INVESTMENTS®

Q2 Fund commentary

As of 6/30/2020

FS Energy & Power Fund

Summary

- Supply/demand dynamics across global commodity markets improved during the second quarter, sparking a partial recovery in energy stocks and bonds.
- Global demand began to recover as stay-at-home orders gradually eased during the quarter. On the supply side, OPEC and its partner countries (OPEC+) announced their intention to extend production cuts through July, while U.S. oil producers continued to limit production.
- Energy senior secured loans returned 25.4% during the quarter, while high yield energy bonds and upstream equities returned 33.1% and 59.5%, respectively, retracing part of their Q1 losses.[1,2,3]
- FS Energy & Power Fund (FSEP or the Fund) generated a shareholder-based total return of -7.4% in the second quarter as we focused on retaining capital and enhancing the Fund's liquidity.[4]

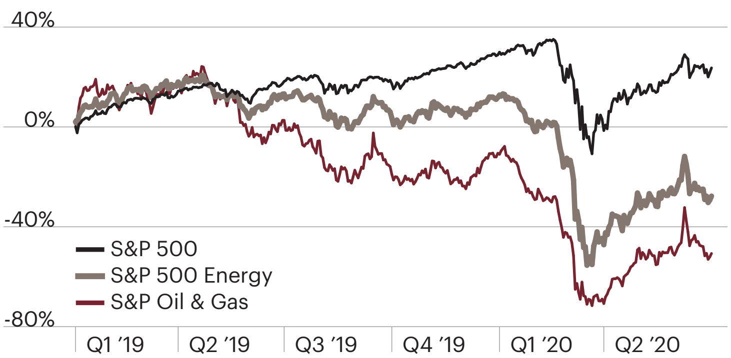
Market review

Following the extreme stress the energy sector experienced during the first quarter of 2020, supply/demand dynamics markedly improved during the second quarter, sparking a rally within energy markets and a partial retracement of Q1 losses. Crude oil prices reached a two-decade low of $16.55 a barrel in late April before closing the quarter approximately 2.5 times higher, near $40 a barrel.[5] Global demand began to recover as stay-at-home orders eased during the quarter. On the supply side, OPEC+ countries announced their intention to extend earlier cuts of 9.4 million barrels a day, which were originally scheduled to end on July 1, through the end of July. Meanwhile, the EIA lowered its forecast for U.S. oil production. It now expects U.S. crude production in 2020 and 2021 to fall 600,000 barrels per day and 1.2 million barrels per day, respectively, below average U.S. daily production in 2019.[6]

Natural gas prices rose a more modest 6.7% during the quarter but experienced significant volatility along the way. Natural gas prices benefited from lower U.S. shale production, which helped to offset reduced demand. U.S. natural gas production averaged approximately 96.9 billion cubic feet per day in the second quarter, down from approximately 103 billion the previous quarter, and the EIA forecasts production will continue its decline though Q2 2021.[7] Natural gas consumption is expected to begin climbing once again in Q4. The more balanced supply/demand picture is expected to help stabilize prices in the second half of this year.[7]

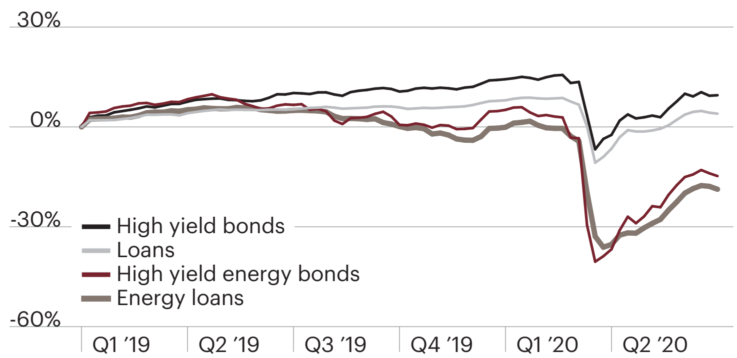
ENERGY STOCKS TOTAL RETURN[1]

Indexed to 1/1/2019



ENERGY BONDS & LOANS TOTAL RETURN[1]

Indexed to 1/1/2019



Source: Bloomberg Finance, L.P., as of June 30, 2020. High yield bonds are represented by the ICE BofAML High Yield Master II Index. Loans are represented by the S&P/LSTA Leveraged Loan Index. High yield energy bonds are represented by the ICE BofAML High Yield Energy Index. Energy loans are represented by the S&P/LSTA Leveraged Loan Index (energy component).

Energy assets saw a significant bounce in the second quarter of 2020, retracing part of their Q1 losses, as senior secured energy loans and high yield energy bonds returned 25.4% and 33.1%, respectively.[1,2] This compares to 30.5% for the S&P 500 Energy Index and 78.6% for mid-cap energy stocks.[3] Yields on high yield energy bonds, which peaked at approximately 23.1% in late March 2020, continued their steady decline, ending the quarter at 10.6%.[2] Yields on the broader high yield market reached as high as 11.1% in March before ending the quarter at 6.8%.[8]

Performance review

TOTAL RETURNS
(without sales charge)

	Q2 2020	2019
FSEP	**-7.4%**	**-37.5%**
Energy high yield bonds	33.1%	-19.8%
Energy senior secured loans	25.4%	-9.9%
Upstream equities	59.5%	-64.9%

Given the challenging market conditions, we took a number of steps this year to retain capital and enhance the Fund's liquidity. This includes suspending the Fund's quarterly tenders and regular monthly distribution following the March distribution, deferring a large portion of management fees, and reducing leverage by paying down borrowings. While the Fund's net asset value declined from $3.59 per share as of March 31, 2020 to $3.32 per share as of June 30, 2020, we believe these efforts helped stabilize the portfolio during the quarter.

Net realized and unrealized losses were $0.24 per share. There were three primary drivers of performance during the quarter:

- **Appreciation in certain EIG-originated assets:** As energy loan and high yield prices rallied near quarter-end, FSEP's broadly syndicated assets sourced through FS/EIG Advisor contributed to NAV performance during the quarter.
- **Sales of assets to repay borrowings:** We sold $395 million in assets during the quarter, with the majority of the proceeds used to pay down $425 million of borrowings. We believe doing so will help de-risk the portfolio and help reduce volatility in FSEP's net asset value over the long term. In the short term, however, the asset sales contributed to realized losses of approximately -$412 million during the quarter.

  Since quarter-end we have fully repaid all borrowings under the Goldman Sachs borrowing facility and amended our borrowing facility with J.P. Morgan, which provides us with the flexibility to borrow against a broader range of asset types. We believe this flexibility may help us increase income for the portfolio. In addition to using the proceeds from asset sales to pay down borrowings, we have focused on increasing the Fund's cash position.
- **Underperformance of select older vintage assets:** Much of the realized and unrealized losses during the quarter, and over the last several quarters, have been driven by older vintage investments in upstream companies that are located in challenged basins and/or have experienced fundamental deterioration in their operations. Therefore, while energy prices rebounded off the April lows during the quarter, the fundamental performance of certain of our older vintage portfolio companies is less correlated to rising energy prices than their peers due to the fundamental stress in their business.

  Ten investments were on non-accrual as of June 30, 2020, representing 11% of the Fund's portfolio based on fair value and 25.1% based on amortized cost. The vast majority of non-accruals were driven by older vintage upstream investments. We are actively working with the management teams and owners of these companies to address their liquidity and operational needs in order to maximize shareholder value. We have taken some of these portfolio companies through restructurings already and will likely take others through restructuring in the coming quarters.

Despite the challenging environment and underperformance of some of the Fund's larger investments in older vintage assets, the portfolio continues to generate a moderate degree of income. As our efforts to raise cash, retain capital and reduce borrowings helped stabilize the Fund's portfolio, the Fund's board of trustees determined that the Fund could make a distribution without placing undue pressure on the portfolio. The board declared a distribution of $0.03 per share paid to shareholders on July 10. The payment of the distribution was based on an investor's election—either cash, or reinvestment through the Fund's distribution reinvestment plan.

While FSEP's board declared a cash distribution, it has not declared or resumed regular cash distributions to shareholders for any period after March 31, 2020, and FS/EIG Advisor and the Fund's board expect that future regular cash distributions to shareholders will be suspended until such time that the Fund's board and FS/EIG Advisor believe that market conditions and the financial condition of the Fund support the resumption of such distributions. FSEP's board has evaluated and will continue to evaluate the Fund's ability to pay any distributions through the balance of the fiscal year. There can be no assurance that the Fund will be able to pay distributions in the future. The timing and amount of any future distributions to shareholders are subject to applicable legal restrictions and the sole discretion of the Fund's board.

Investment activity

Total purchases during the second quarter were $173 million, of which $155 million was committed to new direct originations. In total, FSEP has committed over $1.6 billion to EIG-sourced investments. As of June 30, 2020, direct originations represented 89% of the portfolio based on fair value, compared to 55% as of December 31, 2017, prior to the formation of the FS/EIG partnership. Exited investments totaled approximately $502 million during the second quarter as we sold assets to pay down borrowings.

Since forming the FS/EIG partnership in 2018, we have grown the Fund's allocation to infrastructure assets, including midstream and power companies, which historically tend to have more predictable earnings than upstream companies. At the same time, we have significantly reduced the allocation to older vintage upstream companies, which have dragged on performance for several quarters.

Portfolio by subsector (based on fair value)	**12/31/2018**	**6/30/2020**
Upstream	64%	48%
Midstream	11%	36%
Downstream	1%	—
Power	6%	6%
Service & equipment	18%	6%
Industrials	—	1%
Sustainable Infrastructure Investments, LLC	—	3%

We have focused on growing our allocation to senior secured debt and preferred equity investments in order to achieve our income and growth objectives. Senior secured debt represented 59% of all purchases during the quarter. More broadly, as of June 30, 2020, senior secured debt investments also represented approximately 59% of the portfolio's total fair value.

As of June 30, 2020, preferred equity investments represented approximately 25% of the portfolio based on fair value, unchanged from the previous quarter. It is important to note that EIG-originated preferred equity investments differ from typical preferred equity in that these investments are usually income generating and normally include structural protections and significant asset coverage. For FSEP's preferred equity investments, we typically seek a high current coupon, structural downside protections and some form of equity upside.

Portfolio by asset type (based on fair value)	**12/31/2018**	**6/30/2020**
1st lien loans	23%	28%
2nd lien loans	20%	13%
Senior secured bonds	17%	18%
Unsecured debt	30%	9%
Preferred equity	2%	25%
Sustainable Infrastructure Investments, LLC	—	3%
Equity/other	8%	4%

Additional resources

Please visit FSEP's webpage at www.fsinvestments.com/investments/all-investments/fsep or www.fsinvestments.com/resources/fs-energy-power-fund-update for additional resources.

SHAREHOLDER RETURNS AS OF 6/30/2020

(without sales charge), compounded monthly					(with sales charge)	
1 year	**3 year** (annualized)	**5 year** (annualized)	**Since inception** (annualized)	**Cumulative total return since inception**	**Cumulative total return since inception**	**Inception date**
-42.1%	-16.2%	-10.2%	-3.0%	-23.8%	-31.4%	July 18, 2011

Shareholder 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. Except for shareholder returns (without sales charge) for the 1-year period, the calculation assumes that the investor purchased shares at FSEP's public offering price, excluding any selling commissions or dealer manager fees, at the beginning of the applicable period and reinvested all distributions pursuant to FSEP's distribution reinvestment plan (DRP). Since FSEP closed its public offering in November 2016 and has since issued new shares only pursuant to its DRP, the calculation for the 1-year period assumes the investor purchased shares at the beginning of the applicable period at a price based on FSEP's DRP on such date. Shareholder returns (without sales charge) do not include selling commissions and dealer manager fees, which 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.

Shareholder 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 FSEP's public offering price (which includes the maximum selling commissions and dealer manager fees) at inception and reinvested all distributions pursuant to FSEP's DRP.

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

FSEP'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. FSEP's total expenses as a percentage of average net assets attributable to common shares was 7.75% for the year ended June 30, 2020.

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

1 S&P/LSTA Leveraged Loan Index (energy component).

2 ICE BofAML U.S. High Yield Energy Index.

3 SPDR S&P Oil & Gas Exploration & Production ETF.

4 For more information on shareholder returns, see the table above. For the 12 months ended June 30, 2020, FSEP's cash distributions on a tax basis were sourced 100% from net investment income. The payment of future distributions on FSEP's common shares is subject to the discretion of FSEP's board of trustees and applicable legal restrictions and, therefore, there can be no assurance as to the amount or timing of any such future distributions.

5 Federal Reserve Bank of St. Louis, https://fred.stlouisfed.org/series/WTISPLC.

6 U.S. Energy Information Administration, https://bit.ly/2XvHGDw.

7 U.S. Energy Information Administration, https://bit.ly/30sSBQa.

8 ICE BofAML U.S. High Yield Master II Index.

RISK FACTORS

An investment in the common shares of FSEP involves a high degree of risk and may be considered speculative. The following are some of the risks an investment in our common shares involves; however, you should carefully consider all of the information found in Item 1A of our annual report on Form 10-K and subsequent quarterly reports on Form 10-Q entitled “Risk Factors” and the Form 8-K filed on March 31, 2020.

- Because there is no public trading market for our common shares and we are not obligated to effectuate a liquidity event by a specified date, it will be difficult for you to sell your common shares. If you are able to sell your common shares before we complete a liquidity event, it is likely that you will receive less than what you paid for them. While we intend to conduct quarterly tender offers for our common shares, only a limited number of our common shares will be eligible for repurchase and we may suspend or terminate the share repurchase program at any time.
- Our 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 us for investment. Any capital returned to shareholders through distributions will be distributed after payment of fees and expenses.
- **Our investment policy is to invest, under normal circumstances, at least 80% of our total assets in securities of energy and power companies. The revenues, income (or losses) and valuations of energy and power companies can fluctuate suddenly and dramatically due to a number of environmental, regulatory, political and general market risks, which have historically impacted our financial performance, including our offering price, and may continue to in the future. For information about the Fund’s offering price, visit www.fsinvestments.com.**
- 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 our operating results.
- A lack of liquidity in certain of our investments may adversely affect our business.
- We are subject to financial market risks, including changes in interest rates, which may have a substantial negative impact on our investments.
- We have borrowed funds to make investments, which increases the volatility of our investments and may increase the risks of investing in our securities.
- FSEP is a long-term investment for persons of adequate financial means who have no need for liquidity in their investment. To invest in FSEP, an investor must have either (i) a net worth of at least $70,000 and an annual gross income of at least $70,000, or (ii) a net worth of at least $250,000. Some states, such as Kansas, impose higher suitability standards.
- Our previous distributions to shareholders 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 our affiliate, FS Investments, and our future distributions may be funded from waivers from our current adviser and affiliate, FS/EIG Advisor. Significant portions of these distributions may not be based on our investment performance, and such waivers by FS/EIG Advisor may not continue in the future. If FS/EIG Advisor does not agree to reimburse certain of our expenses, including through the waiver of advisory fees, significant portions of future distributions may come from offering proceeds or borrowings. The repayment of amounts owed to FS/EIG Advisor will reduce the future distributions to which you would otherwise be entitled.
- The global outbreak of COVID-19 (commonly known as the coronavirus) has caused volatility, severe market dislocations and liquidity constraints in many markets, including securities FSEP holds, and may adversely affect FSEP’s investments and operations.

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