minimize potential drawdowns, but such volatility often creates dislocations that can create attractive investment opportunities for the Fund.

### **Listing update and post-listing liquidity**

FSCO listed its common stock on the New York Stock Exchange (NYSE) on November 14, 2022, through a direct listing. The Fund ranks as one of the largest credit-focused closed-end funds based on total assets in the market investing in public and private credit.

We expect to reinstate the amended and restated distribution reinvestment plan on May 16 following the listing of the third tranche of shares on the NYSE on May 15. Once the distribution reinvestment plan is reinstated, registered shareholders who elected to receive cash prior to the listing and still hold their shares with the Fund's transfer agent will continue to receive cash distributions.

**Note: All figures may be rounded. Returns shown are historical and based on past performance. Past performance is not indicative of future results. Effective March 23, 2022, the Fund has been renamed FS Credit Opportunities Corp. Prior to that date, the Fund operated under the name FS Global Credit Opportunities Fund.**

1. ICE BofAML U.S. High Yield Master II Index.
2. Credit Suisse Leveraged Loan Index.
3. The total return for each period presented is historical and is calculated by determining the percentage change in net asset value, assuming the reinvestment of all distributions in additional common shares of the Fund at the Fund's net asset value per share as of the share closing date occurring on or immediately following the distribution payment date. The total return does not consider the effect of the sales load from the sale of the Funds' common shares.
4. ICE BofAML U.S. High Yield CCC Rated or Below Index.
5. Credit Suisse CCC Rated Loan Index.
6. The payment of future distributions on FSCO's common shares is subject to the discretion of FSCO's board of directors and applicable legal restrictions and, therefore, there can be no assurance as to the amount or timing of any such future distributions.

#### **Risk factors**

FS Credit Opportunities Corp. ("FSCO" or the "Company") is a non-diversified, closed-end management investment company that carries out the investment strategies generally described herein. An investment in FSCO involves a high degree of risk and may be considered speculative. The following are some of the risks an investment in the shares of common stock of the Company (the "Shares") involves; however, investors should carefully consider all of the risks discussed in FSCO's reports filed with the U.S. Securities and Exchange Commission (the "SEC") before deciding to invest in the Shares. Investors may obtain a copy of these filings free of charge at [www.fsinvestments.com](http://www.fsinvestments.com) or by contacting FS Investments at 201 Rouse Boulevard, Philadelphia, PA 19112 or by phone at 877-628-8575.

- Shareholders of the Company (the "Shareholders") should consider that an investment in the Shares may result in loss of principal.
- When a Shareholder sells their Shares, the Shareholder may receive less than their purchase price and the then-current net asset value, or NAV, per Share.
- Shares of closed-end funds frequently trade at a discount to NAV and this creates a risk of loss for investors who purchased Shares at the time of listing on the New York Stock Exchange (the "Listing"). This risk is separate and distinct from the risk that FSCO's NAV will decrease.
- FSCO's distributions may be funded from unlimited amounts of offering proceeds or borrowings, which may constitute a return of capital and reduce the amount of capital available to FSCO for investment. Any capital returned to Shareholders through distributions will be distributed after payment of fees and expenses, as well as the sales load.
- FSCO's previous distributions to Shareholders were funded in significant part from the reimbursement of certain expenses, including through the waiver of certain investment advisory fees, and additional support payments that may be subject to repayment to FSCO's affiliate, Franklin Square Holdings, L.P. ("FS Investments"), and FSCO's future distributions may be funded from such waivers, reimbursements or payments. Significant portions of these distributions were not based on FSCO's investment performance and such waivers, reimbursements and payments by FS Investments may not continue in the future. If FS Investments had not agreed to reimburse certain of FSCO's expenses, including through the waiver of certain advisory fees payable by FSCO, and provide additional support payments, significant portions of FSCO's distributions would have come from offering proceeds or borrowings. The repayment of any amounts owed to FS Investments will reduce the future distributions to which the Shareholders would otherwise be entitled.
- FSCO's investments in securities and other obligations of companies that are experiencing distress involve a substantial degree of risk, require a high level of analytical sophistication for successful investment and require active monitoring.
- FSCO's investments in various types of debt securities and instruments may be secured, unsecured, rated or unrated, are subject to non-payment risk, and may be speculative in nature.
- Below investment grade instruments (commonly referred to as "high yield" securities or "junk bonds") may be particularly susceptible to economic downturns, which could cause losses.
- FSCO may invest in illiquid and restricted securities that may be difficult to dispose of at a fair price.
- FSCO's use of leverage could result in special risks for the Shareholders and can magnify the effect of any losses.
- Investments in certain securities or other instruments of non-U.S. issuers or borrowers may involve factors not typically associated with investing in the United States or other developed countries.
- Securities or other instruments of non-U.S. securities may be traded in underdeveloped, inefficient and less liquid markets and may experience greater price volatility, illiquidity and changes in value.
- FS Global Advisor, LLC and certain of its affiliates may experience conflicts of interest in connection with the management of FSCO.
- FSCO seeks to achieve its investment objectives by focusing on a limited number of opportunities across the investment universe.
- The national and global political environment, including foreign relations and trading policies, as well as the impact of Russia's invasion of Ukraine and related sanctions, and potential retaliatory actions may adversely affect the performance of FSCO's investments and FSCO.
- Inflation increased substantially in 2022, and the Federal Reserve has raised interest rates several times to, among other things, control inflation, and has signaled that additional increases are likely in the future, which may adversely affect the performance of FSCO's investments and FSCO.
- We expect that the current market conditions may have a lasting and, in some instances, permanent impact on some of our portfolio companies as they struggle to meet covenant obligations and face insolvency in future periods. Poor performance or insolvency of our portfolio companies could have a material adverse impact on our financial condition and results of operations.

#### **Cautionary statement concerning forward-looking statements**

Statements included herein may constitute "forward-looking" statements as that term is defined in Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, including statements with regard to future events or the future performance or operations of FS Credit Opportunities Corp. (the "Company"). Words such as "intends," "will," "expects," and "may" or similar expressions are intended to identify forward-looking statements. These forward-looking statements are subject to the inherent uncertainties in predicting future results and conditions. Certain factors could cause actual results to differ materially from those projected in these forward-looking statements. Factors that could cause actual results to differ materially include changes in the economy, geo-political risks, risks associated with possible disruption to the Company's operations or the economy generally due to hostilities, terrorism, natural disasters or pandemics such as COVID-19, future changes in laws or regulations and conditions in the Company's operating area, unexpected costs, the price at which the Company's shares of common stock may trade on the New York Stock Exchange and such other factors that are disclosed in the Company's filings with the SEC. The inclusion of forward-looking statements should not be regarded as a representation that any plans, estimates or expectations will be achieved. Any forward-looking statements speak only as of the date of this communication. Except as required by federal securities laws, the Company undertakes no obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. Readers are cautioned not to place undue reliance on any of these forward-looking statements. Non-GAAP financial measures are not meant to be considered in isolation or as a substitute for comparable GAAP financial measures and should be read only in conjunction with FSCO's consolidated financial statements prepared in accordance with GAAP.