# Mergers and liquidity plan for FSIC II, FSIC III, FSIC IV and CCT II

## Overview

**1. What are the details of the mergers and liquidity plan?**

- On December 18, 2019, FS/KKR Advisor, LLC (FS/KKR), a partnership between FS Investments and KKR Credit Advisors, announced the completion of the previously announced mergers of FS Investment Corporation III (FSIC III), FS Investment Corporation IV (FSIC IV) and Corporate Capital Trust II (CCT II) into FS Investment Corporation II (FSIC II). FSIC II, which has been renamed **FS KKR Capital Corp. II (FSK II)**, is now the second-largest business development company (BDC), with approximately $9.5 billion in assets. FSK II will continue to be advised by FS/KKR.

- The mergers are part of a three-step process to create a liquidity event for all shareholders.

  – Mergers: FSIC II served as the surviving entity in net asset value (NAV)-for-NAV mergers with FSIC III, FSIC IV and CCT II (the "Acquired Funds").

  – Recapitalization: Prior to listing and subject to board approval, FSK II intends to issue (on a pro rata basis) to holders of FSK II's common equity 5.5% perpetual preferred equity with an aggregate liquidation preference representing approximately 20% of FSK II's NAV.

  The preferred shares will provide current income for shareholders (5.5%) and help align the dividend yield and return on equity of FSK II's common stock to a competitive level with some of the largest publicly traded BDCs.

  Following the recapitalization, an investor's total value will consist of the following (assuming the value of the common shares is the NAV per share and the value of the preferred shares is the liquidation preference):

  - Common shares of FSK II representing approximately 80% of total shareholder value
  - Preferred shares of FSK II representing approximately 20% of total shareholder value

  – Listing: After the recapitalization, FSK II intends to list its common equity on the New York Stock Exchange. Subject to market conditions and board approval, we currently intend to complete a listing during the first half of 2020.

**2. What is the purpose of the staged liquidity plan?**

- We believe the staged liquidity plan provides FS/KKR Advisor, LLC (the "Adviser"), the investment adviser to FSK II, and the board with the flexibility to pursue an optimal liquidity event for shareholders following the closing of the mergers and the recapitalization based on, among other considerations, market conditions, public BDC valuations and FSK II's performance.

- The liquidity plan is intended to maximize shareholder value, diversify FSK II's portfolio, align the dividend of FSK II's common stock to be competitive in the public market, and manage the key risks of a public listing. The strategic rationale for each stage of the liquidity plan is as follows.

**MERGERS**

– Create significant scale and visibility for public markets as FSK II ranks as the second-largest BDC based on assets under management, with approximately $9.5 billion in assets.

– Ensure shareholders receive equal value
  - Shareholders of the Acquired Funds received shares of FSIC II common stock equal in value on a NAV basis to their shares of the applicable Acquired Fund's common stock prior to the mergers.
  - The number of FSIC II common shares issued to shareholders of the Acquired Funds was based on an exchange ratio equal to the NAV per share of the respective Acquired Fund's common stock divided by the NAV per share of FSIC II's common stock.
  - Based on the merger exchange ratios, FSIC III, FSIC IV and CCT II shareholders received 0.9804, 1.3634 and 1.1319 FSK II shares, respectively, for each share of FSIC III, FSIC IV and CCT II held. The exchange ratios were determined based on the NAV per share of each fund as of December 16, 2019.

| | **FSIC II** | **FSIC III** | **FSIC IV** | **CCT II** |
|---|---|---|---|---|
| NAV | $7.36 | $7.22 | $10.03 | $8.33 |
| (\) FSIC II NAV per share | -- | $7.36 | $7.36 | $7.36 |
| Exchange ratio* | -- | 0.9804 | 1.3634 | 1.1319 |

*Numbers may be rounded

– Enhance portfolio diversification
  - The pro forma portfolio is composed of 210 portfolio companies as of September 30, 2019.
  - The pro forma portfolio reduces the percentage of fair value represented by the top 10 portfolio companies from as high as 32% for FSIC III to 26% on a pro forma basis for FSK II as of September 30, 2019.
  - In addition, the mergers reduce single-issuer concentration, which will help limit the impact of a single investment's performance on the total portfolio.
  - FSK II's investment objectives and strategy is consistent with the existing strategy of each of the Acquired Funds, which sought to generate current income and, to a lesser extent, long-term capital appreciation by investing primarily in the debt of middle market U.S. companies with a focus on originated transactions sourced through the network of the Adviser and its affiliates.

– Reduce expenses:

- The mergers are expected to create operational synergies as FSK II's fixed costs will be spread across a larger asset base, and duplicative fixed costs (e.g., administrative, regulatory and other professional services expenses) will be eliminated.

- As a result, although certain one-time costs were borne by the funds in connection with the mergers, the annual operating expense borne by the shareholders of the funds as a percentage of assets is expected to be reduced in part due to the reduction in general and administrative expenses.

- The mergers are expected to result in approximately $11 million in annual cost savings for FSK II.

- In addition, the mergers are expected to help reduce FSK II's cost of borrowing by consolidating existing facilities, leveraging scale to reduce borrowing costs and by potentially accessing debt capital markets as a publicly traded company.

## RECAPITALIZATION

– Assuming the board of FSK II approves the recapitalization, shareholders of the funds would hold approximately 80% of their pre-merger value in common shares of FSK II and approximately 20% in preferred shares (assuming the value of the common shares is the NAV per share and the value of the preferred shares is the liquidation preference).

– The recapitalization is intended to achieve the following:

- **Provide current income:** The preferred shares are expected to carry an annual preferred dividend of 5.5% and are paid ahead of dividends on common shares.

- **Align the distribution yield on FSK II's common shares with the public markets:** Following the recapitalization, FSK II is expected to be able to sustain an annualized dividend yield of 9% or greater on NAV for its common shares, which is highly competitive with some of the largest publicly traded BDCs with a track record of consistently covering their distribution.[1]

- **Ensure sustainable, competitive distribution:** Assuming a dividend yield on FSK II's common shares of 9% or greater, FSK II's projected annualized net investment income is estimated to represent 105%–110% of its dividend compared to approximately 90%–100% without the recapitalization.

  – Publicly traded BDCs that have a track record of consistently funding their distributions through net investment income typically have historically traded at a higher valuation (price-to-book) than their peers.

- **Help mitigate selling pressure at listing:** The preferred shares are not expected to have an active secondary market at or shortly following issuance. We expect the illiquid nature

1 Assumes 20% of shareholder value is in preferred shares following the recapitalization, the preferred shares have a 5.5% dividend and FSK II pays aggregate annualized distributions on its common shares that are equal to 80% of FSIC II's aggregate annualized distributions on common shares as of September 30, 2019. Based on FSIC II's Q3 2019 distributions and yield on common shares based on NAV as of September 30, 2019.

of the preferred shares will help reduce the float of the common stock at listing and, therefore, help preserve shareholder value.

Indicative terms of the preferred shares:

| | |
|---|---|
| **Preferred dividend** | 5.5%; cumulative (must be paid prior to common stock dividends) |
| **Issuance** | Following the mergers and prior to the listing of FSK II's common stock |
| **Amount** | 40M shares (approximately $1 billion in liquidation preference) |
| **Listing** | Subject to market conditions after the listing of FSK II's common stock |
| **Maturity** | Perpetual |
| **Liquidation preference** | $25.00 per share |

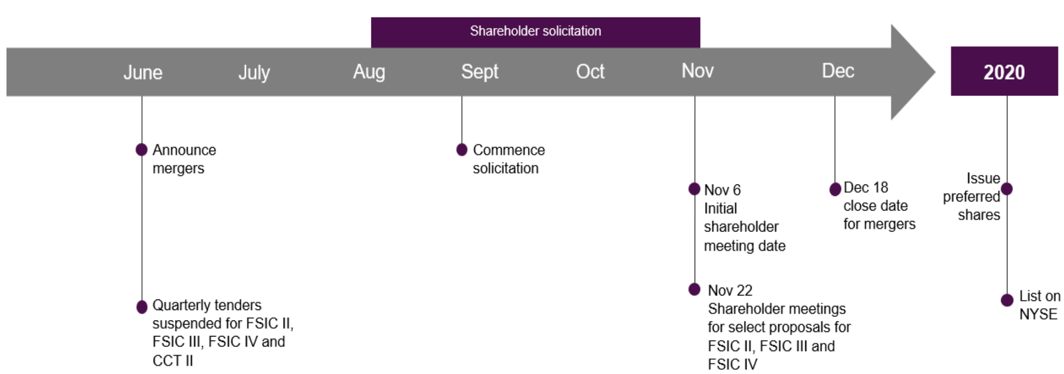
**LISTING**

– Flexibility to select optimal path to liquidity: Subject to board approval and market conditions, we currently intend to list FSK II's common stock on the New York Stock Exchange in the first half of 2020. Prior to determining whether to proceed with a listing, the Adviser and the board will take into account, among other considerations, FSK II's performance, market conditions and the valuations of publicly traded BDC peers.

- If the Adviser and board determine that a listing would not be in the best interests of shareholders at such time due to any of the aforementioned factors or other considerations, the staged liquidity plan ensures that FSK II is not "forced" to list its common stock into potentially unfavorable market conditions.
- Furthermore, the timing of a liquidity event will not impact the expected benefits of the mergers, including enhanced portfolio diversification and the reduction of expenses of FSK II.

– A single transaction, consisting of all non-traded BDCs managed by the Adviser, eliminated the uncertainty of the timing and impact of future mergers on shareholder value.

### 3. What is the expected timeline for the proposed staged liquidity plan?



## Distributions Q&A

**4. Will FSK II pay a regular distribution in December?**

- The regular December distributions of FSIC II, FSIC III, FSIC IV and CCT II were paid on December 18, 2019. The distribution reinvestment plan (DRP) for each fund were suspended for December in preparation for the closing of the mergers.

- FSK II's DRP has been reinstated following the completion of the mergers and FSK II's distributions may be paid according to investors' previous elections. Please consult with your broker-dealer or custodian to verify or update your election.

**5. Did any fund pay a special distribution in connection with the mergers?**

- Since FSIC III, FSIC IV and CCT II were the acquired funds, they were required to distribute any remaining undistributed net investment income and capital gains to investors prior to the closings of the mergers. The special distributions per share for FSIC IV and CCT II, as shown below, were paid with the payment of the regular December distribution for each fund. FSIC III did not pay a special distribution.
  - FSIC IV: $0.2625
  - CCT II: $0.1850

**6. Will FSK II pay monthly or quarterly distributions?**

- Subject to applicable legal restrictions and the discretion of FSK II's board, we expect that FSK II will declare and pay quarterly distributions.

**7. What is the expected quarterly distribution of FSK II?**

- We expect the board to declare the Q1 2020 distribution in mid to late February 2020.

- **Prior to the recapitalization, and assuming a listing occurs after the payment of FSK II's first quarterly distribution, we expect that the annualized distribution of FSK II's common shares will be lower than the previous annualized distribution amounts for FSIC II and FSIC III shareholders and higher than the previous annualized distribution rate for FSIC IV and CCT II shareholders**.

- Following the recapitalization, we expect that the annualized blended distribution amount of FSK II's common shares and preferred shares will be lower than the current annualized distribution amount for FSIC II and FSIC III shareholders.
  - However, we anticipate that the issuance of the preferred shares will help improve FSK II's distribution coverage of its common shares to a competitive level with some of the largest publicly traded BDCs in the market.
  - Since public markets generally assign a higher valuation to BDCs with strong distribution coverage, we view the issuance of the preferred shares as a critical step toward preparing the common shares for a public listing.

## Tender Q&A

**8. Will FSK II conduct regular quarterly tenders following the completion of the mergers and prior to the listing?**

- Subject to board approval and market conditions, we currently intend to list FSK II's common shares on the NYSE in the first half of 2020, providing shareholders with liquidity. Therefore, we do not expect FSK II to conduct quarterly tender offers.

## Merger Q&A

**9. Why was FSIC II the surviving entity?**

- With over $4.4 billion in assets based on fair value as of September 30, 2019, FSIC II was the largest of the non-traded funds managed by the Adviser.

- FSIC II launched in June 2012 and, therefore, has the longest performance track record among the non-traded funds. We believe a longer track record will help garner attention from new potential institutional investors upon a listing.

**10. Are the mergers expected to be taxable to FSIC II shareholders?**

- No. The mergers are not expected to be a taxable event for FSIC II shareholders.

**11. Are the mergers expected to be taxable to FSIC III, FSIC IV or CCT II shareholders?**

- No. Each merger is intended to qualify as tax-free for U.S. federal income tax purposes, and it is a condition to the funds' respective obligations to complete the applicable merger that each of them receives a legal opinion to that effect.

- Shareholders of the Acquired Funds are not expected to recognize any gain or loss for U.S. federal income tax purposes on the exchange of their shares of FSIC III, FSIC IV or CCT II for shares of FSIC II pursuant to the mergers except with respect to any cash received in lieu of fractional shares of FSIC II.

- Tax matters can be complicated, and the tax consequences of the mergers to an FSIC II, FSIC III, FSIC IV or CCT II shareholder will depend on the particular tax situation of such shareholder. Shareholders should review carefully the joint proxy statement/prospectus filed with the SEC on August 13, 2019 for more information and details as to the tax consequences of the mergers to FSIC II, FSIC III, FSIC IV and CCT II and their shareholders. Shareholders should consult with their own tax advisors to determine the tax consequences of the merger.

## Recapitalization Q&A

**12. Will shareholders be able to redeem their preferred shares?**

- We expect to list FSK II's preferred shares on the New York Stock Exchange at a future point following the listing of FSK II's common stock. The anticipated timing of such a listing is subject to market conditions and other considerations.

- We do not expect an active secondary market will exist for FSK II's preferred shares prior to a listing.

**13. When does the Adviser anticipate listing the preferred equity?**

- The Adviser and board intend to list the preferred shares following the listing of FSK II's common equity as soon as the Adviser and board believe market conditions support a listing.

- Among other considerations in determining the timing of the listing, the Adviser and the board will take into account the performance of FSK II's common stock price with the goal to mitigate technical pressure on the stock.

**14. Will shareholders be able to transfer ownership of their preferred shares?**

- The preferred shares will not be registered under the Securities Act of 1933, as amended (the Securities Act) at the time of issuance. Therefore, the preferred shares may only be resold pursuant to registration under the Securities Act, or a valid exemption from registration.

**15. How frequently will the preferred shares pay dividends?**

- We anticipate that, if issued, the preferred shares will generally pay dividends quarterly on January 31, April 30, July 31 and October 31, as declared by FSK II's board, and in each case, will be paid prior to dividends on shares of FSK II's common stock.

**16. What is the expected tax treatment of the dividend on the preferred shares?**

- We expect the dividends on the preferred shares will be reported as ordinary income on Form 1099-DIV.

**17. How will FSK II account for the preferred shares on its balance sheet?**

- We anticipate that FSK II will record the preferred shares on its balance sheet at their liquidation preference of $25 per share.

**18. How was the anticipated distribution rate for the preferred shares determined?**

- Together with the Adviser, the funds' boards and their joint financial advisor conducted a comprehensive market review.

- While there are limited comparables in the BDC sector, there is a well-developed and liquid market for $25 par preferred stock securities, including in the property REIT and mortgage REIT sectors. The analysis covered a broad range of issuers as well as structures, including fixed and floating rate securities, and issuance sizes.

- FSK II's expected distribution rate takes into account the results of the market analysis as well as the preferred dividend required to achieve the objective of aligning the dividend yield on FSK II's common shares to a competitive level with some of the largest publicly traded BDCs.

## Listing Q&A

**19. When will FSK II's shares be listed on the NYSE?**

- Subject to board approval, market conditions and other factors, FSK II intends to list its common equity on the New York Stock Exchange during the first half of 2020.

**20. What considerations will factor into the board's decision to list FSK II's common shares?**

- The board and the Adviser will evaluate many considerations, including, but not limited to, market conditions and public BDC valuations.
  - In addition, as part of the Adviser's ongoing dialogue with institutional investors and investment banks, we believe publishing consolidated financials of FSK II on a post-merger basis will provide the public markets with a more complete picture of FSK II's portfolio, earnings and distribution coverage.

    FSK II's first post-merger quarterly filing will be the annual report for the year ending December 31, 2019 on Form 10-K, which will be filed in mid-to-late February or early March 2020. Based on this understanding, we expect to list FSK II's shares within the first half of 2020, subject to market conditions and board approval.

- In preparation for the recapitalization, FSK II will seek to consolidate its borrowing facilities and reduce leverage in order to ensure FSK II's leverage ratios remain well within the regulatory required limits.

**21. Will FS/KKR or FSK II purchase shares following the listing?**

- Together with the board, FS/KKR is evaluating potential options to purchase FSK II's stock following a listing of its shares on the NYSE.

- Subject to board approval and the satisfaction of other considerations, FS/KKR expect to provide further details ahead of any listing.

**22. Once listed, how will FSK II differ from FSK?**

- While FSK and FSK II share a common investment adviser and investment strategy focused on investing primarily in the debt of middle market U.S. companies with a focus on originated transactions sourced through the network of the Adviser and its affiliates, the portfolios today differ in the following ways:

  - Portfolio allocations:
    - FSK II's combined portfolio is expected to have a higher allocation to first lien debt (69%) compared to FSK (51%). Senior secured debt represented 84% of the combined portfolio compared to 72% for FSK based on fair value as of September 30, 2019.

    - In addition, given the merger of FS Investment Corporation (FSIC) and Corporate Capital Trust (CCT) in December 2018 to create FSK, FSK's portfolio has a higher concentration of KKR-originated investments compared to FSK II; KKR-originated investments represented 69% of FSK's portfolio based on fair market value as of September 30, 2019, compared to 41% for FSK II. (Note: CCT was sub-advised by KKR Credit since its inception in 2011 until April 2018.)

  - Issuer sizing:
    - While the estimated overlap between FSK and FSK II is approximately 83% based on fair market value as of September 30, 2019, the position sizes may differ significantly between the funds.

    - Therefore, the performance of any single overlapping investment can have a varying impact on the portfolios.

  – Capital structure:
    - As a publicly traded stock, FSK has greater access to the debt capital markets. As of September 30, 2019, FSK had $1.5 billion in unsecured, fixed rate debt outstanding and FSK II had no unsecured, fixed rate debt outstanding on a pro forma basis.

    - Approximately 43% of FSK's borrowings were fixed rate based on principal outstanding as of September 30, 2019. The borrowings of FSK on a pro forma basis were 100% floating rate term facilities as of September 30, 2019.

    - In addition, FSK II's preferred share issuance will be differentiated in the public BDC market.

**23. Do FSK and FSK II have separate boards?**

- FSK and FSK II each have separate boards, although the boards are composed of the same members.

## Fees & expenses Q&A

**24. What will be the investment advisory fees of FSK II?**

- In connection with the approval of the mergers, the board of FSIC II approved an amended investment advisory agreement, which was approved by shareholders.

- **Base management fee:** Under the prior investment advisory agreement, the base management fee is calculated at an annual rate of 1.5% of the average weekly value of FSIC II's gross assets. Under the amended investment advisory agreement, cash and cash equivalents will be excluded from the gross assets on which the base management fee is calculated, and the base management fee will be reduced from 1.5% to 1.0% on all assets financed using leverage over 1.0x debt-to-equity.

- **Subordinated incentive fee on income:** Under the prior investment advisory agreement, the subordinated incentive fee on income is subject to a quarterly hurdle rate expressed as a rate of return on adjusted capital as of the most recently completed calendar quarter of 1.75% (7.0% annualized), subject to a "catch-up" equal to the amount of FSIC II's pre-incentive fee net investment income in excess of the hurdle rate until FSIC II's pre-incentive fee net investment income for such quarter equals 2.1875% (or 8.75% annually) (the "Hurdle Rate"). Under the amended investment advisory agreement, the Hurdle Rate will be calculated on net assets rather than adjusted capital. In addition, under the amended investment advisory agreement, the definition of pre-incentive fee net investment income will exclude any interest expense or dividends paid on any issued and outstanding shares of preferred stock created through a reclassification of common stock or due to a distribution in kind to holders of common stock.

- **New cap on subordinated incentive fee on income:** Under the prior investment advisory agreement, there is no “look-back” or cap feature on the subordinated incentive fee on income. Under the amended investment advisory agreement, commencing with the ninth full fiscal quarter following the closing of the mergers, the subordinated incentive fee on income will be subject to a cap equal to (a) (i) 20% of the per share pre-incentive fee return for the current fiscal quarter and the 11 fiscal quarters (or fewer number of fiscal quarters) preceding the current fiscal quarter (commencing with the first full fiscal quarter following the mergers) less (ii) the cumulative per share incentive fees accrued and/or payable for the 11 fiscal quarters (or fewer number of fiscal quarters) preceding the current fiscal quarter (commencing with the first full fiscal quarter following the mergers) multiplied by (b) the weighted average number of outstanding shares of common stock of FSK II during the applicable fiscal quarter.

- **Incentive fee on capital gains:** The prior investment advisory agreement does not expressly provide for taking into account the historical net realized losses and unrealized depreciation of any merging entity, essentially forgiving them. The amended investment advisory agreement ensures that aggregate historical net realized losses and unrealized depreciation of each of FSIC III, FSIC IV and CCT II are offset by capital gains before the Adviser will receive payment of incentive fees on capital gains.

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### 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 (the Securities Act), and Section 21E of the Securities Exchange Act of 1934, as amended by the Private Securities Litigation Reform Act of 1995, including statements with regard to future events or the future performance or operations of the BDCs. Words such as “believes,” “expects,” “projects,” and “future” 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, risks associated with possible disruption to a BDC’s operations or the economy generally due to terrorism or natural disasters, future changes in laws or regulations and conditions in a BDC’s operating area, unexpected costs, charges or expenses resulting from the business combination transaction involving the BDCs, failure to realize the anticipated benefits of the business combination transaction involving the BDCs, failure to consummate the recapitalization transaction and failure to list the common stock of FSK II on a national securities exchange. Some of these factors are enumerated in the filings the BDCs made with the Securities and Exchange Commission (the SEC) and are also contained in the Prospectus. 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 BDCs undertake 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.