PARTICIPANTS

Corporate Participants

John Costain – Chief Executive & Financial Officer, KNOT Offshore Partners LP

Other Participants

Hillary Cacanando – Analyst, Wells Fargo Securities LLC
Ben Brownlow – Analyst, Raymond James & Associates, Inc.

MANAGEMENT DISCUSSION SECTION

Operator: Good day, and welcome to the Second Quarter 2018 Earnings Conference Call. All participants will be in a listen-only mode. [Operator Instructions] After today's presentation, there will be an opportunity to ask questions. [Operator Instructions] Please note this event is being recorded.

I would now like to turn the conference over to John Costain, CEO. Please go ahead.

John Costain, Chief Executive & Financial Officer, KNOT Offshore Partners LP

Thank you.

If any of you have not seen the earnings release or slide presentation, they're both available on Investors section of our website.

On today's call, our review will include non-U.S. GAAP measures such as distributable cash flow and adjusted earnings before interest, taxation, depreciation and amortization, the EBITDA. The earnings release includes a reconciliation of these non-GAAP measures to the normal directly comparable GAAP financial measures.

A quick reminder that any forward-looking statements made during today's call are subject to risks and uncertainties and these are discussed at length in our annual and quarterly SEC filings. As you know, actual events and results can differ materially from those forward-looking statements. The partnership does not undertake a duty to update any forward-looking statements.

And now on to the presentation.

KNOT Offshore Partners focuses on the shuttle tankers segment. Each vessel is usually built to an individual charter specification. On the non-volume based contracts, we transport oil from the offshore production units to shore side effectively a midstream mobile pipeline business. The chartered vessels forming an integral component of the charter supply chain.

Shuttle tankers operate in a niche space and in our sector to-date, there has been no speculative ordering of tankers by vessel owners. So given the solid growth outlook from the sector the partnership should yield stable and sustainable revenues longer-term.

Our sponsor, Knutsen NYK has placed all their younger vessels in the MLP, all have long-term charters after construction and all remain strategically important to their respective charterers.

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Taken together with the partnership, the Knutsen Group has 29 shuttle tankers. Numerically this equates to the largest fleet on the water.

Our sponsor's an experienced operator having been involved in the design and construction of shuttle tankers for well over 30 years including being involved with the development of the design in the pioneering days, growing their fleet organically over time.

Oil production is moving further offshore as new fields open particularly in Brazil and the Barents Sea and these tankers therefore operate in a space which is seeing substantial oil production growth. This should continue in the coming years. In addition to, much of the shuttle tanker fleet is aging and will need replacing in the medium-term.

Our sponsor Knutsen NYK, is according to Clarksons Platou Research, part of the largest shipping group in the world, and NYK is a major company in the Mitsubishi family. Since the partnership's initial public offering in April 2013, the fleet has grown 300% to 16 vessels with an average age of just under five years at the end of June.

Slide 3, financial highlights. The partnership generated its highest quarterly revenues of $69.8 million and its highest operating income of $32.1 million; a net income of $21.7 million and also generated its highest ever quarterly adjusted EBITDA of $54.4 million. The partnership estimates a distributable cash flow of $27 million and therefore a coverage ratio of 1.5x. We declared and paid cash distribution of $0.52 per unit for Q2 2018 on the 15th of July, 2018.

Since our initial public offering in April 2013, we've declared and paid common unit distributions of $10.30. So our initial investors have we received a total return of 49%. Our current yield is stable distribution of 9.5%.

In this quarter the fleet operated with 100% utilization for scheduled operations and 96.3% utilization considering the scheduled drydocking of the Brasil Knutsen.

In July, Shell exercised its option to extend the time charter of the Windsor Knutsen by one additional year until October 2019.

In August, Eni agreed to amend the time charter of the Hilda Knutsen. KNOT now has a further charter until July 2022 with three one-year extension options after.

The partnership has agreed to enter into a new $375 million loan agreement to refinance the credit facility secured by Windsor, Bodil, Fortaleza, Recife, Carmen and Ingrid.

Slide 4, the income statement. Total revenues were $69.8 million for the three months ended June 30th Q2 compared to $68 million for the three months ended Q1. The increase in revenues is mainly due to full earnings from the Anna Knutsen and the vessels included in the results of operations from March 1, 2018, improved utilization on scheduled operations for the fleet in Q2 and one additional calendar day. The increase was partially offset by the reduced revenues from Brasil Knutsen because of the 53 days offhire incurred during Q2 for the vessel's scheduled first special survey drydocking.

Vessel operating expenses for Q2 were $14 million, an increase of $0.8 million from $13.2 million in Q1. This was mainly due to higher operating expenses due to Anna Knutsen being included in the result of operations and bunkers consumption in connection with the drydocking of Brasil Knutsen charged in Q2. This was partially offset by the reimbursed insurance claim in connection with propeller repairs of the Carmen Knutsen.

General and administrative expenses were $1.4 million for the second quarter compared to $1.3 million in the first quarter.

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Depreciation was $22.3 million for the second quarter, an increase of $0.7 million from $21.6 million in the first quarter due to the Anna Knutsen acquisition in March.

As a result, this quarter the partnership reported highest operating income of $32.1 million compared to $31.9 million for Q1.

Interest expenses for Q2 was $12.5 million, an increase of $1.9 million from Q1. The increase was mainly due to additional debt incurred with the acquisition of Anna Knutsen, higher LIBOR rates on average and increased leverage because of the refinancing of Hilda and Torill Knutsen.

Gains on derivative instruments were $2 million in Q2 compared to $10 million in Q1. This non-cash unrealized element of the gain was $1.8 million for Q2 compared to $9.2 million for Q1.

All unrealized gains in 2018 were because of an increase in the U.S. dollar interest swap rates.

As a result, net income for the second quarter of 2018 was $21.7 million compared to $30.7 million in the first quarter.

Slide 5, adjusted EBITDA. In Q2, the partnership generated adjusted EBITDA of $54.4 million compared to $53.4 million of Q1. Adjusted EBITDA refers to earnings before interest, taxation, depreciation and amortization and is a proxy for cash flow.

Adjusted EBITDA, of course, is a non-U.S. GAAP measure used by our investors to measure partnership performance. With a wasting asset like a vessel, younger fleets tend to produce lower EBITDAs for every dollar invested. The annuity effect reduces the annual loss in the early years, which is factored into the replacement CapEx calculation for the distributable cash flow.

At the end of Q2, the KNOP fleet had 16 vessels with an average age of about 5 years compared to the rest of the industry average for around 12 years without KNOP. Since the formation of KNOP, we have had very high levels of vessel utilization on average around 99.6% of scheduled operations. Financially, this translates into a continually high and increasing predictable revenue, adjusted EBITDA and a discounted cash flow as more vessels are added to the fleet.

Slide 6, distributable cash flow; another non-U.S. GAAP measure to estimate distribution sustainability. Quarterly distributable cash flow was $27 million in Q2. This compares to $27.9 million in Q1. We maintained our distribution level for Q2 at $0.52 per unit equivalent to an annual distribution of $2.08. The distribution coverage ratio for the quarter was 1.5%. It has been improved significantly in the first two quarters with the acquisitions of Brasil and Anna Knutsen.

A coverage ratio of more than 1.4x for the full year in 2018 is expected as the second half results will be impacted by the drydocking of Hilda, Torill and Ingrid Knutsen. The vessels will go off higher and positional bunkers will be expensed.

We are seeing rising interest rates in the U.S. in 2018 and 2019 together with increasing replacement CapEx provisions charged on our vessels as they get older.

Our coverage should be significantly better for this year and in 2019. KNOP has significantly elevated yield compared to most MLPs and we continue to remain focused on firstly building coverage, and then deleveraging when not making accretive investments.

The higher coverage ratio gives the partnership a little bit more flexibility regarding our capital base going forward.

Slide 7, the balance sheet. At the end of Q2, we had cash and cash equivalents of $45.1 million and an undrawn credit facility of $13 million. We have a predictable cash flow and a healthy liquidity position.

Slide 8, long-term contracts by leading energy companies.

The Windsor Knutsen has been on charter to Shell since October 2015 and with the exercise of the latest one-year option, the vessel remains committed to Shell until October 2019 has a further four years of extension options.

The Bodil Knutsen, our largest shuttle tanker operating in the North Sea, is ice -class and on charter to Equinor, formerly named Statoil AS, until May 2019. There are five further years of options to extend.

Torill and Hilda Knutsen operate on the Goliat, the first field to be developed in the Barents Sea and it currently represents the world's most notably offshore development. It is estimated that the Barents Sea contains nearly half of the discovered oil reserves in the Norwegian Shelf. Starting production in 2016, the estimated lifetime of the field is 15 years. It has an estimated recoverable reserves equivalent to about 178 million barrels of oil. Hilda and Torill are two or three specially designed shuttle tankers built to operate in this arctic environment. Our vessels are heavily winterized, allowing the crew and hence the vessels to operate safely in temperatures down to minus 30-degree Celsius.

Hilda Knutsen finished her first special survey drydocking in August and Torill will commence a similar docking in September. Having reached their fifth anniversary, the initial five-year term charters on both vessels will have expired. In August, Eni Trading & Shipping S.p.A (Eni) agreed to amend and extend Hilda time charter for four years with a further three annual extension options. For Torill, we expect Eni to lift the first of five annual extension options in the original time charter in October.

Today, many charterers like this annual option type agreement both for commercial flexibility and because of the imposition of more onerous financial disclosure requirements. There is a much lower impact in the account of the charterer. For the MLP, this mix of short and long term charters in the portfolio is useful because as well as tailoring solutions for the charterer's wishes, we believe asset prices could firm and the market will tighten in the coming years. Given the size of our fleet and therefore commercial footprint, some measure of contract flexibility is desirable.

Four of our vessels are on long term charter bareboats through 2023 with Petrobras Transporte. These vessels are amongst the youngest in the Petrobras fleet delivered between 2011 and 2012 and are heavily utilized. Dan Sabia and Dan Cisne are a unique size, and Fortaleza and Recife have shallow drafts with lots of thruster capacity. Delivered in 2013, Carmen Knutsen is on charter to Repsol Sinopec until 2023.

The Ingrid was delivered in December 2013 and is operating in the North Sea on a time charter for Standard Marine Tønsberg, a Norwegian subsidiary of ExxonMobil. The vessel will commence its first special drydocking and renewal of class in Q4 2018. The initial charter will expire in the first quarter of 2024 after the second scheduled docking. The charterer then has options to extend the charter for five one-year periods.

The Raquel Knutsen was delivered in March 2015 and operates under a charter that expires in the first quarter of 2025 to Repsol Sinopec in Brazil. There are options to extend until 2030.

The Tordis, Vigdis and Lena are on five-year charters to Brazil Shipping I, a subsidiary of Shell. These will all expire during 2022, and the charterer has options to extend with two additional five-year options totaling 15 years.

The Brasil and Anna Knutsen are on charter to Galp Energia until 2022 with options to extend until 2028.

The KNOP fleet has an average remaining fixed contract durations of 4.1 years with an average 4.4 years in charterers' option after they complete the main period. Whilst we currently have no further dropdown candidates, which need no near-term equity requirement, given the market outlook, we would expect to be able to grow the MLP in coming years.

Debt maturity profile, KNOP have agreed to enter a senior secured credit facility on the refinancing of the vessels Windsor Knutsen, Bodil Knutsen, Fortaleza Knutsen, Recife Knutsen, Carmen Knutsen and the Ingrid Knutsen. The facility consisting of a term loan of $320 million and a $55 million revolving credit line. And this will refinance previously existing term loans totalling $320 million and replace the $35 million revolver credit facility secured by the vessels. These were due to mature between December 2018 and June 2019.

The new term loan will be repayable in 20 consecutive quarter installments, with a 20-year profile giving a balloon repayment of $177 million at maturity.

The facility will mature in September 2023 and bear interest at LIBOR plus a margin of 2.125%. There is a commitment fee of 0.85% payable on the undrawn portion of the revolving credit line.

The facility is guaranteed by the Partnership and secured by mortgages on the vessels. As of June 2018, the facility vessels have an average age and remaining contract of 7.1 years and 3.7 years, respectively. We have managed to increase the leverage by $20 million through the credit line increase, retained an attractive margin and stretched the profile from 19 to 20 years. The refinancing gives the Partnership a three year runway to the next loan balloon payment.

In summary,

KNOT Offshore Partners is a midstream business with fully contracted non-volume based revenue streams. We've had another very good quarter with strong financial performance, including a further increase in revenues, operating income and EBITDA following on from a substantial increase in the previous quarter. This is no surprise as 6 vessels have been added to the MLP in the last 18 months.

KNOP has very good access to financing. After executing equity transactions and refinancings in the last year to facilitate the successful acquisitions, this quarter, the Partnership has raised a further $375 million of long-term debt, including $55 million of credit facilities, all on attractive terms.

On the commercial side, we continue to see high demand for our vessels. The charter is extended on Hilda and Windsor Knutsen in this quarter. This translates into very high levels of vessel utilization on average around 99.6% since the formation of KNOP.

Financially, this has enabled the Partnership to achieve high and increasing operating results, adjusted EBITDA and discounted cash flow as more vessels have been added.

KNOP is well-placed to compete in future tenders. We have a solid and profitable contract base, generated by our modern fleet, which by the end of Q2 had an average age of around five years.

No one has more expertise in operating a sophisticated shuttle tanker than KNOT Offshore Partners and we operate these vessels with real expertise. Today, supply is tightening and the market is expanding.

We have a supportive sponsor and we remain an attractive value proposition with a quarterly distribution of $0.52 around at 10% distribution.

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Thank you. And that concludes the narrative for the slides. If anyone has any questions, I'll be happy to take them.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] the first question comes from Hillary Cacanando of Wells Fargo. Please go ahead.

<Q – Hillary Cacanando – Wells Fargo Securities LLC>: Thank you. Hi, John.

<A – John Costain – KNOT Offshore Partners LP>: Hello, Hillary.

<Q – Hillary Cacanando – Wells Fargo Securities LLC>: So you have a healthy target distribution coverage ratio and you've been saying that you're focusing on increasing your coverage ratio and deleveraging first before perhaps increasing distributions. What do the target – like what are the ratios that you're looking for, I guess, for you to start feeling comfortable increasing the distribution?

<A – John Costain – KNOT Offshore Partners LP>: I mean, first of all, today, the way the MLP is operating, we actually don't need to do a refinancing for three years and we can pay the distribution cash flow without looking to releverage or do anything. I mean, that's the first objective is to make it easy for the MLP to function. And that we have had to refinance a fair bit for these ships and now we've done that with our good coverage ratio. I mean, this is a sizable business with lots of people involved and I want to keep it stable and going forward it has to be a long-term investment. So we are happy to build the coverage. I mean, there's been a lot of questions over the inventory that we don't have, but that will come and, obviously, the market has changed a lot and we have another competitor in the market who is being very aggressive and they have won a lot of tenders lately, but the market is there and we are back in and talking to people. So, in the nearness of time, that will happen.

I think as far as the distribution change goes, I don't think the policy will change until we have a bit more clear view of where we're going with the business and how the contracts, how accretive they are and the sponsor how he's doing. I don't have a primary goal to push the distribution at all. I think at the current yield and the current unit price, I'd like to keep it all very stable and keep the distribution very comfortable. I think it's working for us. I mean, don't forget the shipping market generally in the last 10 years we've seen quite a fall in asset prices and it's difficult to make a case when in a falling asset price environment to increase distributions in the shipping MLP because you have a weakening – slightly weakening charter position just inherently if you are moving into the market because the newbuilds are a little bit cheaper.

What is interesting with interest rates going up is actually secondhand tonnage costs when it starts to become more competitive value wise because the cost of a newbuild significantly increases compared to an older vessel. But today I'm happy with where we are. I think 1.50x is a sensible amount of coverage. I think ideally a bit more and it's going to be weaker in the next two quarters – these drydockings. Next year, again, we have a nice relaxed position and people are getting paid a very good yield with the MLP. So, it's just a phase at the moment. We haven't won many contracts. We would expect them to have basically be – have more announcements to make from the sponsor by now. Well, it hasn't happened. And we are clearly aware of that and that's really why we haven't. We just want to keep it very stable, ticking over, good coverage, paying down and keeping a good footprint. You can see the quality of the contracts. There's no problem with bank lease financing. That's the reality.

So I feel fairly confident. I mean, obviously, you got to weigh the risks and the opportunities with this MLP, but I think today the way we're running it is not – I'd be dishonest to say we're going to push the distribution. I mean, we could do that. But I also look at it and I think we've got preference issue in this. It's 10%, 15% of the capital base. When you got that in there, you've really got to think about paying too much distribution because ultimately you are diluting your common unitholders

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against when you got quite a lot of leverage and preference unitholders, you want a longer-term investment for them. So that's really how I see it.

<Q – Hillary Cacanando – Wells Fargo Securities LLC>: So there's really no target – distribution coverage or target debt-to-EBITDA that we should be looking forward?

<A – John Costain – KNOT Offshore Partners LP>: No, I think it will go higher. I mean, we could go up. I mean, to me, I think you could get to 200%. I mean, maybe. I don't think that's possible at the moment, but it depends on how accretive the contracts are. The nice thing is with having this headroom, we can be in the market and contract vessels even directly into MLP, if needs be. So that means we can grow it. And then I think we need to grow the MLP because if we had a bit more liquidity in the units, like it was like 25% more liquidity, we'd be in the Alerian, and that would've been a natural improvement in the unit price just because you would get interest from tracker fund (Exchange traded funds) then, you basically got – I'll calculate probably about 400,000, 500,000 units would be in these sort of firms. Today, we're all in closed end funds.

<Q – Hillary Cacanando – Wells Fargo Securities LLC>: Yeah.

<A – John Costain – KNOT Offshore Partners LP>: And they're quite comfortable with what we're doing. So I've talked to a lot of them and I think until you've got clear path in what – you can make some mathematical models to what it's going to look like and how it's going to go. But I think I've looked at it quite closely in how we perform, and I think people do appreciate the stability of it all and at the end of the day, it is a pension, and we also have a very big businesses. I mean, Knutsen is a sizable organization and the accounts of the MLP don't really reflect that.

<Q – Hillary Cacanando – Wells Fargo Securities LLC>: Right.

<A – John Costain – KNOT Offshore Partners LP>: Probably 200 shore side staff there. So, it's important to keep a stable MLP, which has a long-term future.

<Q – Hillary Cacanando – Wells Fargo Securities LLC>: Yeah I mean, like on the topic of MLPs, I mean, we've seen a lot of – I mean, it's kind of been challenging in the last couple of years and we've seen a lot of rollups and consolidations into the parent on the traditional energy MLP space?

<A – John Costain – KNOT Offshore Partners LP>: Yeah. We're not that blessed with cash.

<Q – Hillary Cacanando – Wells Fargo Securities LLC>: Yeah. On the viability of MLP structure in the marine MLP space, I mean, is this something that you think that will happen eventually as well rolling up to the parent and consolidations?

<A – John Costain – KNOT Offshore Partners LP>: With our MLP, I'd be disappointed. Personally, I think we should – we will. I mean, we raised a lot of capital last year and it would be a shame to end this. I think it's got lots of mileage. I mean, the MLPs are changing, but they are definitely changing the growth story, the distribution growth story and lots of the mature MLPs is out. I mean, except for Shell and one or two others, they basically are not really – there are not many traditional growth story MLPs there.

And when we're paying 9.5%, it's almost dishonest to say we'll be comfortable bumping that up and putting across. If you put a distribution, you're putting it across the full unit base. Better to stay stable and be really comfortable doing distribution increase before you do one.

So, I think there's definite – it's going to be a year or two really before we know what we're doing with the MLP in terms of how it's expanding, how big it's going to get and I think we still have an attractive value proposition. But obviously, we are – I mean, obviously with the banks, if we go to Wells Fargo and someone say I want to issue some units, they're going to say, well, we'd like to

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see an increase in distribution. So, if you're not doing anything in the market, it's dishonest to say, well, why would you push the distribution and weaken the MLP effectively. That's what you're doing, you're financially weakening that. I want to make a strong financial vehicle. And if we have to raise distributions to make it attractive to get units away, then maybe we'll do that, but today there's no need.

We look very stable. We can have vessels occasionally maybe in a couple of years' time, just through leverage without raising equity. And today if we're not achieving a lot of contracts then we could just be putting one or two ships with the MLP to maintain its position because obviously it is a wasting asset, you have to add ships occasionally even without raising equity and leverage. You take a leveraged buy. And we've done a bit of that already. If you do an ATM, I mean, that's possible. I mean, I look at our yield, it's fine. I think I'm comfortable with all that. I talk to people both in the sponsor and in the investors and I think generally people have got used to what we're doing. But yes, obviously, you go over 200% cover or something or the market recovers and we start winning orders, then the situation changes completely. But look at us today, everyone says we got no inventory, so why would you push the distribution. I mean, that's the way I see it really.

<Q – Hillary Cacanando – Wells Fargo Securities LLC>: Okay. Well, thanks for your insight. That's it for me.

<A – John Costain – KNOT Offshore Partners LP>: Yes. That's the way I see it. I mean, I'm not saying everyone sees it that way, but.

Operator: The next question comes from Robert Silvera of RE Silvera & Associates Marine Surveyors. Please go ahead.

<Q>: Hi, gentlemen. My first question deals with the IMO 2020 sulfur content on fuel. Can you give us some color on how that may impact you?

<A – John Costain – KNOT Offshore Partners LP>: Right. Well, obviously, the vessels are time chartered, it's a charterers' expense. But the better vessels with a more economic shift to newer vessels will renew at a better rate because they're going to need less bunkers, I guess. That's how it would impact us.

In Brazil, we burn heavy fuel oil in Brazil and the supply by the refiners in Brazil, it's almost – it's 1% sulfur content, it's quite low in South America. So, I think a lot of the Brazilian refineries could get compliance with the 0.5% on heavy fuel oil. But if they don't, the vessels will have to burn marine diesel, but that's the charterer's problem. But I think within a year or two, the Brazilian fuels will be compliant because the sulfur content is low down there.

In the North Sea, the SECA zone and Barents Sea, there have been quite onerous environmental requirements since 2015 where they had to get the SOx down to 0.1% or something from 1.5%. So basically, we've had to burn marine diesel on those vessels the charterer has.

But basically, it's a pricing issue, these ships are time chartered. So, if a vessel burns LNG and LNG becomes more effective and may want to run it because it complies and maybe they'll get a better rate, but I suspect not.

I mean, as long as they are Tier II compliant, we build ships of Tier 2 without Scrubbers because actually, weirdly, [Tier III] ships with scrubbers are [much] less efficient and they've got more deadweight, they also discharge sulphates into the sea, with an open-loop system, which is not totally desirable.

In fact, I think an open-loop system personally is a weak solution because not only burning of [additional fuel] that, it costs a lot to install it. You're burning 1 to 2 tons a day extra just to run it and

then because the deadweight is increased, you reduce the capacity of the ship or you increase the tonnage. So, all in all, it's inefficient.

And then if it's an open-loop system, you're actually discharging the waste residual product into the sea, which is a lot of sulphate, so it's not an acceptable solution in some parts of the world. You can't use open loop scrubber because they add to the ocean acidity.

So, I'm not a big fan of open loop scrubbers. And also, with the shuttle tanker has a lot of ancillary engines and stuff, so you'd have the amount of fuel consumed at certain points is quite a lot more, so it's more complex. Probably what AET and Teekay have done is build dual-fuel ships, which to the North Sea is quite sensible, but they are a lot more expensive. And in Brazil I feel that it will be a diesel story for many years to come or fuel oil story. So, we tend to build Type 2 Tier 2, which are a bit more efficient actually they burn less fuel.

The funny thing is that a lot of these environmental filters they actually increased the consumption of the vessel and increased its carbon footprint, but obviously IMO 2050 is also going to affect shipping quite heavily as it comes in and there's a lot of climate change issues with vessels. I mean Hillary asked me quite a lot of questions just before and I had to look into it. You're not first investor to ask me about it either, but my stock answer is it's not our problem we time charter the ships out. So it's the charters problem, but it's over simplistic because obviously a charter will eventually look at the relative price of ships.

There's no problem with our vessels being compliant. We just have to burn a more expensive fuel and then it's just down to pricing, but I think in the medium-term, we're not going to be – we're not exposed in 2020 with our fleet, and in the medium-term it will be a solution within 6 months to 12 months I think because 90% of the world fleet will not have scrubbers on them. So they will have to be built up in our compliance and as that ramps up – production ramps up, it will get cheaper. I mean, it is a refinery problem. It is their waste product.

<Q>: Well thank you very much for the additional insight on that. I had no understanding of some of that. Anyhow, you've spoken a lot about debt, okay; the total debt, et cetera which we have increased a little bit because of the additional ships et cetera. Now the market is obviously pricing us as a high-risk operation since we're getting 9.5% based on the price of the stock and the dividend, et cetera and my...

<A – John Costain – KNOT Offshore Partners LP>: With shipping generally - this is the way the market has gone - seems quite high risk. The fact that probably we have some of the best contracts I've seen certainly in tankers because...

<Q>: Right.

<A – John Costain – KNOT Offshore Partners LP>: ... they're fabulous contracts...

<Q>: Right.

<A – John Costain – KNOT Offshore Partners LP>: You know they are fabulous contracts, but obviously you still got the shipping industry risk a little bit. And the market has fallen a bit for vessels and people are always focused on the renewals, but a lot of these ships are our long-term assets for an oil major and we've paid for them and they've agreed a string of rates and options and that's hopefully mostly we basically get close to that, if not exactly the figure that we get in charter as they vary than we intend to give them a little bit of the reduction, but not massive because obviously we've had to build the ship and it's the costs are known.

I mean these contracts are not massively profitable. So the leverage has to be there. The leverage is there by the banks because obviously if you've got ten year, excellent money on a time charter

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which is a needed asset because you can't monetize, the oil flow otherwise it is a pipeline you're going to get good financing terms.

<Q>: Right.

<A – John Costain – KNOT Offshore Partners LP>: It's just the consequence of the quality of the contract you've got. And you might as well take advantage of it. I mean don't forget the Sponsor holds 25%, 26% of the unit anyway. So, he quite likes the high distribution. You're not going to sit down and say well I'm going to have a low leverage and low distribution. You're going to say, I would like to take some money out of this MLP.

<Q>: No.

<A – John Costain – KNOT Offshore Partners LP>: So if you do it and that's why we basically end up where we are. Go with this...

<Q>: But one of the things I was concerned about is changing interest rates. We do have floating interest rates to go along with current LIBOR. And by the looks of it, more time is going to mean more higher rates for us and obviously more core cost, yeah.

<A – John Costain – KNOT Offshore Partners LP>: Yeah but don't forget. It increases the entry cost of the new vessels coming in, because the old ships are getting paid down. So actually, it gives you a competitive advantage with an aging fleet. It's not all bad to use. It's just different use, but you're right. You are right. It has an impact. We hedged about four years forward. That's why we're seeing this big exchange, we've made these big profits on derivative contracts because we've actually hedged about 60% of our debt coverage. But the rest of it isn't hedged and we've achieved lower margins a bit on the financings because part of the reason is because the LIBOR rates going up in banks. In a higher LIBOR environment, they were actually happier to take your money because they get more interest. So they've actually lowered the margins a little bit. So you see we negotiate, we're doing that from 2.5% to 2.15%, 2.25% because you actually achieved the LIBORs higher. Thanks.

<Q>: That's the way I have been looking at, that's the way I have been at it lately because the price is kind of stuck between $21.50 and $22. And the dividend is staying exactly the same. So it's a very stable thing which is what you're trying to achieve, but increasing the size of the business then, increasing the number of ships if we're going to say exactly the same on both price and dividend, what we're really doing is increasing the benefit of the moneylenders and not the shareholders particularly. So, in the long run, is there any possibility that you can buy back some of the preferred, not change the regular dividend but high and the preferred?

<A – John Costain – KNOT Offshore Partners LP>: We don't want to buy in the preferred because after 10 years there is a financial penalty on the preferred shareholder. I think basically that's 70% of book. So, you can't – you won't get his money back up to 10 years if it's still a preferred. Otherwise it's a nice conversion; it's $24.67 now this time. So actually, he has to strike it per unit. Well that preferred is a really nice stuff. It's a really nice preferred. I like it, but as I was alluding to in the call, if you've got preferred, then you should. It's not that moneylenders are losing because they know they're going to get paid on these contracts. They're very, very good. If you pay a higher distribution, you just certainly hurt the Common Unit holders in the long run, you just destabilize the other premium.

<Q>: No, I'm trying to understand the logic of why you don't want to buyback any preferred to reduce our $1.8 million per quarter.

<A – John Costain – KNOT Offshore Partners LP>: Yeah because basically they're relatively cheap compared to the common unit. I know it's not part of the mechanism. The mechanism is that

if they run out, then they take a discount on redemption quite significant. So they won't get paid out at the common unit rate. They get paid out at significantly less. There's always a discount on them. So it's not advisable for us to do that. So we've already run the preferred for two years now, is it. So I think...

<Q>: Is that preferred callable?

<A – John Costain – KNOT Offshore Partners LP>: Yes, but we have to pay the strike cost and I have to check if the premiums have come in, but it doesn't. It's not advisable for us because if we call it we have to issue common units effectively after...

<Q>: To replace that mining.

<A – John Costain – KNOT Offshore Partners LP>: Yeah. Yeah. Because we're quite tight with cash use you can see, and it's actually cheaper than the common unit and it has a nice. I mean, as a quid pro quo obviously they sit on top of the common unit holder. So however, they got these disadvantages. So now it's a fair deal. I like the deal, of course, a very fair deal. Because actually they have residual risk as well after 10 years they take quite a hit on those Prefs but they're happy to receive an 8% yield. I want – I mean basically you get 10% yield as the common unit holder and it does increase the risk levels.

So I know you got to look at the contracts. The quality of these contracts is very high, and you can't AET have been in the market and they are very aggressive because they want the business. It drives the accretion levels down if we want to do the contracts, but there's only so many ships that people will order with different owners. We know the market very well and we know what a vessel costs and we know where we're comfortable going with the charter rates and if we think it's over-competitive we're just staying out and that's just how it is.

And fortunately markets very, very good. I mean we've seen I think have won 7 contracts in the last year and obviously Teekay have ordered six ships. We are talking to people and they are quite keen, especially the staff are very keen to give us some contracts, but it's going to be on the right terms. And I can't say too much because there's nothing being firmly agreed, but I'm not worried about it. I think genuinely some time it's just that we sit it out a bit. There's only so many ships that people want to place with an owner and only so many berths they have to use and only so many ships that they can construct. So sometime people are going a bit aggressive into market that was out itself.

<Q>: But we don't see ourselves increasing our fleet at this point, right?

<A – John Costain – KNOT Offshore Partners LP>: No, because the sponsor has to order the ship and it takes – I'll be just honest. I've got ideas. We obviously quite a large group of vessels but I prefer personally to keep as a Shuttle Tanker business, and I think that's the view of NYK Knutsen today. But obviously there are plenty of other vessels out there, and if this goes on for six months to 12 months, and they're not going anywhere, we're going to I think reappraise because they have sunk a lot of time and effort into building this MLP to where it is today and it would be not something they would want to abandon, I think as you know mainly that's basically what you're saying to close it out one more time. Even that is still a nice. It's going to be nice. It was not much risk to do that. It's not particularly sexy investment, but it's not a risk for you if you know what I mean.

<Q>: Right. Okay. Well, that's all my questions. Thank you very much. You're doing a good job. I don't think the market recognizes the goodness of it and that's why the yield is as high as it is, but I'll take advantage of it. Thank you.

<A – John Costain – KNOT Offshore Partners LP>: Yeah. Absolutely. Good for you.

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<Q>: Okay.

Operator: The next question comes from Ben Brownlow of Raymond James. Please go ahead.

<Q – Ben Brownlow – Raymond James & Associates, Inc.>: Hey, John.

<A – John Costain – KNOT Offshore Partners LP>: Hi.

<Q – Ben Brownlow – Raymond James & Associates, Inc.>: Congrats on the quarter. Just a few quick modeling questions. On the Hilda and the Windsor, the charter extension there, any meaningful change in the day rate with those?

<A – John Costain – KNOT Offshore Partners LP>: No.

<Q – Ben Brownlow – Raymond James & Associates, Inc.>: Okay.

<A – John Costain – KNOT Offshore Partners LP>: No, they're in place.

<Q – Ben Brownlow – Raymond James & Associates, Inc.>: And for the third quarter, it seems like the Torill, the five-year survey was pushed up a little bit from the fourth quarter of – to I guess towards the end of the third quarter?

<A – John Costain – KNOT Offshore Partners LP>: It's late September it's going to be, and the vessel delivered in November mostly just said maybe nearly November when it's delivered. So yes, it's clearly probably a few weeks earlier I don't know. It must have been the scheduling around. But obviously it's not far off exactly on the five-year dates. Whereas the Hilda has been on the five-year dates, you're absolutely right. I guess it just depends when they had discussions with the charterer. But we do have some latitude on when you dock these ships, you're not going to dock them on the anniversary dates. It depends on the yard availability and charterer.

It is close because the Torill was delivered in November 2013. So, it possibly was early November 2nd or 3rd or something, as well it is forward of that because of the 15- to 20-day docking. So yes, you're right. It's going to be late September, so probably two or three weeks early.

<Q – Ben Brownlow – Raymond James & Associates, Inc.>: Okay, great. That's all I had. Thank you.

<A – John Costain – KNOT Offshore Partners LP>: Thank you, Ben.

Operator [Operator Instructions] This concludes our question-and-answer session. I would like to turn the conference back over to John Costain for any closing remarks.

John Costain, Chief Executive & Financial Officer, KNOT Offshore Partners LP

Thank you, operator, and thank you for your questions. They've been very – it's always good to have people on the call who are knowledgeable in our business and I do appreciate it. Thank you very much.

Operator: The conference has now concluded. Thank you for attending today's presentation. You many now disconnect. Thank you for attending today's presentation. You may now disconnect.

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Additional Notes on the Q&A Session

Having read some investor forums it was clear that some areas of the discussion would benefit from additional notes. The transcript was described by some as unintelligible with the CEO appearing disinterested…far from it but sometimes stock answers that read well on a transcript don't really address concerns raised.

Hope the following is illuminating.

John Costain

Distribution and Coverage Calculation Ideas

An MLP in principle is a full distribution vehicle, which means that we only hold back necessary cash to maintain current cash flow distributions. In theory, distributable cash flow (DCF) represents the theoretical amount available for distribution, but this only works if replacement Capex were at least equal to or exceeded the debt repaid.

With Debt repayment, usually significantly more than the replacement Capex charge the Partnership is deleveraging every year. We have corrected for this by doing more highly leveraged dropdowns and refinancing when possible. It is important to maintain leverage to grow both the investment and distribution more efficiently. This process is only possible when there are assets to add to the MLP.

Currently we have no assets to add so no scope for releveraging and adding assets to boost the MLP earnings, however the longer the break the more releveraging possible, and less equity required when a new vessel is added.

The DCF calculation is subjective and contains several key assumptions each of which of course are debatable, an element of judgement is therefore needed when assessing a sensible distribution:

The vessel replacement cost is set annually and is based on the assessed charter free delivered cost of a new tanker this was established when the vessel entered the MLP. The acquisition cost (and hence replacement cost) to the MLP of a Tanker has a small uplift on cost dependent on the Charter attached.

There is an argument for reappraisal of the replacement cost valuation, however keeping a stable year on year vessel replacement cost for the calculation to show a consistent annuity effect over the years has been the rational for not amending each vessels replacement cost valuation.

A twenty-five-years life is assumed from new for the Shuttle Tanker Replacement Capex calculation in line with the depreciation policy. A shorter life span (say 20 years) would increase replacement CAPEX provision and reduce the calculated cover.

A discount rate of 4.8% has been applied to the replacement Capex Annuity calculation (Current 10-year swap rate is 2.61% (25th January 18) and with an average loan margin a little over 2% this rate remains unadjusted from previous years.

A scrap price for calculating residual value of $300 per tonne has a minor impact (300 K$) if adjusting to the current price around $425. Again, numbers have been kept consistent with previous years.

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KNOP Convertible Preference Units Deal

The Preference agreement was filed (as amended) by KNOP on 17 May 2017.

There is an optional redemption (at issuers option) from year 2 to year 10. This is cash only with a redemption price starting at 130% of par in 2019 (on the 2nd anniversary) this then drops gradually to 100% of par at 10th anniversary. This is to protect the holder as there were considerable costs on both sides to set up the transaction.

Current par is between $24 and $25 and this is the price which at any time from year 2 to 10 the holders may convert into common units.

At the 10th anniversary, if the Preference Units has not been converted the holders have a further put but there is a significant financial penalty. They can elect to redeem in cash equal to 70pct of par or in shares equal to 80pct of par.

There is little point in the MLP cashing out of the Preference deal, and there is a good chance the holders will convert into Common units at a strike above the current unit price if the investment follows a decent path.

Bunker Fuel Issues Going Forward

Vessel Efficiency and Emissions

One estimate by the International Council on Clean Transportation found that if treated as a country, international shipping would be the sixth largest emitter of carbon dioxide in the world – roughly the same as Germany. Shipping currently accounts for 2 per cent of global carbon dioxide emissions, and if the sector is not cleaned up experts predict this figure could rise to a fifth of emissions by 2050. Despite its key role in polluting the planet, shipping was not accounted for in the Paris agreement on climate change.

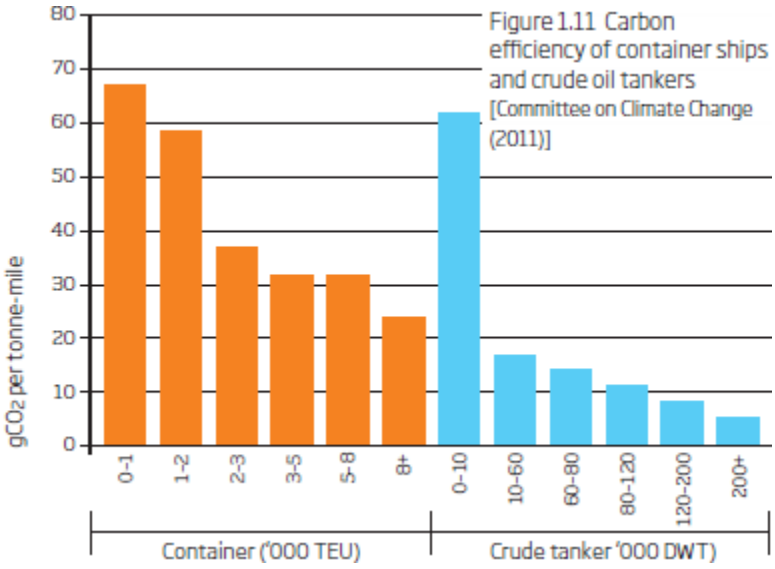

Figure 1.11 Carbon efficiency of container ships and crude oil tankers [Committee on Climate Change (2011)]

In April 2018 at the International Maritime Organisation (IMO) in London ways to clean up the sector, for the first time were debated 'The world's shipping industry in April 2018, defined, its commitment to tackle climate change'.

Ultimately the goal is for shipping's greenhouse gas emission to be reduced to zero and to achieve this target most newly built ships will have to run without fossil fuels by the 2030s. Whilst the stated 2050 target is to at least halve 2008 emissions, IMO's ambition is to cut CO2 emissions for international shipping by an average of 40% by 2030 and 70% by 2050, compared to the baseline year of 2008.

If early recycling of relatively young assets is to be avoided - counterproductive given the energy consumed in building vessels - we can reasonably assume new build consumptions must come down much quicker.

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Owners have some flexibility in making decisions about vessel propulsion, but work to fine margins. LNG propulsion is a step in the right direction but insufficient alone and comes with a price for a new build shuttle tanker of around $15 million, conversion is not a realistic option.

This target is very challenging, although Vessels today are on average 30% more efficient than those of 2008 vintage, over the same time in dead weight tonnage terms the world fleet has grown 70%.

Whilst the intention long term must be to move away from fossil fuel sources and if that is the case tankers may no longer be a major part of the problem, however oil of all fuels transported has the highest calorific value and is still a much greener fuel than coal, on which many developing economies remain dependent.

Mode of transport	Relative CO_2 index
Aeroplane	398
Small goods vehicle	226
Large articulated truck	49
Railway haulage	6
Large container ship	3
Large tanker	1

Table 1.4 Relative CO_2 emissions of different modes of transport [MOL, 2004]

Ships compare very well in CO2 emission terms with other forms of transport. Using a large tanker as reference for transporting one tonne of cargo over one mile, whilst the table is 14 years old and all transport methods have improved so some detail changes can be expected, it fully illustrates ***Large Tankers are an incredibly efficient form of transportation.***

Recent History of Emission Regulation for Shipping

During the 1990s, attention to air pollution and global warming led to regulations restricting the emission of the oxides of nitrogen (NOX) and sulphur (SOX): pollutants produced during combustion in diesel engine cylinders.

Subsequent amendments have included restrictions on the emissions of ozone, particulate matter and greenhouse gases.
Since 2007 large tankers have practiced slow steaming and generally reduced voyage speeds as fuel costs became a much larger proportion of a vessels earnings. More recently this has led to the adoption of ultra-long stroke, slower engines in combination with larger propellers, and the so-called eco-ship with lower carbon emissions.
Ship technology is changing fast and must accelerate if the industry is to fulfil the global regulator's eventual ambition to phase out emissions of CO2.

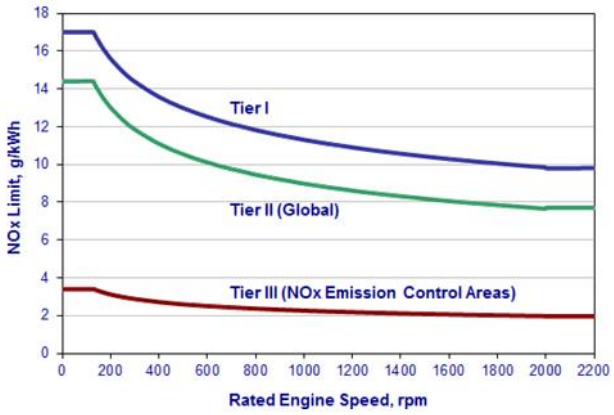
NOx Emissions
The MARPOL Annex VI NOX emission standards are arranged in three tiers: Tiers I, II and III. The Tier I standards were defined in the 1997 version of the Annex, while the Tier II/III standards were introduced by amendments adopted in 2008, as follows:

• 1997 Protocol (Tier I) – The 1997 Protocol to MARPOL, which includes Annex VI, became effective on 18 May 2004 when Annex VI was ratified by states with 54.6% of world merchant shipping tonnage. Accordingly, Annex VI entered into force on 19 May 2005. It applied retrospectively to new engines of greater than 130 kW installed on vessels constructed on or after 1st January 2000, or which underwent a major conversion after that date. In anticipation of the Annex VI ratification, most marine engine manufacturers have been building engines compliant with the above standards since 2000.

• 2008 Amendments (Tier II/III) – Annex VI introduced new fuel quality requirements which commenced in July 2010; Tier II and III NOX emission standards for new engines; and Tier I NOX requirements for existing pre-2000 engines.

The Tier III controls apply only to the specified ships while operating in Emission Control Areas (ECA) established to limit NOx emissions, outside such areas the Tier II controls apply, certain small ships are not be required to install Tier III engines.

A marine diesel engine that is installed on a ship constructed on or after 1 January 2016 and operating in the North American ECA and the United States Caribbean Sea ECA has to comply with the Tier III NOx standards.



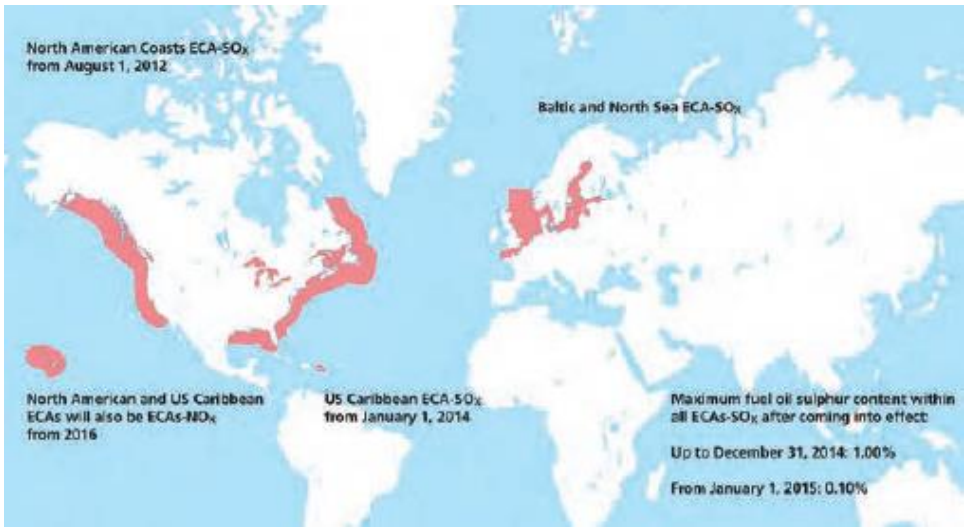
The change in NOx emission limit from Tier I to Tier II for slow speed engines was only 2g/kWh, while going from Tier II to Tier III the change is 11g/kWh, and this is why there is so much about Tier III compared to Tier I -> Tier II.

To reduce NOx, engines have to be fitted with either of the following systems:

Selective Catalytic Reduction (SCR) or,
Exhaust Gas Recirculation (EGR) system.

SCR converts NOx into nitrogen and water with the aid of a catalyst, by injecting urea into the exhaust. The EGR is based on (as the name says) recirculating the exhaust and removing the NOx while doing it. Both systems can also be combined with a scrubber (for removing sulphur, SOx). Installing SCR/EGR/scrubbers reason for higher fuel consumption are due to worse combustion and extra running equipment.

Tier III equipment is very expensive, and brings more equipment, increased fuel consumption, increased OPEX, etc. so if you do not plan on trading the vessel in US/Canada there is no point in having it as it only brings negative effects except for NOx emission.



The NOX limits apply globally, whereas at this time the SOX emissions requirements of Annex VI vary depending on where the ship is sailing.

More stringent emission levels for SOX apply in certain Emission Control Areas. Currently there are four ECAs located in the Baltic Sea, North Sea, around North America and the US Caribbean.

SOx Emissions
IMO decided that from January 2020 to introduce a reduction in the global sulphur level in fuels.

Today then most attention is focused on designing ships to operate on alternative fuels, some owners switching to LNG, which emits zero SOx, virtually no particulate matter and significantly less NOx. It is however not very effective in reducing greenhouse gas emissions.

Others advocate the use of scrubbers with the potential social and environmental benefits of reduced SOx emissions (95% less) and Particulate Matter (60% less), they also positively impact the NOx emissions. By 2020 a small number of owners will have fitted exhaust-gas scrubbers to their deep-sea fleet, meaning the vast majority of ships will be using distillates or blended fuels.

An open loop-type scrubber uses sea water as the medium for cleaning or scrubbing the exhaust, normally supplied by a dedicated pump, the CO2 dissolves in sea water forming carbonic acid, bicarbonate or carbonate ions depending on the pH. The positive companion ion can be calcium or sodium.

There are drawbacks, however regarding the sulphates being discharged into the sea as they increase locally the acidity of the water, and ocean acidification has been ongoing since the start of the industrial revolution. An estimated 30-40% of carbon dioxide released from human activity is dissolved in the sea shifting the oceans to more pH neutral conditions this is likely having an impact on sea water biodiversity, especially among fish species although research is limited.

In a closed loop-type scrubber, treated water is circulated through the scrubber to keep the scrubbing process independent of the chemistry of the waters the vessel is sailing in, plus there is little or no water discharged overboard from the scrubbing process, reducing the need for processing the wash water to make it suitable for discharge. Sodium hydroxide as a chemical additive is typically used in marine EGC systems to control the water alkalinity which can also be produced by electrolysis of sea water.

A Hybrid combination of the two types of scrubber is increasingly a popular choice as the open loop system whilst simpler, in certain areas of low ocean acidity it is not environmentally acceptable. IMO regulations have focused on SOx NOx and CO2 however most health indices are based on PM2.5 believed to be the main source of cancers. LNG is unbeatable and could prevail in the near future despite additional costs.

Today KNOT Offshore operates Tier II type vessels and will not be installing scrubbers on any of the fleet, this has generally been the choice of the Charterer when specifying the vessel with the lower new build cost being reflected in the initial charter rate.

As well as being significantly more expensive and adding significantly to the dead weight of the vessel, both Tier III and Scrubbers significantly increase the Carbon footprint of cargo movement. Typically for an “upgrade” from Tier II to Tier III there is an increase of between 3 to 4% in fuel consumption. The figure for the installation of Scrubber is similar. Additional elements of concern include the scrubber’s end of life management, and the production of the scrubber system itself is energy intensive.

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