Robert Paun: Good morning and welcome to FS Credit Opportunity Corp.'s second quarter 2023 earnings conference call. Please note that FS Credit Opportunities Corp. may be referred to as FSCO, the fund or the company throughout the call. Today's conference call is being recorded and an audio replay of the call will be available for 30 days. Replay information is included in a press release that FSCO issued on July 25th, 2023. In addition, FSCO has posted on its website a presentation containing supplemental financial information with respect to its portfolio and financial performance for the quarter ended June 30th, 2023. A link to today's webcast and the presentation is available on the company's webpage at www.fsinvestments.com, under the FSCO tab. Please note that this call is the property of FSCO. Any unauthorized rebroadcast of this call in any form is strictly prohibited.

Today's conference call includes forward-looking statements with regard to future events, performance or operations of FSCO. 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. We ask that you refer FSCO's most recent filings with the SEC for important factors and risks that could cause actual results or outcomes to differ materially from these statements. FSCO does not undertake to update its forward-looking statements unless required to do so by law. Additionally, information related to past performance while helpful as an evaluative tool, is not necessarily indicative of future results, the achievement of which cannot be assured. Investors should not view the past performance of FSCO or information about the market as indicative of FSCO's future results.

In addition, this call will include certain financial measures that have not been prepared in accordance with generally accepted accounting principles in the US or GAAP. FSCO uses these non-GAAP financial measures internally in analyzing financial results and believes that the use of these non-GAAP financial measures is useful to investors as an additional tool to evaluate ongoing results and trends and in comparing FSCO's financial results with other close end funds. For such non GAAP measures, reconciliations to the most directly comparable gap measures can be found in FSCO's form N-CSRS that was filed with the SEC on August 22nd, 2023.

Non-gap information should be considered supplemental in nature and should not be considered in isolation or as a substitute for the related financial information prepared in accordance with GAAP. In addition, these non-GAAP financial measures may not be the same as similarly named measures reported by other companies. To obtain copies of the company's latest SEC filings, please visit FSCO's

website. Speaking on today's call will be Andrew Beckman, head portfolio manager for FSCO and Nick Heilbut, director of Research and Portfolio Manager for FSCO. Also, joining us on the phone is Jason Zelesnik, Chief Operating Officer of the fund.

Just a reminder, we will not be taking live Q&A during today's webinar. However, you can submit your questions using the Q&A function on the left side of your screen, and we will strive to answer as many questions as possible throughout the webinar and at the Q&A session at the end. In addition, I'd like to point out the resources that we have listed at the bottom of the screen, which you can access throughout the webinar. And with that, I will now turn the call over to Andrew.

Andrew Beckman: Thank you, Robert, and thank you all for joining us today. We are pleased to report solid results for the second quarter as the fund returns 7.5% driven by strong earnings as net income fully covered distributions of 15 cents per share and nav appreciation of 33 cents per share. Performance was broad based across the portfolio with contributors far outnumbering detractors. Since quarter end, the funds nav increased by approximately 3.9%, driven by company specific events for a select number of the funds larger positions bringing year to date NAV based returns to 14.9% as of August 18th, 2023. We are pleased to announce a 15% increase in the annualized distribution effective with the July monthly payment, bringing the annualized distribution rate to approximately 9.9% based on NAV as of August 18th. This marks the second increase since the fund's common shares were listed on the NYSE in November of last year.

As many participants are aware, we implemented a phased approach to listing FSCO's common shares through which one third of common shares were available for trading in November of last year. An additional one third of shares were made available for trading 90 days after the listing on February 13th, and the final one third of shares were made available for trading on May 15th. While the stock was largely range bound during the quarter, the discount at which it has traded compared to net asset value narrowed following quarter end. We believe this is reflective of the fund's recent positive performance and broader market strength, but also the reduced selling pressure on the stock now that all the phases of the listing are complete. In our view, the current discount at which the stock is trading compared to the net asset value is not indicative of the health of the portfolio, where the forward return potential of our diversified credit strategy.

We believe FSCO offers a differentiated value proposition in the market for several key reasons. First, FSCO is one of the largest credit focused close end funds in the market, size and scale matter in credit

investing, especially when it comes to maximizing deal flow, mitigating risks, and achieving economies of scale. Our dynamic strategy provides the flexibility to invest across public and private credit based on what we believe are the best risk adjusted return opportunities. As of June 30th, 2023, the split between public and private investments was 55% and 45% respectively. We tend to have a differentiated focus than traditional credit funds. We are not constrained by a specific asset class mandate. We can invest across loans, bonds, structured credit for highly structured equity investments, and across fixed and floating rate assets. We look for situations where return premiums exist due to complexity, illiquidity, or as a result of corporate events.

These opportunities often require significant expertise and resources to source and analyze due to the complexity of company balance sheets, a lack of publicly available information or the illiquidity of the asset. Our private investment portfolio includes highly bespoke investments, originated through our firm-wide sourcing network. Our intensive due diligence process benefits from the sharing of collective insights on markets and individual credits. We believe our origination capabilities within the private market and focus on providing specialized financing solutions differentiates us from our closed end fund peer group.

The fund offers a highly attractive annualized distribution yield of approximately 9.9% based on NAV and a current yield of approximately 13% based on stock price, which we believe is attractive on an absolute and relative basis compared to our peers. The distribution has been fully covered through net income since I joined FS Investments and the current investment team assumed management of the fund in January of 2018. Over that time, net investment income has represented 116% of distributions paid to shareholders. The portfolio is weighted to senior secure debt with the focus on first lien debt, which has helped preserve capital over time. Senior secured debt represented 77% of the portfolio's fair value as of June 30th, 2023.

June 30th, 2023. Floating rate assets comprise approximately 58% of the portfolio as of June 30th. We're seeing the benefit of higher base rates pass through to shareholders as evidenced by our ability to increase the annualized distribution by a total of 34% through two distribution increases since December of last year.

Finally, the fund uses a modest level of leverage to help enhance shareholder returns. Our diversified capital structure provides us with the flexibility to invest across asset types and maturities through a mix of revolving term loan and preferred financings. I'll now turn the

call over to Nick to provide our perspective on the markets and discuss our investment activity during the quarter.

Nick Heilbut: Thanks, Andrew. Markets have displayed notable strength throughout much of 2023 against the backdrop of slowing US inflation, a strong labor market and steady consumer demand. Year to date, high-yield bonds and loans have returned 5.9% and 8.4% respectively with lower-rated credits materially outperforming higher-rated credit. Interest rates and uncertain economic outlook continue to weigh on M&A activity, which has reduced private equity demand for LBO financings and limited the supply of new issuance.

In addition, just 142 billion or 4.5% of loans and high-yield bonds outstanding is scheduled to mature by the end of 2024. With new issuance and refinancing activity down significantly from the 2021 peak, demand has outstripped supply year to date, despite net outflows for both high-yield and loan retail funds. Demand has remained strong from investors reinvesting interesting income in proceeds from pay downs, along with continued demand from CLOs. As a result, the size of the public credit market is on pace to shrink for the second consecutive year. The technical supply-demand imbalance has supported credit prices through the first half of the year. Despite the positive technical backdrop, we still see reasons for caution. Default rates have slowly risen across bond and loan markets and now sit at two-year highs. High yield defaults, including distressed exchanges, increased to 2.71% while loan defaults and distressed exchanges increased to 2.94%.

However, default rates remain below the long-term average of 3.2% for high-yield bonds and 3.1% for loans. In addition, the rapid rise in interest rates has pressured coverage ratios, margins, and the liquidity profile of many companies across various sectors. We believe the current environment requires a deep bottoms-up understanding of fundamental credit risks. In our experience, inflection points in a market cycle or periods of volatility often present attractive investment opportunities. As Andrew will discuss further, you're focused on businesses with strong cash flows, moderate leverage profiles and management teams and or private equity sponsors with deep operational experience managing through market cycles.

Turning to the portfolio, sales and repayments of 216 million outpaced purchases of 144 million during the second quarter. The majority of investment purchases during the quarter were to existing portfolio companies. Our incumbency position provides a natural source of deal flow with companies and capital structures that we know well. Senior secured debt investments represented the majority of purchases during the quarter and 77% of the portfolio. Fair value at

year, at quarter end was senior secured debt. As Andrew mentioned, the mix of public and private assets was approximately 55% and 45% as of quarter end. As of June 30th, the largest sector rating was healthcare equipment services followed by consumer services and commercial and professional services. We believe these investments offer the potential to drive strong risk-adjusted returns and operate in areas of the economy that may be more insulated in the event of a broader economic slowdown.

Turning to the liability side of our balance sheet, we believe our cost structure gives us a competitive edge with 58% of drawn leverage comprised of preferred debt financings, which provide favorable regulatory treatment versus traditional term or revolving debt facilities. Approximately 52% of drawn leverage is multi-year fixed rate preferred debt, and provides flexibility in the types of assets we can borrow against.

On August 1st, the fund paid down $100 million of preferred debt maturing during the month. As a result, all the funds remaining preferred debt matures in 2024 or beyond. On a pro forma basis, following the pay-down, the fund's cash balance was approximately 39 million. Despite a modest cash balance, we have ample availability in our credit facilities should a liquidity need arise. I'll now turn it back to Andrew to discuss our forward outlook.

Andrew Beckman: Thanks, Nick. As I commented earlier, we believe the strong index level returns this year mask strong underlying cross currents in the public and private credit markets. Performance differences across ratings and asset classes could become more pronounced as economic conditions change. We believe active management combined with sound fundamental credit underwriting will be critical to driving returns and avoiding excess risk. 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 running less levered than our long-term targets is prudent, not only to minimize potential drawdowns, but also to be positioned well if we are to see volatility, which can create attractive investment opportunities for the fund in the future.

We continue to focus on senior debt investments with strong terms at attractive yields or expected total returns, and are generally avoiding debt and private-equity-owned companies where we think there could be material risk on asset leakage or lender-on-lender violence. We're also cautious on credits where there are significant EBITDA add-backs that may never materialize. We are invested in credit

instruments with appropriate loaner values to ensure ultimate repayment of the obligations even if the environment deteriorates.

Our sector allocations are informed by our bottoms-up fundamental research, and we tend to avoid highly cyclical areas of the economy. We've constructed the portfolio around these attributes and are confident in the position of the portfolio as well as the opportunity set. In our experience, the opportunities in private and public credit tend to ebb and flow and relative attractiveness can shift meaningfully. Our goal is to dynamically allocate capital, the most attractive opportunities across the credit and business cycle, and we think this leads to enhanced stockholder returns relative to a more confined strategy.

We believe the flexibility of our strategy and the expertise of our team have helped drive strong outperformance versus the loan and high-yield bond indices. From January 2018 through June 30th, 2023, FSCO outperformed high-yield bonds by approximately 252 basis points per year and loans by approximately 135 basis points per year. Performance has been strong on an absolute and risk-adjusted basis as demonstrated by our higher sharp ratio compared to the liquid benchmarks.

In summary, based on our well-positioned portfolio, low average duration, healthy distribution, diversified capital structure, and the flexibility of our strategy, we believe FSCO is a compelling long-term investment opportunity. We will continue to be highly proactive in our efforts to broaden the investor base for FSCO's shares in the public markets, with sell-side research analysts, mutual fund managers, private wealth managers, and other private credit and close-end focused asset managers.

Once again, thank you all for joining us today. Before taking questions, we have one housekeeping note. We reinstated the amended and restated distribution reinvestment plan on May 16th, following the final phase of the listing on May 15th. With that, we will take a brief pause to review the queue before answering your questions.

Robert Paun: Again, as a reminder, you can submit your questions using the Q&A function on the left side of your screen. We'll just pause for another five seconds.

Okay. Our first question. What is your leverage at the end of the quarter?

Andrew Beckman: On a debt-to-asset basis, as of June 30th our leverage was 34%, that included both debt and preferred stock; and on a debt-to-equity

basis, that translated into 52%. The debt mix, which I mentioned includes both debt and preferred stock, is comprised approximately 40% debt and 60% preferred.

Robert Paun: Next question. Can you provide some more color on the net asset value move in the quarter? Seems like a strong move higher.

Andrew Beckman: Yes. So NAV increased to $6.68 a share June 30th, and that compared to $6.35 per share the prior quarter, so that represented roughly a 5.2% increase in NAV.

Robert Paun: Great. Can you talk about your valuation process specifically on the private investments?

Andrew Beckman: Sure. Our private investments are valued by a third party on a monthly basis, so we get monthly valuations on all our private investments from a third party; and interim month, the investments are valued internally.

Robert Paun: The next question is on fee structure. Can you discuss your current fee structure and how it compares to your peers?

Andrew Beckman: FSCO has a dynamic investment strategy; and as mentioned, we have an allocation to both privately sourced and privately originated and structured investments, as well as more liquid investments that are made through traded securities. We think that differentiates us from a typical closed-end fund. It puts us in between a closed-end fund and a BDC; and as such, our fee structure straddles the closed-end fund space and publicly traded BDCs, so our management fee is in between the two. And if you look at our incentive fee, we have an incentive fee on income, we do not have an incentive fee on capital gains, and our incentive fee is also in between not having an incentive fee and the incentive fees that BDCs have.

Robert Paun: Next question. What's the target allocation for private versus public investments in the fund today?

Andrew Beckman: We really approach investing based on the market opportunity and the bottoms-up opportunity that we're seeing on individual investments. We don't have a specific fund target, but I think a long-term average of approximately 50:50 is a reasonable metric to think about.

Robert Paun: And then in today's environment, where are you seeing the best investment opportunities from a private versus public standpoint?

Andrew Beckman: I guess within the market they're a little bit different. PrivateS, we were a little bit less focused on privates in the back half of last year.

There was a decent amount of market dislocation; and there were a number of idiosyncratic situations in the liquid credit markets, whether it was the traded loan market or bond market, where we were able to find some very attractive opportunities for total return investments.

If you rewind and go back to late 2021 or early 2022 where the credit markets were really tight, we were finding much more attractive opportunities in the private market... idiosyncratic, high total return opportunities... that were very well-structured when the public credit markets had fairly loose documentation. So back half of last year, we became more focused on liquid opportunities.

The markets wrapped its head around more of a soft landing this year. Credit spreads have tightened. I would say when there was an inclination of hope last year that documentation in the public credit markets was going to get better, that that has not really happened this year because of the tightening we've seen in the credit market. So new issues are back to just having very loose creditor protections, and our focus has shifted back to private credit.

If you ask me about private versus public credit right now, I would tell you private credit is more attractive. We can get the returns we're looking for, and the structured documentation and covenants we're looking for. Within private credit, we tend to find the best opportunities in non-sponsored transactions, so not competing against the huge amounts of capital that were raised in private credit to do sponsor driven finance.

And then within public credit, we are still focused on some idiosyncratic situations. There are some things that are overlooked by more typical public credit investors. They tend to be event-driven situations, and that's where our focus is there.

Robert Paun: Great. And the next question. On new deal opportunities, what industries are you seeing the best opportunities?

Andrew Beckman: We always want to maintain a portfolio balanced across multiple industries and be focused on businesses with the ability to maintain steady operating margins through changes in the economic cycle. That said, from time to time there are opportunities to generate excess returns in industries where capital scarcity has raised the cost of credit; and to a certain extent, we've seen this over the past several quarters in healthcare and financial services. We've found some opportunities in those sectors with pretty low LTVs, and other significant margins of safety, with some excess return as well.

Robert Paun: The next question. Curious as to your views on the economic outlook, specifically interest rates, potential challenges such as inflationary pressures, and its impact on the portfolio.

Andrew Beckman: We think we're likely in a higher-for-longer type of interest rate environment, which generally bodes well for portfolio income and fixed income total return. Obviously, we have a lot of floating rate debt in the portfolio which has benefited from changes. So for an overall, the portfolio is fairly short duration; so as rates move higher, we tend not to experience large negative marks in the fixed coupon portion of the portfolio. We think eventually the economy slows down as a result of elevated cost of capital, but the portfolio is deliberately positioned to withstand this eventual downturn. We think a slow-down will present incremental opportunity for us, and we're well set up for that eventuality.

Robert Paun: Next, the stock continues to trade at a discount.

Next, the stock continues to trade at a discount to net asset value. What are your plans to close that gap?

Andrew Beckman: The stock has performed well over the last few months, and we've closed the discount meaningfully in this calendar quarter, so subsequent to June 30th. We're focused on the performance of the fund, making good investments that perform well, and we're in constant contact with the research community, current investors and prospective buyers. We think that solid performance and continued and new outreach to the investment community will help to close the discount over time.

Robert Paun: Great. And then can you please comment on your approach to share buybacks and any plans to initiate a share repurchase program?

Andrew Beckman: Sure. We continue to assess all options from a capital allocation standpoint, including share repurchases. We have an active dialogue with our board in these decisions. We're mindful of leverage and our liquidity position, especially in today's environment. Clearly, we view that shares of the fund are an attractive investment opportunity with the stock trading at a discount to NAV and an attractive yield, so we'll continue to assess all options including share repurchases.

Robert Paun: And then on the dividend policy. Can you remind us of the dividend policy and the plan going forward here?

Andrew Beckman: Sure. Our dividend policy is to pay out net income, but we also believe it's important to make sure we earn what we pay out. There are closed end funds out there that over-distribute and don't cover their dividend. We don't think that's prudent. And if you look at our

dividend and our net income, you'll see that they've increased. We had that 15% increase in July, and we will continue to assess the dividend as we see our net income trends materialize.

Robert Paun: Okay. And then another one on leverage. Can you talk about how you utilize leverage at the fund?

Andrew Beckman: We look for alpha at the investment level, and we're not looking to be a highly levered fund that's really using leverage to generate our returns that differentiate us from the market. We're on the run credit instruments. We think it's a better way to produce differentiated returns and also protect downside. At quarter end, as mentioned, our debt to assets was approximately 34%. That did include a cash balance that was above average due to some of the preferred that was maturing. So if you adjust for cash, our debt to assets was probably just sub 30%. We've given out roughly 33, 34% as the right long-term average and don't see that changing right now.

Robert Paun: Great. And then the next one on non-accruals. What is the non-accrual rate as of June 30th?

Andrew Beckman: The non-accrual rate as of June 30th is approximately 2%. The thing I should mention is because of our event-driven strategy, sometimes we purposely buy investments that are not accruing because we think they're trading at sizable discounts to intrinsic value. I just want to point out that the 2% includes things that may have been specifically purchased while not accruing.

Robert Paun: Great. Next question. Equity exposure increased to 10% of the portfolio at the end of June. What drove that increase?

Andrew Beckman: The increase was not driven by new purchases, it was primarily driven by appreciation, positive events and positive performance on instruments that are in that bucket. I would say we're generally not buying common equities. If you look at our equity portfolio, it's primarily comprised of warrants that we may get as part of loans, private loans that we make that could appreciate or warrants that we could exercise, debt positions that we might convert from debt to equity. And then there's definitely one sizable position in there that is preferred stock, which is a bespoke investment that we made, and it's a company that doesn't really have any debt, but for competitive purposes, the company preferred to have its liability show up as preferred stock. We basically structured a preferred stock investment that looks and smells very much like a debt security and has covenants that doesn't really allow any debt in front of us, and that goes in that equity bucket, but that is accruing and paying a dividend.

Robert Paun: The next question's a follow-up on fees and the fee structure. What are the exact percentages for management fees and incentive fees?

Andrew Beckman: Our management fee is 1.35%. That was reduced from 1.5% upon our listing. And our incentive fee is 10% on investment income, subject to a 6% hurdle based on net assets, and we do not have a capital gains incentive fee.

Robert Paun: Great. Thank you, Andrew and Nick. Looks like that we've addressed all the questions in the chat. Thank you all for joining us today. If you do have any follow-up questions, please feel free to reach out to us, to myself, Robert Paun, Head of Investor Relations, and we look forward to speaking with you on our next call. Thank you.