FSKR | FS KKR Capital Corp. II

Q4 Fund commentary

As of 12/31/2020

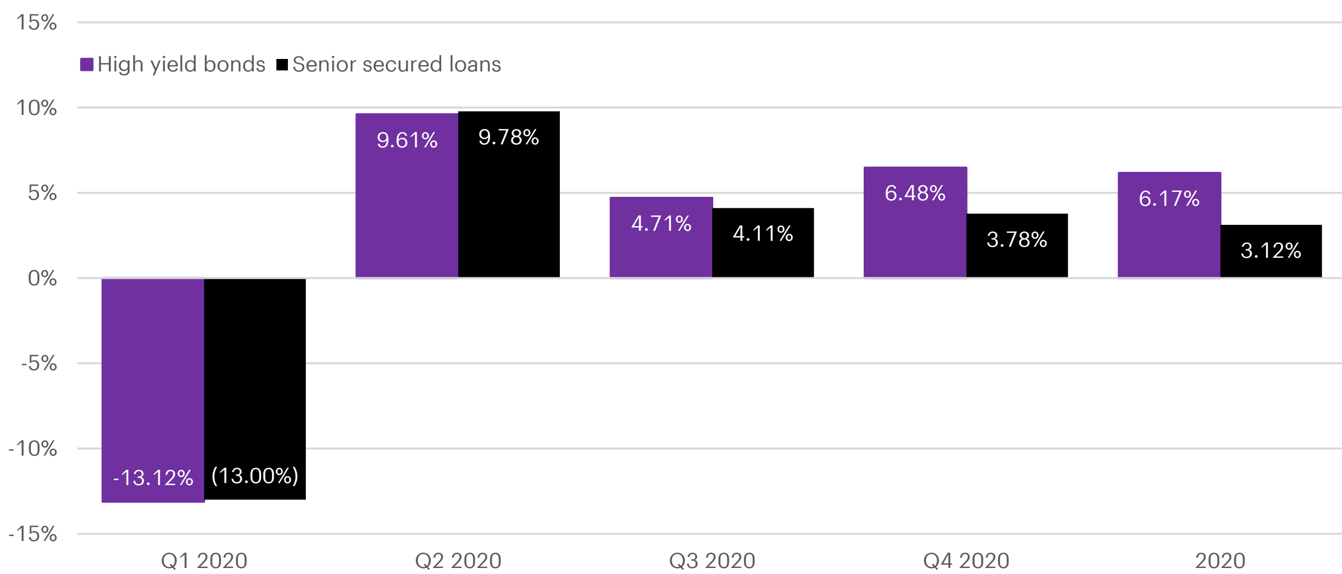
Summary

- Despite the economic slowdown during the fourth quarter of 2020, investors remained optimistic and credit markets marched higher. High yield bonds and senior secured loans returned 6.5% and 3.8% during Q4, respectively, and returned 6.2% and 3.1%, respectively, in full-year 2020.[1]
- The Fund's net asset value (NAV) rose 1.8% to $25.10 per share as of December 31, 2020, up from $24.66 per share as of September 30, 2020.[2] Broad portfolio appreciation during Q4 was modestly offset by realized losses as a result of four legacy investments that were restructured during the quarter.
- The board declared a distribution of $0.55 per share for the first quarter of 2021, which equates to an 8.8% annualized yield based on the Fund's NAV as of December 31, 2020.

Market review

On the heels of record GDP growth in Q3 2020, the economic recovery showed clear signs of slowing during the fourth quarter of 2020 as the pandemic raged. Retail sales fell by -1.1% in November, the largest month-over-month drop since April, as consumers dealt with new restrictions and colder weather.[3] Labor market improvement slowed in Q4, culminating with 140,000 jobs lost in December, mostly in the hotel and restaurant sectors, and weekly jobless claims crept upward, albeit modestly.[4] At the same time, investors largely remained optimistic as two highly effective vaccines were approved and rolled out during the quarter and Congress passed an additional round of fiscal stimulus with more likely on the way in 2021. Against this backdrop, the 10-year U.S. Treasury yield continued its gradual rise during the quarter. The 10-year rose 24 bps, to 0.93%, breaking out of the 0.60%–0.75% range it had occupied for much of the previous six months. Market-based measures of inflation also continued their steady rise during the quarter. While the Federal Reserve upgraded many of its projections for economic growth in the next two years, policymakers held firm in their expectation that the target federal funds rate will remain intact.

High yield bond and senior secured loan total returns by quarter



Source: ICE BofAML U.S. High Yield Index, S&P/LSTA Leveraged Loan Index, as of December 31, 2020.

An investment in FS KKR Capital Corp. II involves substantial risks. For a summary of these important risk factors, please turn to page 5 or click here.

High yield bonds and senior secured loans returned 6.5% and 3.8%, respectively, during the fourth quarter, as both asset classes benefited from an improved technical environment.[1] High yield bonds, for example, saw quarterly flows of approximately $6.3 billion, well above Q3 flows of $820 million, while rising rates fueled demand for loans, which nearly stanched the $3.3 billion outflow from the previous quarter. For the year, high yield bonds and senior secured loans returned 6.2% and 3.1%, respectively.[1]

During the fourth quarter, FSKR's NAV increased 1.8%, we fully covered our quarterly distributions and outearned the Fund's $0.55 per share distribution.

Fourth quarter returns across both the high yield bond and senior secured loan markets were largely driven by lower-rated securities as emerging news of multiple viable COVID-19 vaccines provoked a strong reversal in earlier year-to-date trends. CCC rated bonds returned 12.2% in Q4, ending the year up 2.9%, while CCC loans returned 9.1% in Q4, ending the year down -0.9%.[1] Adding to the risk-on focus, top performers during November and December were credits in sectors like transportation, gaming, lodging and leisure, and broadcasting, with exposure to companies that produce live events.

FSK and FSKR merger announcement

We announced the proposed merger of FS KKR Capital Corp. (NYSE: FSK) and FSKR in November 2020, which was a significant step toward our long-term strategic goal of creating a premier middle-market lending franchise and industry leading BDC, and we believe a significant step forward for our shareholders. Upon completion of the proposed merger, the FS KKR franchise will become a single BDC with approximately $16 billion in assets, affording it the size, scale, market reach, balance sheet strength, and investing discipline to become a premier provider of capital to companies operating in the upper middle market. We would expect the merger to close during the second or third quarter of 2021, shortly after receiving shareholder approval and other customary closing conditions.

Performance review

FS KKR Capital Corp. II's (NYSE: FSKR) NAV rose 1.8% quarter over quarter to $25.10 per share as of December 31, 2020, from a NAV of $24.66 per share as of September 30, 2020.[3] Net realized and unrealized gains on investments of $87 million comprised:

- **Broad portfolio appreciation:** Unrealized appreciation across the portfolio of $347 million during the quarter was primarily driven by a combination of positive operating results and improved valuation inputs.
- **Realized losses due to the restructuring of older vintage assets:** Realized depreciation totaled $260 million during the quarter, partially offsetting the unrealized appreciation. Approximately 92% of our realized depreciation was the result of four legacy investments that were restructured during the fourth quarter. We view these restructurings as a significant step forward in our efforts over the last several quarters to address the performance of larger, stressed businesses in the portfolio, which have dragged on performance.

  As of December 31, 2020, nonaccruals represented approximately 3.5% of the portfolio on a cost basis and 1.8% of our portfolio on a fair value basis. This compares to 9.3% and 4.2%, respectively, as of September 30, 2020. The decline in nonaccruals was primarily related to the removal of three investments, two of which were restructured during the quarter and one of which was sold. We did not place any new investments on nonaccrual in the fourth quarter.
- **Share repurchases:** We executed approximately $43 million of the $100 million share buyback program, which was terminated as of November 23, 2020, in connection with the transactions contemplated by the proposed merger of FSK and FSKR. Through November 23, 2020, we repurchased approximately $43 million of

shares under this program, which was accretive to the portfolio, adding $0.04 per share to the Fund's NAV during the quarter.

Our board declared a distribution of $0.55 per share for the first quarter of 2021, which equates to an annualized yield of 8.8% based on FSKR's NAV per share of $25.10 as of December 31, 2020. Over the long term, we expect our dividends per share will equate to a target of 9.0% yield based on NAV per share. We acknowledge there will be certain quarters where our annualized yield may be greater or less than this figure due to quarter-to-quarter fluctuations in the business from an operational standpoint.

Investment activity

Across the FS/KKR platform, we believe the Fund benefits significantly from our incumbency positions with existing borrowers as well as our deep relationships with key sponsors. These positions and relationships have allowed us to see new opportunities while still maintaining a selective bias that hinges on protection of principal first and yield second.

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As a result of these fundamental drivers, during the fourth quarter we originated $1.3 billion in new investments. Those investments, combined with $587 million of net sales and repayments, when factoring in sales to our joint venture, equated to net portfolio growth of approximately $712 million during the quarter. During the period from January 1 to February 28, 2020, we closed an additional $489 million in investments. Despite the pickup in origination activity in Q4, we remained very focused on structure and investment quality. Our 2020 closure rate of under 3%, as compared to transactions screened, is slightly lower than our historical closure rate of approximately 4%. In addition, approximately 44% of our originations during the fourth quarter came from opportunities and companies previously invested in by KKR, illustrating the power of incumbency and our relationships.

We are pleased with the assets we've added since the FS/KKR Advisor partnership was formed. From its inception in Q2 2018 through December 31, 2019, we made approximately $3.2 billion in new investments, resulting in just 62 basis points of cumulative depreciation. From its inception through December 31, 2020, which includes the effects of COVID-19, FS/KKR Advisor has originated approximately $5.1 billion of new investments with just 45 basis points of cumulative depreciation.

As of December 31, 2020, the Fund had a fair value of approximately $8.0 billion, up from $7.3 billion the previous quarter. The Fund consisted of 155 portfolio companies, down from 160 portfolio companies as of September 30, 2020. We maintained the Fund's focus on senior secured debt during the quarter and, since FS/KKR Advisor was formed, we have worked to turn the investment portfolio toward what we believe to be more conservative investment structures in companies we see as having more defensible operating positions. Senior secured debt represented 77% of the portfolio's fair value as of December 31, 2020. Approximately 57% of our investment portfolio is composed of assets originated by FS/KKR Advisor, and approximately 63% of total assets in the portfolio have been originated by the KKR Credit platform.

Portfolio by asset type (based on fair value)	**12/31/2020**	**12/31/2019**
1st lien loans	66%	66%
2nd lien loans	10%	9%
Other senior secured debt	1%	3%
Subordinated debt	1%	6%
Asset-based finance	10%	6%

Credit Opportunities Partners, LLC	8%	6%
Equity/other	4%	4%

Outlook

Looking ahead, we believe sustained government investment and spending on initiatives in education, infrastructure, health care, supply chain resilience and clean energy will continue to garner focus and attention. Combining these elements of governmental involvement in the economy with an expected rebound in consumer spending, inflation targeting by the Federal Reserve, and an outlook for operating companies which includes relatively easy year-over-year comps, we believe 2021 has many of the key ingredients to be a year filled with meaningful economic growth opportunities.

Within the BDC industry, we believe company and platform size increasingly will lead the way as strategic differentiators. As companies increasingly use private credit interchangeably with the syndicated loan markets, we believe private credit alternatives can be increasingly attractive when they are delivered on a scale which is relevant to larger borrowers. We believe the KKR Credit platform, one of the few platforms able to operate at such scale, is poised to continue attracting this new transaction volume, thereby leading to more attractive long-term growth prospects. As private credit continues to grow as a distinct asset class, our goal is to position ourselves as favorably as possible to capture more than our fair share of the corresponding increase in transaction volume.

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

1 Total returns are based on indexes and represent income from regular interest and dividend payments and appreciation in market value with respect to the securities included in the indexes. Indexes used: high yield bonds – ICE BofAML U.S. High Yield Master II Index, which is designed to track the performance of U.S. dollar-denominated below investment grade corporate debt publicly issued in the U.S. domestic market; investment grade bonds – ICE BofAML U.S. Corporate Master Index, which tracks the performance of U.S. dollar-denominated investment grade corporate debt publicly issued in the U.S. domestic market; senior secured loans – S&P/LSTA Leveraged Loan Index, which is a market value-weighted index designed to measure the performance of the U.S. leveraged loan market; 10-year U.S. Treasuries – ICE BofAML 10-year U.S. Treasury Index, which measures the total return of the 10-year U.S. Treasury note. This data is for illustrative purposes only and is not indicative of any investment. An investment cannot be made directly in an index.

2 Assumes the value in common shares is the NAV per share.

3 Census.gov, http://bit.ly/3kppSEn.

4 U.S. Bureau of Labor Statistics.

Risk factors

Investing in FS KKR Capital Corp. II 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 the Fund's common stock involves; however, you should carefully consider all of the information found in Item 1A of our annual report on Form 10-K entitled "Risk Factors" filed with the U.S. Securities and Exchange Commission (the SEC).

- The Fund 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.
- The Fund'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 the Fund for investment. Any capital returned to shareholders 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 the Fund's operating results.
- A lack of liquidity in certain of the Fund's investments may adversely affect its business.
- The Fund is subject to financial market risks, including changes in interest rates, which may have a substantial negative impact on its investments.
- The Fund has borrowed funds to make investments, which increases the volatility of its investments and may increase the risks of investing in its securities.
- The Fund's previous distributions to shareholders were funded in significant part from the reimbursement of certain expenses, including through the waiver of certain investment advisory fees.

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 FS KKR Capital Corp. II. 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 the Fund's operations or the economy generally due to terrorism, natural disasters or pandemics such as COVID-19, future changes in laws or regulations and conditions in the Fund's operating area, unexpected costs, charges or expenses resulting from the business combination transaction involving the Fund, and failure to realize the anticipated benefits of the business combination transaction involving the Fund. Some of these factors are enumerated in the filings the Fund makes with the SEC. The inclusion of forward-looking statements should not be regarded as a representation that any plans, estimates or expectations will be achieved. Any forward-looking statements speak only as of the date of this communication. Except as required by federal securities laws, the Fund undertakes no obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. Readers are cautioned not to place undue reliance on any of these forward-looking statements.

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