INVESTMENTS®

Fund commentary

FIRST QUARTER 2017

FS INVESTMENT CORPORATION III

Summary

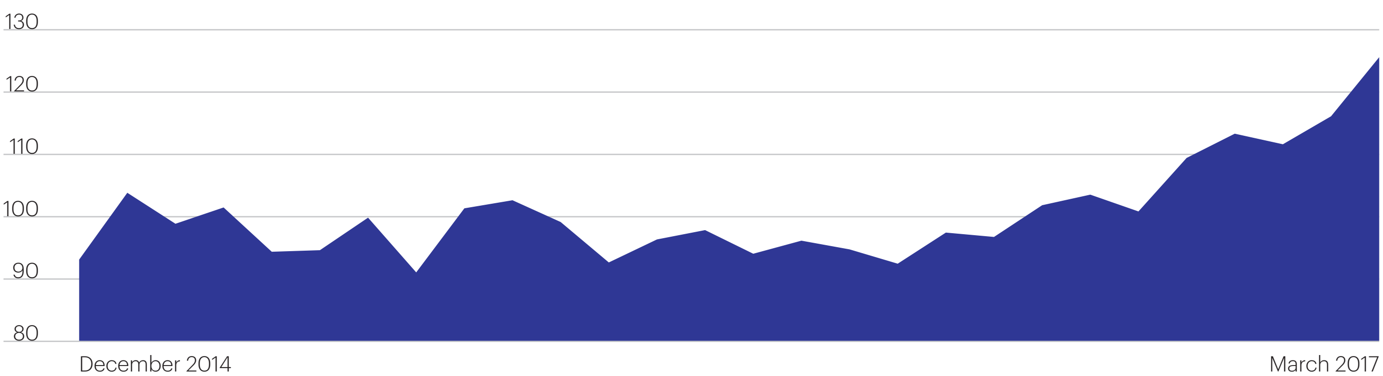
- The U.S. economy continued its steady expansion during the first quarter of 2017, led once again by strong employment data.
- High yield bonds and senior secured loans generated total returns of approximately 2.7% and 1.2%, respectively, during the first quarter of 2017.[1]
- Both asset classes fared well compared to higher-duration asset classes as investors continued to anticipate an environment of faster economic growth along with a more active Federal Reserve.[1]
- FS Investment Corporation III (FSIC III, or the Fund) generated a stockholder return (without sales charge) of 3.1% for the quarter ended March 31, 2017, compared to 1.2% for senior secured loans.[1,2]

Market review

Credit markets performed well during the first quarter of 2017 as the positive sentiment that took shape after the U.S. presidential election in November 2016 largely remained in place. Senior secured loans and high yield bonds benefited from strong investor demand for floating rate and low-duration investments as investors continued to anticipate an environment of higher economic growth along with a more active Federal Reserve. The momentum that gathered in the first two months of the quarter paused in March amid a rapid change in the Fed narrative, a rise in U.S. Treasury yields above 2.60% and a marked decline in oil prices.[3] The Federal Open Market Committee (FOMC) raised the target federal funds rate at its March meeting by 0.25%, to 0.75%–1.00%, but left its outlook for economic conditions largely unchanged from its previous meeting.[4,5] The Fed continues to expect slow, yet steady, economic growth and, according to its longer-run estimate, projects the federal funds rate to rise to just 3.0%.[5]

SOARING CONSUMER CONFIDENCE HELPED STOKE THE RALLY DURING THE FIRST QUARTER OF 2017

U.S. Consumer Confidence Index



Source: Bloomberg, via The Conference Board.

An investment in FSIC III involves substantial risks. For a summary of these important risk factors, please turn to page 4 or click here.

The U.S. economy continued its steady expansion during the quarter. Strong employment data led the way once again as the pace of jobs growth increased from late 2016.[6] After the FOMC raised the target federal funds rate at its March meeting, Fed Chair Janet Yellen noted that the increase was appropriate "in light of the economy's solid progress toward our goals of maximum employment and price stability."[7] Manufacturing growth remained near a two-year high during the quarter, despite a slight pullback in March, while non-manufacturing activity also moved higher throughout the quarter.[8] Meanwhile, economic sentiment soared during the quarter, in some cases moving beyond the pace of so-called hard data. In March, for example, the Conference Board Consumer Confidence Index increased sharply from February and reached its highest level since December 2000.[9] The University of Michigan Index of Consumer Sentiment also rose slightly in March and remained near its 10-year high.[10]

At approximately 2.7% and 1.2%, respectively, high yield bonds and senior secured loans generated competitive total returns during the first quarter of 2017.[1] With more than $9 billion in inflows during the quarter, investor demand for bank loan mutual funds remained strong as investors continued positioning themselves toward asset classes whose values are less impacted by changes in interest rates.[11] Inflows into high yield bond mutual funds turned negative as volatility resurfaced in March.[11] Over the entire quarter, however, the asset class benefited from solid corporate fundamentals, including supportive oil prices through January and February, and from the yield premium high yield bonds offered over their investment grade counterparts.

Performance review

Throughout the first quarter of 2017, FSIC III maintained its focus on senior secured, floating rate investments. Senior secured loans are at the top of the corporate capital structure, which has historically translated to higher recovery rates compared to high yield bonds and equity investments.[12] The Fund raised its institutional offering price to $8.64 during the first quarter and generated a stockholder-based return of 3.1% (without sales charge).[2] Since its inception on April 2, 2014, FSIC III's annualized stockholder return is 6.9% (without sales charge) and 3.2% (with sales charge).[2] By comparison, senior secured loans returned 3.7% and high yield bonds returned 4.6% during the same period.[1]

Since its inception on April 2, 2014, FSIC III's annualized stockholder return is 6.9% (without sales charge) and 3.2% (with sales charge).[2] By comparison, senior secured loans returned 3.7% and high yield bonds returned 4.6% during the same period.[1]

FSIC III paid distributions of approximately $0.175 per share during the quarter ended March 31, 2017, representing an annualized distribution rate of 8.10% based on the Fund's institutional offering price as of quarter end.[13] FSIC III has not lowered its distribution amount since its inception.

We believe that FSIC III's long-term fund structure and focus on directly originated senior secured loans will allow us to manage through volatile markets, as we witnessed in March 2017, and capitalize on investment opportunities.

We continue to leverage our direct lending platform to identify, source and structure investments with attractive return profiles.

Market trends and opportunities

We believe there are several market trends and opportunities that are beneficial to FSIC III's long-term investment horizon and investment objectives, including the following:

Rising interest rates	FSIC III provides investors with access to low duration investments, such as floating rate senior secured loans, whose coupon payments typically "float," or adjust, as market interest rates rise or fall.
Access to the U.S. middle market	FSIC III offers investors access to the U.S. middle market, which comprises nearly 200,000 businesses and would represent the world's third-largest economy if ranked as a country.[14] Although investing in middle market companies may involve a significant number of risks, we believe they are largely insulated from international uncertainties as middle market companies generate the bulk of their revenues domestically.[15]
Reduced market liquidity	According to the Federal Reserve, primary dealer corporate bond balance sheets have fallen more than 84%, from approximately $235 billion pre-credit crisis in 2007 to roughly $36 billion as of December 21, 2016.[16] Reduced market liquidity may lead to increased volatility during periods of market stress. We believe FSIC III's continuous offering and long-term investment view allow it to capitalize on periods when assets may trade below what we believe is their fundamental value.
Need for alternative capital	There were approximately 2,100 fewer U.S. commercial banks in operation as of December 31, 2016 than there were in 2007, with small- and medium-sized banks comprising the bulk of those declines.[17] We believe increasingly tight banking regulations could further curtail middle market lending and create additional opportunities for direct lending for FSIC III.
Senior secured debt	Senior secured loans are at the top of the corporate capital structure. Senior secured loans are typically issued by below investment grade companies, may be difficult to value and illiquid. Yet, their seniority has historically translated to higher recovery rates compared to high yield bonds and equity investments. Therefore, we expect FSIC III to maintain the majority of its portfolio allocated to senior secured, floating rate debt of private U.S. companies. Although senior secured loans may be secured by a company's assets, there can be no assurance that the collateral will not decrease in value or lose its entire value over time, which may have a financial impact on the Fund.
Continuous offering	In our view, having the flexibility and liquidity to invest during short-term market dislocations via a continuous offering may help create value for FSIC III's investors.

Conclusion

As the largest manager of business development companies (BDCs) with more than $17 billion in BDC assets under management as of December 31, 2016, we believe FS Investments' experience, scale and relationship with GSO / Blackstone, as its sub-adviser, will continue to benefit FSIC III's investors.

Note: All figures may be rounded. Returns shown are historical and are based on past performance. Past performance is not indicative of future results.

1 Total returns are based on indices and represent income from regular interest and dividend payments and appreciation in market value with respect to the securities included in the indices. Indices used: High yield bonds – Bank of America Merrill Lynch High Yield Master II Index, which is comprised of U.S. dollar-denominated below investment grade corporate debt securities publicly issued in the U.S. domestic market. Senior secured loans – Credit Suisse Leveraged Loan Index, which is an index designed to mirror the investable universe of the U.S. dollar-denominated leveraged loan market. This data is for illustrative purposes only and is not indicative of any investment. An investment cannot be made directly in an index.
2 Please see below for a description of how FSIC III's stockholder returns (without sales charge) and stockholder returns (with sales charge) are calculated.
3 Federal Reserve Bank of St. Louis, http://bit.ly/29ecBfp.
4 Federal Reserve, http://bit.ly/2nXH9an.
5 Federal Reserve, http://bit.ly/2nFr8ER.
6 U.S. Bureau of Labor Statistics, http://bit.ly/2ki6Xzc.
7 Federal Reserve, http://bit.ly/2nhhFqu.
8 Bloomberg, based on ISM data.
9 The Conference Board, http://bit.ly/1eu7yyH.
10 University of Michigan surveys of consumers, http://bit.ly/1gDEQwe.
11 J.P. Morgan High-Yield and Leveraged Loan Morning Intelligence, April 3, 2017.
12 Although senior loans in which FSIC III invests may be secured by specific collateral, there can be no assurance that the collateral will not decrease in value or lose its entire value over time, which may have a financial impact on FSIC III.
13 The annualized distribution rate shown is expressed as a percentage equal to the projected annualized distribution amount per share (which is calculated by annualizing the distribution amount per share of $0.175 paid in the quarter ended March 31, 2017, without compounding), divided by FSIC III's institutional offering price per share of $8.64 as of March 31, 2017. The annualized distribution rate may be rounded. The payment of future distributions on FSIC III's shares of common stock is subject to the discretion of FSIC III'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. For the quarter ended March 31, 2017, 100% of FSIC III's distributions were funded through net investment income on a tax basis. No portion of FSIC III's distributions during the quarter ended March 31, 2017 was funded through expense reimbursements from FSIC III's sponsor. The determination of the tax attributes of FSIC III's distributions is made annually at the end of FSIC III's fiscal year, and a determination made on an interim basis may not be representative of the actual tax attributes of FSIC III's distributions for a full year. The actual tax characteristics of distributions to stockholders are reported to stockholders annually on Form 1099-DIV.
14 International Monetary Fund World Economic Outlook, October 2016. National Center for the Middle Market, 4Q 2016 Middle Market Indicator. The Middle Market Indicator is a quarterly business performance update and economic outlook survey conducted among 1,000 C-Suite executives of middle market companies. For purposes of the 4Q 2016 Middle Market Indicator, the National Center for the Middle Market defined the U.S. middle market as U.S. companies having annual revenues from $10 million to $1 billion.
15 National Center for the Middle Market, 4Q 2016 Middle Market Indicator.
16 MarketAxess, Primary Dealer Corporate Bond Inventory, based on data from the Federal Reserve Bank of New York, http://bit.ly/1POKe6H.
17 Federal Deposit Insurance Corporation, http://bit.ly/2nFxHHI. Latest data available.

STOCKHOLDER RETURNS AS OF 3/31/17

(without sales charge), compounded monthly						(with sales charge), compounded monthly	
YTD	**1 year**	**3 year** (annualized)	**5 year** (annualized)	**Since inception** (annualized)	**Cumulative total return since inception**	**Cumulative total return since inception**	**Inception date**
3.1%	3.1%	—	—	6.9%	22.1%	9.9%	April 2, 2014

Stockholder returns (without sales charge) are the total returns an investor received for the highlighted period taking into account all distributions paid during such period, compounded monthly. The calculation assumes that the investor purchased shares at FSIC III's public offering price, excluding any selling commissions or dealer manager fees, at the beginning of the applicable period and reinvested all cash distributions pursuant to FSIC III's distribution reinvestment plan (DRP). Stockholder returns (without sales charge) do not include selling commissions and dealer manager fees, which historically could total up to 10% of the public offering price. Had such selling commissions and dealer manager fees been included, the performance shown would be lower.

Stockholder return (with sales charge) is the compounded monthly total return an investor received since inception taking into account all distributions paid during such period, compounded monthly. The calculation assumes that the investor purchased shares at FSIC III's public offering price (which includes the maximum historical selling commissions and dealer manager fees) at inception and reinvested all distributions pursuant to FSIC III's DRP.

Valuation as of the end of each period shown above is the repurchase price pursuant to FSIC III's share repurchase program on such date. Upon liquidation or repurchase, market conditions may cause the actual values to be more or less than the values shown.

Prior to February 2016, FSIC III's public offering price was subject to a sales charge of up to 10% and offering expenses of up to 1.5% of the gross proceeds received in the Fund's offering. Following February 2016, FSIC III only offers its shares at the institutional offering price, which is not subject to any sales charge, but is subject to offering expenses of up to 1.5% of the gross proceeds received in the Fund's offering. FSIC III's total expenses as a percentage of average net assets attributable to common stock was 7.51% for the year ended December 31, 2016. Expenses and fees are described more fully in FSIC III's prospectus. Please consult the prospectus and read it carefully.

An investment in any fund sponsored by FS Investments involves significant costs, and investors should review the information in the applicable fund's prospectus regarding fees and expenses.

RISK FACTORS

Investing in FSIC III may be considered speculative and involves a high level of risk, including the risk of a substantial loss of investment. The following are some of the risks an investment in FSIC III's common stock involves; however, you should carefully consider all of the information found in the section of FSIC III's prospectus entitled "Risk Factors" before deciding to invest in shares of FSIC III's common stock.

- Because there is no public trading market for shares of FSIC III's common stock and FSIC III is not obligated to effectuate a liquidity event by a specified date, if at all, it is unlikely that you will be able to sell your shares. If you are able to sell your shares before FSIC III completes a liquidity event, it is likely that you will receive less than you paid for them. While FSIC III intends to conduct quarterly tender offers for its shares, only a limited number of shares will be eligible for repurchase and FSIC III may amend, suspend or terminate the share repurchase program at any time. In addition, any such repurchases will be at the institutional offering price on the date of repurchase.
- FSIC III invests in securities that are rated below investment grade by rating agencies or that would be rated below investment grade if they were rated. Below investment grade securities, which are often referred to as "junk," have predominantly speculative characteristics with respect to the issuer's capacity to pay interest and repay principal. They may also be difficult to value and illiquid.
- FSIC III'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 FSIC III for investment. Any capital returned to stockholders through distributions will be distributed after payment of fees and expenses.
- An investment strategy focused primarily on privately held companies presents certain challenges, including the lack of available information about these companies.
- A lack of liquidity in certain of FSIC III's investments may adversely affect its business.
- FSIC III is subject to financial market risks, including changes in interest rates, which may have a substantial negative impact on its investments.
- FSIC III has borrowed funds to make investments, which increases the volatility of its investments and may increase the risks of investing in its securities.
- If FSIC III is unable to raise substantial funds in its ongoing, continuous "best efforts" public offering, then it will be more limited in the number and type of investments it may make.
- FSIC III's previous distributions to stockholders were funded in significant part from the reimbursement of certain expenses, including through the waiver of certain investment advisory fees that are subject to repayment to its affiliate, FS Investments, and its future distributions may be funded from such waivers and reimbursements. Significant portions of these distributions were not based on FSIC III's investment performance, and such waivers and reimbursements by FS Investments may not continue in the future. If FS Investments had not agreed to reimburse certain of FSIC III's expenses, including through the waiver of certain of its advisory fees, significant portions of these 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 you would otherwise be entitled.

FSIC III is a long-term investment for persons of adequate financial means who have no need for liquidity in their investment. To invest in FSIC III, an investor must have either (i) a net worth (not including home, furnishings and personal automobiles) of at least $70,000 and an annual gross income of at least $70,000, or (ii) a net worth (not including home, furnishings and personal automobiles) of at least $250,000. Some states impose higher suitability standards. Please consult the prospectus for a detailed description of the suitability standards imposed on investors, including heightened standards required by certain states.

FS Investment Solutions, LLC, the dealer manager for the public offering, is an affiliate of the investment adviser and serves or has served as the dealer manager for the public offerings of shares by other non-traded funds sponsored by FS Investments. These relationships may create conflicts in connection with FS Investment Solutions' due diligence obligations under the federal securities laws. Prior to February 2016, FS Investment Solutions was entitled to compensation in connection with the public offering, including receiving selling commissions (which were generally reallowed to selling broker-dealers) and dealer manager fees based on the gross offering proceeds of shares sold in the offering. FS Investment Solutions may also be reimbursed for accountable due diligence expenses based on the gross offering proceeds of shares sold in the public offering. In addition, FSIC III's investment adviser and its affiliates may face conflicts of interest as a result of compensation arrangements, time constraints and competition for investments, which they will attempt to resolve in a fair and equitable manner.