



Second quarter 2017

FS INVESTMENT CORPORATION III

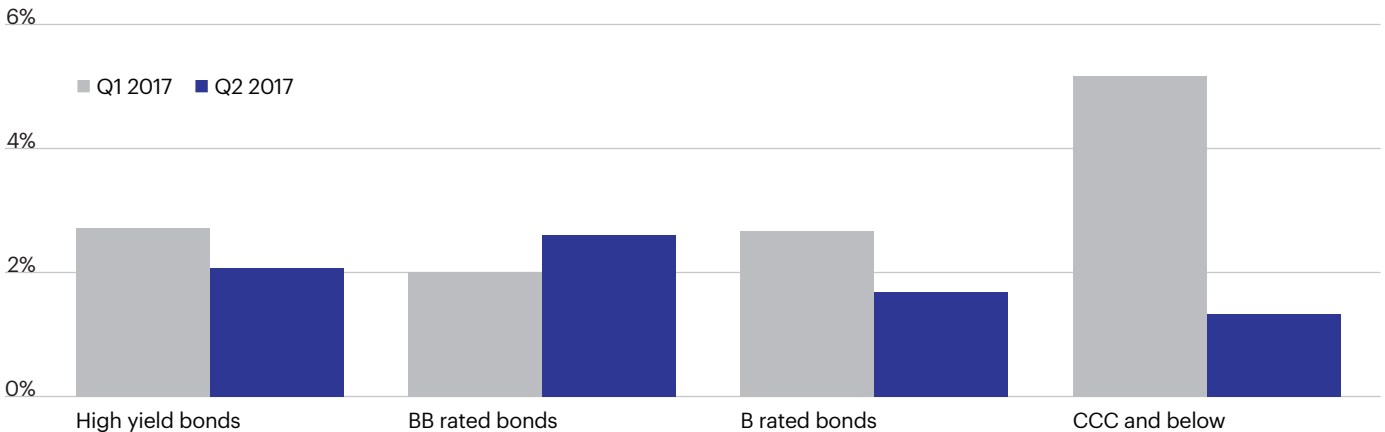
Summary

- The pace of the U.S. economic expansion slowed during the quarter as both inflation and consumer spending data trended lower.
- High yield bonds and senior secured loans generated total returns of approximately 2.1% and 0.7%, respectively, during the second quarter of 2017.¹
- FS Investment Corporation III (FSIC III, or the Fund) generated a stockholder return (without sales charge) of 2.0% for the quarter ended June 30, 2017, compared to 0.7% for senior secured loans.^{1,2}

Market review

Credit markets continued to advance during the second quarter of 2017 as economic and market data generally remained positive. However, demand for high yield bonds and senior secured loans slowed from recent quarters as expectations of rising interest rates moderated, inflation pressures cooled and oil prices declined. Investors remained concerned about an ongoing oversupply of oil despite OPEC’s May agreement to extend output cuts by nine months.³ Oil prices fell during the quarter from a high of approximately \$53 per barrel, briefly reaching as low as \$42, before staging a modest comeback in the final days of June, closing at \$46.04 per barrel on June 30.⁴ Major government interest rates also continued to decline from their March 2017 highs. In early June, for example, yields on the 10-year U.S. Treasury note fell to approximately 2.12%, their lowest point since November 2016, before ending the quarter at approximately 2.30%.⁵ Despite mixed economic data, the Federal Open Market Committee (FOMC) raised the target federal funds rate at its June meeting by 0.25%, to 1.00%–1.25%.⁶ Otherwise, policy makers made very few changes to their Summary of Economic Projections from the March meeting.⁷ The Fed continues to anticipate slow, but steady, economic growth and affirmed its plan to raise interest rates a total of three times in 2017.⁷

HIGHER-RATED HIGH YIELD BONDS OUTPERFORMED IN THE SECOND QUARTER OF 2017



Source: Bank of America Merrill Lynch U.S. High Yield Master II Index.

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

An investment in FSIC III 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 FSIC III carefully before investing. FSIC III’s prospectus contains this and other information about FSIC III. Investors may obtain a copy of FSIC III’s prospectus free of charge at www.fsinvestments.com or by contacting FS Investments at 201 Rouse Boulevard, Philadelphia, PA 19112 or by phone at 877-628-8575. Investors should read and carefully consider all information found in FSIC III’s prospectus and other reports filed with the U.S. Securities and Exchange Commission before investing.

This is neither an offer to sell nor a solicitation of an offer to buy the securities described herein. **An offering is made only by a prospectus, which must be made available to you in connection with this offering.** No offering is made to New York investors except by a prospectus filed with the Department of Law of the State of New York.

This commentary is available for advisor use only in the state of Ohio. This material has not been approved for use in the state of Kansas.

An investment in shares of FSIC III’s common stock involves significant costs, and investors should review the information in FSIC III’s prospectus regarding fees and expenses.

The pace of the U.S. economic expansion slowed during the quarter as both inflation and consumer spending data trended lower. After an unexpectedly weak reading in April, for example, the Consumer Price Index fell below 2.0% in May.⁸ The Fed's preferred measure of inflation, the personal consumption expenditures index, increased just 1.7% in April 2017 from one year earlier and 1.4% in May 2017 from May 2016.⁹ Consumer spending followed a similarly weak pattern, rising just 0.1% in May from a month earlier.⁹ Fed Chair Janet Yellen brushed off the soft inflation data, referring to lower prices at the Fed's June press conference as having been driven by "one-off reductions" in certain prices.¹⁰ Instead, members of the FOMC focused primarily on the strengthening labor market and solid sentiment data in raising interest rates for the third time in as many quarters.⁶ Unemployment fell to just 4.3% in May, the lowest reading since May 2001.¹¹ Meanwhile, consumers and businesses remained optimistic about the economy. Both the University of Michigan Index of Consumer Sentiment and the National Federation of Independent Business (NFIB) Index of Small Business Optimism remain close to their 10-year highs.^{12,13}

Senior secured loans generated total returns of 0.7% compared to 2.1% for high yield bonds during the quarter.¹ Returns on investment grade bonds outpaced both asset classes for the quarter, at approximately 2.4%.¹ Senior secured loans and high yield bonds generally saw lighter inflows during the quarter as interest rate concerns eased, the U.S. Treasury curve flattened, and volatility in the energy markets increased. Within this environment, higher-rated securities across both asset classes outperformed their lower-rated peers during the quarter. This was a reversal from recent quarters, when CCC rated securities handily outpaced both B and BB rated loans and bonds.¹

Performance review

Throughout the second quarter of 2017, FSIC III maintained its focus on senior secured, floating rate investments, which we expect will help drive long-term performance and provide downside protection in the event of further credit market volatility.¹⁴ The Fund's institutional offering price of \$8.64 was unchanged during the second quarter, and the Fund generated a stockholder-based return (without sales charge) of 2.0%.² Since its inception on April 2, 2014, FSIC III's annualized stockholder return is 7.0% (without sales charge) and 3.6% (with sales charge).² By comparison, senior secured loans returned 3.7% and high yield bonds returned 4.9% during the same period.¹

FSIC III paid distributions of approximately \$0.18 per share during the quarter ended June 30, 2017, representing an annualized distribution rate of 8.10% based on the Fund's institutional offering price as of quarter end.¹⁵

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 and capitalize on investment opportunities.

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

Conclusion

As the largest manager of BDCs with more than \$18 billion in BDC assets under management as of March 31, 2017, we believe FS Investments' experience and the size of its direct lending business will help provide FSIC III's investors with strong and sustainable levels of income through changing markets.

Since its inception on April 2, 2014 through June 30, 2017, FSIC III's annualized stockholder return is 7.0% (without sales charge) and 3.6% (with sales charge).² By comparison, senior secured loans returned 3.7% and high yield bonds returned 4.9% during the same period.¹

STOCKHOLDER RETURNS AS OF 6/30/17

(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
5.2%	14.5%	7.0%	—	7.0%	24.6%	12.1%	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 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.

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

- 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 U.S. 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. 10-year U.S. Treasuries – Bank of America Merrill Lynch 10-year U.S. Treasury Index, which measures the total return of the 10-year U.S. Treasury note. Investment grade bonds – Bank of America Merrill Lynch U.S. Corporate Master Index, which is comprised of publicly issued, fixed-rate investment grade corporate debt. This data is for illustrative purposes only and is not indicative of any investment. An investment cannot be made directly in an index.
- Please refer to the table above for a description of how FSIC III's stockholder returns (without sales charge) and stockholder returns (with sales charge) are calculated.
- Organization of the Petroleum Exporting Countries, <http://bit.ly/2rP9Hr3>.
- West Texas Intermediate Cushing Crude Oil Spot Price.
- Federal Reserve Bank of St. Louis, <http://bit.ly/29ecBfp>.
- Federal Reserve, <http://bit.ly/2s5LDj5>.
- Federal Reserve, <http://bit.ly/2rhINV5>.
- Bureau of Labor Statistics, <http://bit.ly/2uKlunl>.
- Bureaus of Economic Analysis, <http://bit.ly/1cR0lcA>.
- Federal Reserve, <http://bit.ly/2sx779K>.
- Bureau of Labor Statistics, <http://bit.ly/2ibnFLh>.
- University of Michigan Index of Consumer Sentiment, <http://bit.ly/2thH0mu>.
- National Federation of Independent Business, <http://bit.ly/Lg4Ndz>.
- 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.
- 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 June 30, 2017, without compounding), divided by FSIC III's institutional offering price per share of \$8.64 as of June 30, 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 June 30, 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 June 30, 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.

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.
- Investing in middle market companies involves a number of significant risks, any one of which could have a material adverse effect on FSIC III's operating results.
- 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 reallocated 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.