

KNOT Offshore Partners LP  
Form 6-K  
September 04, 2018

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 6-K**

**REPORT OF FOREIGN PRIVATE ISSUER**  
**PURSUANT TO RULE 13a-16 OR 15d-16**  
**UNDER THE SECURITIES EXCHANGE ACT OF 1934**

**For the quarterly period ended June 30, 2018**

**Commission File Number: 001-35866**

**KNOT OFFSHORE PARTNERS LP**  
**(Translation of registrant's name into English)**

**2 Queen's Cross,**  
**Aberdeen, Aberdeenshire**

**AB15 4YB**

**United Kingdom**

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**(Address of principal executive office)**

Indicate by check mark whether the registrant files or will file annual reports under cover of Form 20-F or Form 40-F.

Form 20-F

Form 40-F

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(1):

Yes

No

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(7):

Yes

No

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**KNOT OFFSHORE PARTNERS LP**

REPORT ON FORM 6-K FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2018

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**THIS REPORT ON FORM 6-K IS HEREBY INCORPORATED BY REFERENCE INTO THE REGISTRATION STATEMENT ON FORM F-3 (NO. 333-218254) ORIGINALLY FILED WITH THE SECURITIES AND EXCHANGE COMMISSION ( SEC ) ON MAY 26, 2017.**

**KNOT OFFSHORE PARTNERS LP**

## Unaudited Condensed Consolidated Statements of Operations

For the Three and Six Months Ended June 30, 2018 and 2017

*(U.S. Dollars in thousands, except per unit amounts)*

|  | Three Months Ended<br>June 30, |                  | Six Months Ended<br>June 30, |                  |
|--|--------------------------------|------------------|------------------------------|------------------|
|  | 2018                           | 2017             | 2018                         | 2017             |
| Operating revenues: (Notes 3 and 12)             |                                |                  |                              |                  |
| Time charter and bareboat revenues               | \$ 69,221                      | \$ 51,537        | \$ 136,608                   | \$ 95,284        |
| Loss of hire insurance recoveries                | 450                            | 2,276            | 450                          | 3,426            |
| Other income                                     | 94                             | 593              | 750                          | 687              |
| <b>Total revenues</b>                            | <b>69,765</b>                  | <b>54,406</b>    | <b>137,808</b>               | <b>99,397</b>    |
| Operating expenses: (Note 12)                    |                                |                  |                              |                  |
| Vessel operating expenses                        | 13,974                         | 9,427            | 27,221                       | 19,709           |
| Depreciation                                     | 22,332                         | 17,372           | 43,906                       | 33,125           |
| General and administrative expenses              | 1,350                          | 1,493            | 2,695                        | 2,962            |
| <b>Total operating expenses</b>                  | <b>37,656</b>                  | <b>28,292</b>    | <b>73,822</b>                | <b>55,796</b>    |
| <b>Operating income</b>                          | <b>32,109</b>                  | <b>26,114</b>    | <b>63,986</b>                | <b>43,601</b>    |
| Finance income (expense): (Note 12):             |                                |                  |                              |                  |
| Interest income                                  | 161                            | 44               | 296                          | 80               |
| Interest expense (Note 5)                        | (12,526)                       | (7,252)          | (23,119)                     | (13,466)         |
| Other finance expense (Note 5)                   | (288)                          | (328)            | (626)                        | (630)            |
| Realized and unrealized gain (loss) on           |                                |                  |                              |                  |
| derivative instruments (Note 6)                  | 1,968                          | (1,536)          | 11,944                       | (1,017)          |
| Net gain (loss) on foreign currency transactions | 260                            | (124)            | (70)                         | (218)            |
| <b>Total finance expense</b>                     | <b>(10,425)</b>                | <b>(9,196)</b>   | <b>(11,575)</b>              | <b>(15,251)</b>  |
| <b>Income before income taxes</b>                | <b>21,684</b>                  | <b>16,918</b>    | <b>52,411</b>                | <b>28,350</b>    |
| Income tax benefit (Note 8)                      | (3)                            | (3)              | (6)                          | (6)              |
| <b>Net income</b>                                | <b>\$ 21,681</b>               | <b>\$ 16,915</b> | <b>\$ 52,405</b>             | <b>\$ 28,344</b> |

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|  |    |        |    |        |    |        |    |        |
|--|----|--------|----|--------|----|--------|----|--------|
| Series A Preferred unitholders' interest in net income | \$ | 1,800  | \$ | 1,009  | \$ | 3,600  | \$ | 1,653  |
| General Partner's interest in net income               |    | 367    |    | 294    |    | 901    |    | 493    |
| Limited Partners' interest in net income               |    | 19,514 |    | 15,613 |    | 47,904 |    | 26,198 |
| Earnings per unit (Basic): (Note 14)                   |    |        |    |        |    |        |    |        |
| Common unit (basic)                                    | \$ | 0.597  | \$ | 0.526  | \$ | 1.465  | \$ | 0.886  |
| General Partner unit (basic)                           | \$ | 0.597  | \$ | 0.526  | \$ | 1.465  | \$ | 0.882  |
| Earnings per unit (Diluted): (Note 14)                 |    |        |    |        |    |        |    |        |
| Common unit (diluted)                                  | \$ | 0.585  | \$ | 0.522  | \$ | 1.415  | \$ | 0.886  |
| General Partner unit (diluted)                         | \$ | 0.597  | \$ | 0.526  | \$ | 1.465  | \$ | 0.882  |

*The accompanying notes are an integral part of the unaudited condensed consolidated interim financial statements.*

**KNOT OFFSHORE PARTNERS LP**

Unaudited Condensed Consolidated Statements of Comprehensive Income

For the Three and Six Months Ended June 30, 2018 and 2017

*(U.S. Dollars in thousands)*

|  | <b>Three Months Ended<br/>June 30,</b> |                  | <b>Six Months Ended<br/>June 30,</b> |                  |
|--|--|------------------|--------------------------------------|------------------|
|  | <b>2018</b>                            | <b>2017</b>      | <b>2018</b>                          | <b>2017</b>      |
| Net income                             | \$ 21,681                              | \$ 16,915        | \$ 52,405                            | \$ 28,344        |
| Other comprehensive income, net of tax |  |                  |                                      |                  |
| <b>Comprehensive income</b>            | <b>\$ 21,681</b>                       | <b>\$ 16,915</b> | <b>\$ 52,405</b>                     | <b>\$ 28,344</b> |

*The accompanying notes are an integral part of the unaudited condensed consolidated interim financial statements.*

**KNOT OFFSHORE PARTNERS LP**

## Unaudited Condensed Consolidated Balance Sheets

As of June 30, 2018, and December 31, 2017

*(U.S. Dollars in thousands)*

|   | <b>At June 30,<br/>2018</b> | <b>At December 31,<br/>2017</b> |
|---|-----------------------------|---------------------------------|
| <b>ASSETS</b>   |                             |                                 |
| <i>Current assets:</i>                                    |                             |                                 |
| Cash and cash equivalents (Note 7)                        | \$ 45,085                   | \$ 46,104                       |
| Amounts due from related parties (Note 12)                | 1,381                       | 571                             |
| Inventories   | 2,495                       | 2,241                           |
| Derivative assets (Notes 6 and 7)                         | 3,875                       | 1,579                           |
| Other current assets                                      | 2,199                       | 5,610                           |
| <b>Total current assets</b>                               | <b>55,035</b>               | <b>56,105</b>                   |
| <i>Long-term assets:</i>                                  |                             |                                 |
| Vessels, net of accumulated depreciation (Note 9)         | 1,803,204                   | 1,723,023                       |
| Intangible assets, net (Note 10)                          | 2,195                       | 2,497                           |
| Derivative assets (Notes 6 and 7)                         | 19,765                      | 9,850                           |
| Accrued income  | 2,577                       | 1,693                           |
| <b>Total long term assets</b>                             | <b>1,827,741</b>            | <b>1,737,063</b>                |
| <b>Total assets</b>                                       | <b>\$ 1,882,776</b>         | <b>\$ 1,793,168</b>             |
| <b>LIABILITIES AND EQUITY</b>                             |                             |                                 |
| <i>Current liabilities:</i>                               |                             |                                 |
| Trade accounts payable (Note 12)                          | \$ 4,866                    | \$ 5,224                        |
| Accrued expenses  | 6,860                       | 6,504                           |
| Current portion of long-term debt (Notes 7 and 11)        | 80,206                      | 92,985                          |
| Current portion of derivative liabilities (Notes 6 and 7) | 261                         | 978                             |
| Income taxes payable                                      | 18                          | 175                             |
| Current portion of contract liabilities                   | 1,518                       | 1,518                           |
| Prepaid charter and deferred revenue                      | 9,686                       | 9,980                           |
| Amount due to related parties (Note 12)                   | 1,766                       | 5,450                           |
| <b>Total current liabilities</b>                          | <b>105,181</b>              | <b>122,814</b>                  |

|   |                            |                            |
|---|----------------------------|----------------------------|
| <b><i>Long-term liabilities:</i></b>                          |                            |                            |
| Long-term debt (Notes 7 and 11)                               | 1,029,053                  | 933,630                    |
| Derivative liabilities (Notes 6 and 7)                        |                            | 164                        |
| Contract liabilities  | 5,963                      | 6,722                      |
| Deferred tax liabilities (Note 8)                             | 632                        | 624                        |
| <b><i>Total long-term liabilities</i></b>                     | <b><i>1,035,648</i></b>    | <b><i>941,140</i></b>      |
| <b><i>Total liabilities</i></b>                               | <b><i>1,140,829</i></b>    | <b><i>1,063,954</i></b>    |
| <i>Commitments and contingencies (Note 13)</i>                |                            |                            |
| <b>Series A Convertible Preferred Units</b> (Notes 16 and 17) | 89,264                     | 89,264                     |
| <b><i>Equity:</i></b>   |                            |                            |
| Partners' capital:  |                            |                            |
| Common unitholders  | 640,969                    | 628,471                    |
| General partner interest                                      | 11,714                     | 11,479                     |
| <b><i>Total partners' capital</i></b>                         | <b><i>652,683</i></b>      | <b><i>639,950</i></b>      |
| <b><i>Total liabilities and equity</i></b>                    | <b><i>\$ 1,882,776</i></b> | <b><i>\$ 1,793,168</i></b> |

*The accompanying notes are an integral part of the unaudited condensed consolidated interim financial statements.*



**KNOT OFFSHORE PARTNERS LP**

Unaudited Condensed Consolidated

Statements of Changes in Partners' Capital

for the Year Ended December 31, 2017 and

the Six Months Ended June 30, 2018

*(U.S. Dollars in thousands)*

| <i>(U.S. Dollars in thousands)</i>                   | Partners' Capital<br>Common<br>Units | General Partner<br>Units | Accumulated<br>Other<br>Comprehensive<br>Income<br>(Loss) | Total<br>Partners<br>Capital | Series A<br>Convertible<br>Preferred<br>Units |
|--|--------------------------------------|--------------------------|---|------------------------------|---|
| <b>Consolidated balance at<br/>December 31, 2016</b> | <b>\$ 511,413</b>                    | <b>\$ 10,297</b>         | <b>\$</b>   | <b>\$ 521,710</b>            | <b>\$</b>                                     |
| Net income   | 61,651                               | 1,160                    |   | 62,811                       | 5,253   |
| Other comprehensive<br>income                        |                                      |                          |   |                              |   |
| Cash distributions                                   | (64,307)                             | (1,210)                  |   | (65,517)                     | (3,453)                                       |
| Net proceeds from<br>issuance of common units        | 119,714                              | 1,232                    |   | 120,946                      |   |
| Net proceeds from sale of<br>Series A                |                                      |                          |   |                              |   |
| Convertible Preferred<br>Units                       |                                      |                          |   |                              | 87,464  |
| <b>Consolidated balance at<br/>December 31, 2017</b> | <b>\$ 628,471</b>                    | <b>\$ 11,479</b>         | <b>\$</b>   | <b>\$ 639,950</b>            | <b>\$ 89,264</b>                              |
| Net income   | 47,904                               | 901                      |   | 48,805                       | 3,600   |
| Other comprehensive<br>income                        |                                      |                          |   |                              |   |
| Cash distributions                                   | (35,402)                             | (666)                    |   | (36,068)                     | (3,600)                                       |
| Net proceeds from<br>issuance of common units        | (4)                                  |                          |   | (4)                          |   |
| <b>Consolidated balance at<br/>June 30, 2018</b>     | <b>\$ 640,969</b>                    | <b>\$ 11,714</b>         | <b>\$</b>   | <b>\$ 652,683</b>            | <b>\$ 89,264</b>                              |

*The accompanying notes are an integral part of the unaudited condensed consolidated interim financial statements.*



**KNOT OFFSHORE PARTNERS LP**

## Unaudited Condensed Consolidated Statements of Cash Flows

For the Six Months Ended June 30, 2018 and 2017

*(U.S. Dollars in thousands)*

| <i>(U.S. Dollars in thousands)</i>  | <b>Six Months Ended<br/>June 30,</b> |                 |
|---|--------------------------------------|-----------------|
|   | <b>2018</b>                          | <b>2017</b>     |
| <b>OPERATING ACTIVITIES</b>   |                                      |                 |
| Net income  | \$ 52,405                            | \$ 28,344       |
| Adjustments to reconcile net income to cash provided by operating activities: |                                      |                 |
| Depreciation  | 43,906                               | 33,125          |
| Amortization of contract intangibles / liabilities                            | (456)                                | (632)           |
| Amortization of deferred revenue  | (743)                                | (743)           |
| Amortization of deferred debt issuance cost                                   | 1,271                                | 755             |
| Drydocking expenditure  | (3,803)                              | (3,800)         |
| Income tax expense  | 6                                    | 6               |
| Income taxes paid   | (172)                                | (182)           |
| Unrealized (gain) loss on derivative instruments                              | (11,253)                             | (757)           |
| Unrealized (gain) loss on foreign currency transactions                       | (44)                                 | (2)             |
| Changes in operating assets and liabilities:                                  |                                      |                 |
| Decrease (increase) in amounts due from related parties                       | (290)                                | 38,590          |
| Decrease (increase) in inventories  | 4                                    | (216)           |
| Decrease (increase) in other current assets                                   | 3,516                                | (1,914)         |
| Decrease (increase) in accrued revenue  | (884)                                | (300)           |
| Increase (decrease) in trade accounts payable                                 | (1,222)                              | 71              |
| Increase (decrease) in accrued expenses                                       | (656)                                | 826             |
| Increase (decrease) prepaid revenue   | 449                                  | 360             |
| Increase (decrease) in amounts due to related parties                         | (3,800)                              | 4,490           |
| <b>Net cash provided by operating activities</b>                              | <b>78,234</b>                        | <b>98,021</b>   |
| <b>INVESTING ACTIVITIES</b>   |                                      |                 |
| Disposals (additions) to vessel and equipment                                 | (10)                                 | (180)           |
| Acquisition of <i>Tordis Knutsen</i> (net of cash acquired)                   |                                      | (32,374)        |
| Acquisition of <i>Vigdis Knutsen</i> (net of cash acquired)                   |                                      | (28,321)        |
| Acquisition of <i>Anna Knutsen</i> (net of cash acquired)                     | (15,376)                             |                 |
| <b>Net cash provided by (used in) investing activities</b>                    | <b>(15,386)</b>                      | <b>(60,875)</b> |
| <b>FINANCING ACTIVITIES</b>   |                                      |                 |
| Proceeds from long-term debt  | 145,500                              | 130,000         |
| Repayment of long-term debt   | (146,002)                            | (167,460)       |

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|  |                  |                  |
|--|------------------|------------------|
| Repayment of long-term debt from related parties           | (22,535)         | (70,663)         |
| Payment of debt issuance cost                              | (1,114)          | (1,140)          |
| Cash distribution  | (39,668)         | (33,403)         |
| Net proceeds from issuance of common units                 | (4)              | 54,879           |
| Net proceeds from sale of Convertible Preferred Units      |                  | 87,443           |
| <b>Net cash provided by (used in) financing activities</b> | <b>(63,823)</b>  | <b>(344)</b>     |
| Effect of exchange rate changes on cash                    | (45)             | 35               |
| Net increase in cash and cash equivalents                  | (1,019)          | 36,837           |
| Cash and cash equivalents at the beginning of the period   | 46,104           | 27,664           |
| <b>Cash and cash equivalents at the end of the period</b>  | <b>\$ 45,085</b> | <b>\$ 64,501</b> |

*The accompanying notes are an integral part of the unaudited condensed consolidated interim financial statements.*

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## KNOT OFFSHORE PARTNERS LP

### Notes to Unaudited Condensed Consolidated Financial Statements

#### 1) Description of Business

KNOT Offshore Partners LP (the Partnership) is a publicly traded Marshall Islands limited partnership initially formed for the purpose of acquiring 100% ownership interests in four shuttle tankers owned by Knutsen NYK Offshore Tankers AS (KNOT) in connection with the Partnership's initial public offering of common units (the IPO), which was completed in April 2013.

As of June 30, 2018, the Partnership had a fleet of sixteen shuttle tankers, the *Windsor Knutsen*, the *Bodil Knutsen*, the *Recife Knutsen*, the *Fortaleza Knutsen*, the *Carmen Knutsen*, the *Hilda Knutsen*, the *Torill Knutsen*, the *Dan Cisne*, the *Dan Sabia*, the *Ingrid Knutsen*, the *Raquel Knutsen*, the *Tordis Knutsen*, the *Vigdis Knutsen*, the *Lena Knutsen*, the *Brasil Knutsen* and the *Anna Knutsen*, each referred to as a Vessel and, collectively, as the Vessels. The Vessels operate under fixed charter contracts to charterers.

The initial term for a time charter or bareboat charter commences upon the vessel's delivery to the customer. The Partnership's charters include options, exercisable by the customer, to extend the charter's initial term. Pursuant to the Omnibus Agreement, KNOT agreed to guarantee the payments of the hire rate under the initial charters for the *Windsor Knutsen* and the *Bodil Knutsen* for five years from the closing of the Partnership's IPO (until April 15, 2018). The time charter for the *Windsor Knutsen* expires in 2019 and the charterer has four one-year extension options. The time charter for the *Bodil Knutsen* expires in 2019 and contains customer options for extension through 2024. The *Recife Knutsen* and the *Fortaleza Knutsen* are under bareboat charter contracts that expire in 2023. The time charter for the *Carmen Knutsen* expires in 2023 and contains customer options for extension through 2026. The time charter for the *Hilda Knutsen* expires in 2022 and contains customer options for extension through 2025. The time charter for the *Torill Knutsen* expires in November 2018 and contains customer options for extension through 2023. The *Dan Cisne* and the *Dan Sabia* are under bareboat charter contracts that expire in 2023 and 2024, respectively. The time charter for the *Ingrid Knutsen* expires in 2024 and contains customer options for extension through 2029. The time charter for the *Raquel Knutsen* expires in 2025 and contains customer options for extension through 2030. The time charter for the *Tordis Knutsen* expires in 2022 and contains customer options for extension through 2032. The time charter for the *Vigdis Knutsen* expires in 2022 and contains customer options for extension through 2032. The time charter for the *Lena Knutsen* expires in 2022 and contains customer options for extension through 2032. The time charter for the *Brasil Knutsen* expires in 2022 and contains customer options for extension through 2028. The time charter for the *Anna Knutsen* expires in 2022 and contains customer options for extension through 2028.

Pursuant to the Partnership's Amended and Restated Agreement of Limited Partnership (the Partnership Agreement), KNOT Offshore Partners GP LLC, a wholly owned subsidiary of KNOT, and the general partner of the Partnership (the General Partner), has irrevocably delegated to the Partnership's board of directors the power to oversee and direct the operations of, manage and determine the strategies and policies of the Partnership. During the period from the Partnership's IPO until the time of the Partnership's first annual general meeting (AGM) on June 25, 2013, the General Partner retained the sole power to appoint, remove and replace all members of the Partnership's board of directors. From the first AGM, four of the seven board members became electable by the common unitholders and accordingly, from this date, KNOT, as the owner of the General Partner, no longer retained the power to control the Partnership's board of directors and, hence, the Partnership. As a result, the Partnership is no longer considered to be under common control with KNOT and as a consequence, the Partnership accounts for acquisitions of businesses and assets under the purchase method of accounting and not as transfers of equity interests between entities under common control. All acquisitions have been consolidated into the Partnership's results as of the date of acquisition.

On March 1, 2018, the Partnership's wholly owned subsidiary, KNOT Shuttle Tankers AS, acquired KNOT Shuttle Tankers 30 AS, the company that owns the *Anna Knutsen*, from KNOT. The acquisition of the *Anna Knutsen* was accounted for as an acquisition of an asset. As a result, the Partnership has recorded the results of operations of the *Anna Knutsen* in its consolidated statement of operations from March 1, 2018.

## **2) Summary of Significant Accounting Policies**

### ***(a) Basis of Preparation***

The accompanying unaudited condensed consolidated interim financial statements are prepared in accordance with accounting principles generally accepted in the United States of America ( U.S. GAAP ) and applicable rules and regulations of the U.S. Securities and Exchange Commission (the SEC ) for interim financial information. In the opinion of management of the Partnership, all adjustments considered necessary for a fair presentation, which are of normal recurring nature, have been included. All intercompany balances and transactions are eliminated. The unaudited condensed consolidated financial statements do not include all the disclosures and information required for a complete set of annual financial statements; and, therefore, these unaudited condensed consolidated financial statements should be read in conjunction with the Partnership's audited consolidated financial statements for the year ended December 31, 2017, which are included in the Partnership's Annual Report on Form 20-F (the 2017 20-F ).

***(b) Significant Accounting Policies***

Except as described below under *(c) Recent Accounting Pronouncements - Adoption of new accounting standards*, the accounting policies adopted in the preparation of the unaudited condensed consolidated interim financial statements are consistent with those followed in the preparation of the Partnership's audited consolidated financial statements for the year ended December 31, 2017, as contained in the Partnership's 2017 20-F.

***(c) Recent Accounting Pronouncements***

*Adoption of new accounting standards*

In January 2017, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2017-01, *Business Combinations: Clarifying the Definition of a Business*. The amendments clarify the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions of businesses. The amendments provide a screen to determine when an acquisition is not a business. The screen may apply when substantially all of the fair value related to a single, or group of similar, identifiable asset(s). If the screen is not met, it (1) requires that to be considered a business, an acquisition must include, at a minimum, an input and a substantive process that together significantly contribute to the ability to create output and (2) removes the evaluation of whether a market participant could replace the missing elements. The guidance is effective for annual periods beginning after December 15, 2017, including interim periods within those annual periods. The Partnership implemented this guidance on January 1, 2018. As a result, this increases the likelihood that future vessel dropdowns may be considered the acquisition of an asset rather than a business combination. However, this will be dependent upon the facts and circumstances of each prospective transaction. Based on the new guidance, the acquisition of the *Anna Knutsen* is determined to be an asset acquisition as the assessment is that substantially all the fair value of the gross assets acquired is considered concentrated in a single identifiable asset or group of similar assets. See Note 1 Description of Business.

In August 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows: Classification of Certain Cash Receipts and Cash Payments*, which provides guidance on the disclosure and classification of certain items within the statements of cash flows. The Partnership adopted this guidance on January 1, 2018. The adoption of this standard did not have any impact on the Partnership's Consolidated Statement of Cash Flows or related disclosures.

In November 2016, the FASB issued ASU 2016-18, *Statement of Cash Flows: Restricted Cash*. The standard eliminates the presentation of transfers between cash and cash equivalents and restricted cash and restricted cash equivalents in the statement of cash flows. When cash, cash equivalents and restricted cash equivalents are presented in more than one line item on the balance sheet, a reconciliation of the totals in the cash flows to the related captions in the balance sheet are required, either on the face of the cash flow or in the notes to the financial statements. Additional disclosures are required for the nature of the restricted cash and restricted cash equivalents. The Partnership adopted this guidance on January 1, 2018. The adoption of this standard did not have any impact on the Partnership's Consolidated Statement of Cash Flows or related disclosures.

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (ASC 606)*, as subsequently updated by the FASB, which provides new authoritative guidance on the methods of revenue recognition and related disclosure requirements. This new standard supersedes all existing revenue recognition requirements, including most industry-specific guidance. The new standard requires a company to recognize revenue when it transfers goods or services to customers in an amount that reflects the consideration that the company expects to receive for those goods or services. This update creates a five-step model and requires a company to exercise judgment when considering the terms of the contract(s) which include (i) identifying the contract(s) with the customer, (ii) identifying the separate performance obligation in the contract, (iii) determining the transaction price, (iv) allocating the transaction price to the separate performance obligations, and (v) recognizing revenue as each performance obligation is satisfied. Under

the new standard, additional qualitative and quantitative disclosures are required. The standard is effective for annual periods beginning after December 15, 2017, including interim periods within those annual periods. The Partnership made an assessment on the various implementation aspects of ASU 2014-09 and its amendments and concluded that the effect of the implementation of this new guidance will cause no material cumulative effect to the Partnership's future or historical financial position, results of operations or cash flows. Effective January 1, 2018, the Partnership applied the standard of ASC 606 to new and existing contracts not yet completed as of January 1, 2018, using the modified retrospective approach where the cumulative effect of initially applying the standard is recorded as an adjustment to the opening balance of equity. There were no changes to the timing or amount of revenue recognized and, therefore, no cumulative effect of initially applying the standard.



*Accounting pronouncements to be adopted*

In February 2016, the FASB issued revised guidance for leasing. The objective is to establish the principles that lessors and lessees shall apply to report useful information to users of financial statements about the amount, timing and uncertainty of cash flows arising from a lease. The standard is effective for annual periods beginning after December 15, 2018. The Partnership is currently assessing the impact the adoption of this standard will have on the consolidated financial statements. Based upon preliminary assessments performed to date, the Partnership does not expect adoption of the standard to have material effects on the accounting for existing leases in the consolidated financial statements.

Any other accounting pronouncements yet to be adopted by the Partnership are consistent with those disclosed in the Partnership's audited consolidated financial statements for the year ended December 31, 2017.

**3) Segment Information**

The Partnership has not presented segment information as it considers its operations to occur in one reportable segment, the shuttle tanker market. As of June 30, 2018, the Partnership's fleet consisted of sixteen vessels and operated under twelve time charters and four bareboat charters. As of June 30, 2017, the Partnership's fleet consisted of thirteen vessels and operated under nine time charters and four bareboat charters. Under the time charters and bareboat charters, the charterer, not the Partnership, controls the choice of which trading areas the applicable Vessel will serve. Accordingly, the Partnership's management, including the chief operating decision makers, does not evaluate performance according to geographical region.

The following table presents revenues and percentages of consolidated revenues for customers that accounted for more than 10% of the Partnership's consolidated revenues during the three and six months ended June 30, 2018 and 2017. All of these customers are subsidiaries of major international oil companies.

| (U.S. Dollars in thousands)  | Three Months Ended<br>June 30, |     |           |     | Six Months Ended<br>June 30, |     |           |     |
|--|--------------------------------|-----|-----------|-----|------------------------------|-----|-----------|-----|
|  | 2018                           |     | 2017      |     | 2018                         |     | 2017      |     |
| Eni Trading and Shipping S.p.A.  | \$ 11,555                      | 17% | \$ 11,345 | 22% | \$ 22,936                    | 17% | \$ 22,905 | 24% |
| Fronape International Company, a subsidiary of Petrobras Transporte S.A. | 11,248                         | 16% | 11,249    | 22% | 22,378                       | 16% | 22,378    | 23% |
| Equinor ASA  | 5,850                          | 8%  | 5,778     | 11% | 11,582                       | 8%  | 11,459    | 12% |
| Repsol Sinopec Brasil, S.A., a subsidiary of Repsol Sinopec Brasil, B.V. | 9,283                          | 13% | 7,094     | 14% | 18,222                       | 13% | 14,396    | 15% |
| Brazil Shipping I Limited, a subsidiary of Royal Dutch Shell             | 20,399                         | 29% | 11,675    | 23% | 40,572                       | 30% | 15,401    | 16% |
| Standard Marine Tønsberg AS, a Norwegian subsidiary of ExxonMobil        | 4,448                          | 6%  | 4,396     | 9%  | 8,847                        | 6%  | 8,745     | 9%  |
|  | 6,438                          | 9%  | 0%        | 0%  | 12,071                       | 9%  |           | 0%  |

Galp Sinopec Brasil Services  
B.V.

#### 4) Insurance Proceeds

##### *Raquel Knutsen*

In February 2017, the *Raquel Knutsen* damaged its propeller hub. As a result, the Vessel was off-hire from February 22, 2017 to May 15, 2017 for repairs. Under the Partnership's loss of hire policies, its insurer will pay the Partnership the hire rate agreed in respect of each vessel for each day, in excess of 14 deductible days, for the time that the Vessel is out of service as a result of damage, for a maximum of 180 days. For the three and six months ended June 30, 2017, the Partnership received payments for loss of hire insurance of \$2.15 million and \$2.9 million, respectively, which was recorded as a component of total revenues since day rates are recovered under terms of the policy.

In addition, for the three and six months ended June 30, 2017, the Partnership recorded \$2.17 million and \$3.89 million, respectively, for recoveries up to the amount of loss under hull and machinery insurance for the repairs as a result of the propeller hub damage to the *Raquel Knutsen*. For the three and six months ended June 30, 2017, \$0.1 million is classified under vessel operating expense along with the cost of the repairs.

##### *Carmen Knutsen*

During the fourth quarter of 2017, the *Carmen Knutsen* undertook her 5-year special drydocking survey. During dismantling for overhaul, a technical default with her controllable pitch propeller was found. As a result, the vessel went to a different yard to complete the repair. Repairs were completed and the *Carmen Knutsen* was back on hire on January 1, 2018. The additional off-hire and technical costs are subject to an insurance claim. Under its loss of hire insurance policies, the Partnership's insurer is expected to pay the hire rate agreed in respect of the *Carmen Knutsen* for each day in excess of 14 deductible days while the vessel was off-hire as a result of the repairs of the controllable pitch propeller. For the three and six months ended June 30, 2018, the Partnership received payments for loss of hire insurance of \$2.2 million, which is recorded as a component of total revenues since day rates are recovered under terms of the policy.

In addition, for the three and six months ended June 30, 2018, the Partnership received payments for loss under its hull and machinery insurance of \$1.5 million.

## 5) Other Finance Expenses

### (a) Interest Expense

The following table presents a reconciliation of total interest cost and interest expense as reported in the consolidated statements of operations for the three and six months ended June 30, 2018 and 2017:

| <i>(U.S. Dollars in thousands)</i>                                | <b>Three Months Ended</b> |                 | <b>Six Months Ended</b> |                  |
|---|---------------------------|-----------------|-------------------------|------------------|
|   | <b>June 30,</b>           |                 | <b>June 30,</b>         |                  |
|   | <b>2018</b>               | <b>2017</b>     | <b>2018</b>             | <b>2017</b>      |
| Interest expense  | \$ 11,830                 | \$ 6,846        | \$ 21,848               | \$ 12,711        |
| Amortization of debt issuance cost and fair value of debt assumed | 696                       | 406             | 1,271                   | 755              |
| <b>Total interest cost</b>  | <b>\$ 12,526</b>          | <b>\$ 7,252</b> | <b>\$ 23,119</b>        | <b>\$ 13,466</b> |

### (b) Other Finance Expense

The following table presents the other finance expense for three and six months ended June 30, 2018 and 2017:

| <i>(U.S. Dollars in thousands)</i> | <b>Three Months Ended</b> |               | <b>Six Months Ended</b> |               |
|------------------------------------|---------------------------|---------------|-------------------------|---------------|
|                                    | <b>June 30,</b>           |               | <b>June 30,</b>         |               |
|                                    | <b>2018</b>               | <b>2017</b>   | <b>2018</b>             | <b>2017</b>   |
| Bank fees, charges                 | \$ 151                    | \$ 119        | \$ 241                  | \$ 191        |
| Guarantee costs                    | 140                       | 158           | 282                     | 318           |
| Commitment fees                    | (3)                       | 51            | 103                     | 121           |
| <b>Total other finance expense</b> | <b>\$ 288</b>             | <b>\$ 328</b> | <b>\$ 626</b>           | <b>\$ 630</b> |

## 6) Derivative Instruments

The unaudited condensed consolidated interim financial statements include the results of interest rate swap contracts to manage the Partnership's exposure related to changes in interest rates on its variable rate debt instruments and the results of foreign exchange forward contracts to manage its exposure related to changes in currency exchange rates on its operating expenses, mainly crew expenses, in currency other than U.S. Dollars and on its contract obligations. The Partnership does not apply hedge accounting for derivative instruments. The Partnership does not speculate using derivative instruments.

By using derivative financial instruments to economically hedge exposures to changes in interest rates, the Partnership exposes itself to credit risk and market risk. Derivative instruments that economically hedge exposures are used for risk management purposes, but these instruments are not designated as hedges for accounting purposes. Credit risk is

the failure of the counterparty to perform under the terms of the derivative instrument. When the fair value of a derivative instrument is positive, the counterparty owes the Partnership, which creates credit risk for the Partnership. When the fair value of a derivative instrument is negative, the Partnership owes the counterparty, and, therefore, the Partnership is not exposed to the counterparty's credit risk in those circumstances. The Partnership minimizes counterparty credit risk in derivative instruments by entering into transactions with major banking and financial institutions. The derivative instruments entered into by the Partnership do not contain credit risk-related contingent features. The Partnership has not entered into master netting agreements with the counterparties to its derivative financial instrument contracts.

Market risk is the adverse effect on the value of a derivative instrument that results from a change in interest rates, currency exchange rates or commodity prices. The market risk associated with interest rate contracts is managed by establishing and monitoring parameters that limit the types and degree of market risk that may be undertaken.

The Partnership assesses interest rate risk by monitoring changes in interest rate exposures that may adversely impact expected future cash flows and by evaluating economical hedging opportunities.

The Partnership has historically used variable interest rate mortgage debt to finance its vessels. The variable interest rate mortgage debt obligations expose the Partnership to variability in interest payments due to changes in interest rates. The Partnership believes that it is prudent to limit the variability of a portion of its interest payments. To meet this objective, the Partnership has entered into London Interbank Offered Rate (LIBOR)-based interest rate swap contracts to manage fluctuations in cash flows resulting from changes in the benchmark interest rate of LIBOR. These swaps change the variable rate cash flow exposure on the mortgage debt obligations to fixed cash flows. Under the terms of the interest rate swap contracts, the Partnership receives LIBOR-based variable interest rate payments and makes fixed interest rate payments, thereby creating the equivalent of fixed rate debt for the notional amount of its debt hedged.

As of June 30, 2018, the Partnership had entered into various interest swap agreements for a total notional amount of \$539.5 million to hedge against the interest rate risks of its variable rate borrowings. Under the terms of the interest rate swap agreements, the Partnership receives interest based on three or six month LIBOR and pays a weighted average interest rate of 1.82%.

As of June 30, 2018 and December 31, 2017, the total notional amount of the Partnership's outstanding interest rate swap contracts that were entered into in order to hedge outstanding or forecasted debt obligations were \$539.5 million and \$650.5 million, respectively. As of June 30, 2018 and December 31, 2017, the carrying amount of the interest rate swaps contracts were net assets of \$23.5 million and \$9.7 million, respectively. See Note 7 Fair Value Measurements.

Changes in the fair value of interest rate swap contracts are reported in realized and unrealized gain (loss) on derivative instruments in the same period in which the related interest affects earnings.

The Partnership and its subsidiaries utilize the U.S. Dollar as their functional and reporting currency, because all of their revenues and the majority of their expenditures, including the majority of their investments in vessels and their financing transactions, are denominated in U.S. Dollars. Payment obligations in currencies other than the U.S. Dollar, and in particular operating expenses in Norwegian Kroner (NOK), expose the Partnership to variability in currency exchange rates. The Partnership believes that it is prudent to limit the variability of a portion of its currency exchange exposure. To meet this objective, the Partnership entered into foreign exchange forward contracts to manage fluctuations in cash flows resulting from changes in the exchange rates towards the U.S. Dollar. The agreements change the variable exchange rate to fixed exchange rates at agreed dates.

As of June 30, 2018 and December 31, 2017, the total contract amount in foreign currency of the Partnership's outstanding foreign exchange forward contracts that were entered into to economically hedge outstanding future payments in currencies other than the U.S. Dollar were NOK 202.1 million and NOK 249.9 million, respectively. As of June 30, 2018 and December 31, 2017, the carrying amount of the Partnership's foreign exchange forward contracts was a net liability of \$0.1 million and a net asset of \$0.6 million, respectively. See Note 7 Fair Value Measurements.

The following table presents the realized and unrealized gains and losses that are recognized in earnings as net gain (loss) on derivative instruments for the three and six months ended June 30, 2018 and 2017:

| <i>(U.S. Dollars in thousands)</i> | <b>Three Months Ended</b> |             | <b>Six Months Ended</b> |             |
|------------------------------------|---------------------------|-------------|-------------------------|-------------|
|                                    | <b>June 30,</b>           |             | <b>June 30,</b>         |             |
|                                    | <b>2018</b>               | <b>2017</b> | <b>2018</b>             | <b>2017</b> |

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|   |    |         |    |         |    |        |    |         |
|---|----|---------|----|---------|----|--------|----|---------|
| <b>Realized gain (loss):</b>  |    |         |    |         |    |        |    |         |
| Interest rate swap contracts  | \$ | 57      | \$ | (938)   | \$ | (247)  | \$ | (1,607) |
| Foreign exchange forward contracts  |    | 134     |    | (97)    |    | 1,239  |    | (166)   |
| Total realized gain (loss):   |    | 191     |    | (1,035) |    | 992    |    | (1,773) |
| <b>Unrealized gain (loss):</b>  |    |         |    |         |    |        |    |         |
| Interest rate swap contracts  |    | 2,995   |    | (1,334) |    | 11,942 |    | (275)   |
| Foreign exchange forward contracts  |    | (1,218) |    | 833     |    | (990)  |    | 1,031   |
| Total unrealized gain (loss):   |    | 1,777   |    | (501)   |    | 10,952 |    | 756     |
| <b>Total realized and unrealized gain (loss) on derivative instruments:</b> |    |         |    |         |    |        |    |         |
|   | \$ | 1,968   | \$ | (1,536) | \$ | 11,944 | \$ | (1,017) |

## 7) Fair Value Measurements

### (a) Fair Value of Financial Instruments

The following table presents the carrying amounts and estimated fair values of the Partnership's financial instruments as of June 30, 2018 and December 31, 2017. Fair value is defined as the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

| (U.S. Dollars in thousands)                | June 30, 2018   |            | December 31, 2017 |            |
|--|-----------------|------------|-------------------|------------|
|  | Carrying Amount | Fair Value | Carrying Amount   | Fair Value |
| <b>Financial assets:</b>                   |                 |            |                   |            |
| Cash and cash equivalents                  | \$ 45,085       | \$ 45,085  | \$ 46,104         | \$ 46,104  |
| <i>Current derivative assets:</i>          |                 |            |                   |            |
| Interest rate swap contracts               | 3,693           | 3,693      | 950               | 950        |
| Foreign exchange forward contracts         | 182             | 182        | 629               | 629        |
| <i>Non-current derivative assets:</i>      |                 |            |                   |            |
| Interest rate swap contracts               | 19,765          | 19,765     | 9,850             | 9,850      |
| Foreign exchange forward contracts         |                 |            |                   |            |
| <b>Financial liabilities:</b>              |                 |            |                   |            |
| <i>Current derivative liabilities:</i>     |                 |            |                   |            |
| Interest rate swap contracts               | 3               | 3          | 961               | 961        |
| Foreign exchange forward contracts         | 258             | 258        | 17                | 17         |
| <i>Non-current derivative liabilities:</i> |                 |            |                   |            |
| Interest rate swap contracts               |                 |            | 164               | 164        |
| Foreign exchange forward contracts         |                 |            |                   |            |
| Long-term debt, current and non-current    | 1,117,045       | 1,115,285  | 1,033,330         | 1,032,484  |

The carrying amounts shown in the table above are included in the consolidated balance sheets under the indicated captions. Carrying amount of long-term debt, current and non-current, above excludes capitalized debt issuance cost of \$7.8 million and \$6.7 million as of June 30, 2018 and December 31, 2017, respectively. The carrying value of trade accounts receivable, trade accounts payable and receivables/payables to owners and affiliates approximate their fair value.

The fair values of the financial instruments shown in the above table as of June 30, 2018 and December 31, 2017 represent the amounts that would be received to sell those assets or that would be paid to transfer those liabilities in an orderly transaction between market participants at that date. Those fair value measurements maximize the use of observable inputs. However, in situations where there is little, if any, market activity for the asset or liability at the measurement date, the fair value measurement reflects the Partnership's own judgment about the assumptions that market participants would use in pricing the asset or liability. Those judgments are developed by the Partnership based

on the best information available in the circumstances, including expected cash flows, appropriately risk-adjusted discount rates and available observable and unobservable inputs.

The following methods and assumptions were used to estimate the fair value of each class of financial instruments:

*Cash and cash equivalents and restricted cash:* The fair value of the Partnership's cash balances approximates the carrying amounts due to the current nature of the amounts. As of June 30, 2018 and December 31, 2017 there is no restricted cash.

*Interest rate swap contracts:* The fair value of interest rate swap contracts is determined using an income approach using the following significant inputs: the term of the swap, the notional amount of the swap, discount rates interpolated based on relevant LIBOR swap curves and the rate on the fixed leg of the swap

*Foreign exchange forward contracts:* The fair value is calculated using mid-rates (excluding margins) as determined by counterparties based on available market rates as of the balance sheet date. The fair value is discounted from the value at expiration to the current value of the contracts.



*Long-term debt:* With respect to long-term debt measurements, the Partnership uses market interest rates and adjusts that rate for all necessary risks, including its own credit risk. In determining an appropriate spread to reflect its credit standing, the Partnership considered interest rates currently offered to KNOT for similar debt instruments of comparable maturities by KNOT's and the Partnership's bankers as well as other banks that regularly compete to provide financing to the Partnership.

**(b) Fair Value Hierarchy**

The following table presents the placement in the fair value hierarchy of assets and liabilities that are measured at fair value on a recurring basis (including items that are required to be measured at fair value or for which fair value is required to be disclosed) as of June 30, 2018 and December 31, 2017:

|  | Fair Value Measurements at Reporting Date Using |   |   |  |
|--|---|---|---|--|
|  | Carrying Value<br>June 30,<br>2018              | Quoted Price<br>in Active<br>Markets<br>for<br>Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| <i>(U.S. Dollars in thousands)</i>         |   |   |   |  |
| <b>Financial assets:</b>                   |   |   |   |  |
| Cash and cash equivalents                  | \$ 45,085                                       | \$ 45,085   | \$  | \$   |
| <i>Current derivative assets:</i>          |   |   |   |  |
| Interest rate swap contracts               | 3,693   |   | 3,693   |  |
| Foreign exchange forward contracts         | 182   |   | 182   |  |
| <i>Non-current derivative assets:</i>      |   |   |   |  |
| Interest rate swap contracts               | 19,765  |   | 19,765  |  |
| Foreign exchange forward contracts         |   |   |   |  |
| <b>Financial liabilities:</b>              |   |   |   |  |
| <i>Current derivative liabilities:</i>     |   |   |   |  |
| Interest rate swap contracts               | 3   |   | 3   |  |
| Foreign exchange forward contracts         | 258   |   | 258   |  |
| <i>Non-current derivative liabilities:</i> |   |   |   |  |
| Interest rate swap contracts               |   |   |   |  |
| Foreign exchange forward contracts         |   |   |   |  |
| Long-term debt, current and non-current    | 1,117,045                                       |   | 1,115,285   |  |

|  | Fair Value Measurements at<br>Reporting Date Using |   |   |  |
|--|--|---|---|--|
|  | Carrying<br>Value<br>December 31,<br>2017          | Quoted<br>Price<br>in Active<br>Markets for<br>Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| <i>(U.S. Dollars in thousands)</i>         |  |   |   |  |
| <b>Financial assets:</b>                   |  |   |   |  |
| Cash and cash equivalents                  | \$ 46,104  | \$ 46,104   | \$  | \$   |
| <i>Current derivative assets:</i>          |  |   |   |  |
| Interest rate swap contracts               | 950  |   | 950   |  |
| Foreign exchange forward contracts         | 629  |   | 629   |  |
| <i>Non-current derivative assets:</i>      |  |   |   |  |
| Interest rate swap contracts               | 9,850  |   | 9,850   |  |
| Foreign exchange forward contracts         |  |   |   |  |
| <b>Financial liabilities:</b>              |  |   |   |  |
| <i>Current derivative liabilities:</i>     |  |   |   |  |
| Interest rate swap contracts               | 961  |   | 961   |  |
| Foreign exchange forward contracts         | 17   |   | 17  |  |
| <i>Non-current derivative liabilities:</i> |  |   |   |  |
| Interest rate swap contracts               | 164  |   | 164   |  |
| Foreign exchange forward contracts         |  |   |   |  |
| Long-term debt, current and non-current    | 1,033,330  |   | 1,032,484   |  |

The Partnership's accounting policy is to recognize transfers between levels of the fair value hierarchy on the date of the event or change in circumstances that caused the transfer. There were no transfers into or out of Level 1, Level 2 or Level 3 as of June 30, 2018 and December 31, 2017.

## 8) Income Taxes

### *Components of Current and Deferred Tax Expense*

After the reorganization of the Partnership's predecessor's activities into the new group structure in February 2013, all profit from continuing operations in Norway is taxable within the tonnage tax regime. The consequence of the reorganization was a one-time entrance tax into the tonnage tax regime due to the Partnership's acquisition of the shares in the subsidiary that owns the *Fortaleza Knutsen* and the *Recife Knutsen*. Under the tonnage tax regime, the tax is based on the tonnage of the vessel and operating income is tax free. The net financial income and expense remains taxable as ordinary income tax for entities subject to the tonnage tax regime. For the portion of activities subject to the tonnage tax regime, tonnage taxes are classified as vessel operating expenses while the current and deferred taxes arising on net financial income and expense are reflected as income tax expense in the consolidated financial statements.

The total amount of the entrance tax was estimated to be approximately \$3.0 million, which was recognized in the three months ended March 31, 2013. The entrance tax is payable over several years and is calculated by multiplying the tax rate by the declining balance of the gain, which will decline by 20% each year. The amount payable will be affected by the change in tax rate which was reduced to 23% in 2018 from 24% in 2017, from 25% in 2016, from 27% in 2014 and from 28% in 2013 and the fluctuation in currency rates. Approximately \$0.2 of the entrance tax was paid during the first quarter of 2018 and 2017. As of June 30, 2018 and December 31, 2017, UK income tax is presented as

income taxes payable, while \$0.6 million is presented as non-current deferred taxes payable.

Significant components of current and deferred income tax expense attributable to income from continuing operations for the three and six months ended June 30, 2018 and 2017 as follows:

| <i>(U.S. Dollars in thousands)</i> | <b>Three Months Ended<br/>June 30,</b> |             | <b>Six Months Ended<br/>June 30,</b> |             |
|------------------------------------|--|-------------|--------------------------------------|-------------|
|                                    | <b>2018</b>                            | <b>2017</b> | <b>2018</b>                          | <b>2017</b> |
| Income before income taxes         | \$ 21,684                              | \$ 16,918   | \$ 52,411                            | \$ 28,350   |
| Income tax (expense)               | (3)                                    | (3)         | (6)                                  | (6)         |
| Effective tax rate                 | \$ 0%                                  | \$ 0%       | \$ 0%                                | \$ 0%       |

The Partnership records a valuation allowance for deferred tax assets when it is more likely than not that some of or all of the benefit from the deferred tax assets will not be realized. In assessing the realizability of deferred tax assets, which relates to financial loss carry forwards and other deferred tax assets within the tonnage tax regime, the Partnership considers whether it is more-likely-than-not that some portion or all of the deferred tax assets will not be realized taking into account all the positive and negative evidence available. As of June 30, 2018 and December 31, 2017 there are no deferred tax assets recognized.

## 9) Vessels and Equipment

| <i>(U.S. Dollars in thousands)</i> | <b>Vessels &amp;<br/>equipment</b> | <b>Accumulated<br/>depreciation</b> | <b>Net<br/>Vessels</b> |
|------------------------------------|------------------------------------|-------------------------------------|------------------------|
| <b>Vessels, December 31, 2016</b>  | <b>\$ 1,468,913</b>                | <b>\$ (212,024)</b>                 | <b>\$ 1,256,889</b>    |
| Additions                          | 522,369                            |                                     | 522,369                |
| Drydock costs                      | 15,348                             |                                     | 15,348                 |
| Disposals                          | (3,289)                            | 3,289                               |                        |
| Depreciation for the year          |                                    | (71,583)                            | (71,583)               |
| <b>Vessels, December 31, 2017</b>  | <b>\$ 2,003,341</b>                | <b>\$ (280,318)</b>                 | <b>\$ 1,723,023</b>    |
| Additions                          | 117,955                            |                                     | 117,955                |
| Drydock costs                      | 6,132                              |                                     | 6,132                  |
| Disposals                          | (260)                              | 260                                 |                        |
| Depreciation for the period        |                                    | (43,906)                            | (43,906)               |
| <b>Vessels, June 30, 2018</b>      | <b>\$ 2,127,168</b>                | <b>\$ (323,964)</b>                 | <b>\$ 1,803,204</b>    |

As of June 30, 2018 and December 2017, Vessels with a book value of \$1,803 million and \$1,723 million, respectively, are pledged as security held as a guarantee for the Partnership's long-term debt. See Note 11 Long-term debt.

## 10) Intangible Assets

| <i>(U.S. Dollars in thousands)</i>    | <b>Above market time charter</b> |              | <b>above market time charter</b> |              | <b>Total</b>       |
|---------------------------------------|----------------------------------|--------------|----------------------------------|--------------|--------------------|
|                                       | <b><i>Tordis Knutsen</i></b>     |              | <b><i>Vigdis Knutsen</i></b>     |              | <b>intangibles</b> |
| <b>Intangibles, December 31, 2016</b> | <b>\$</b>                        |              | <b>\$</b>                        |              | <b>\$</b>          |
| Additions                             |                                  | 1,468        |                                  | 1,458        | 2,926              |
| Amortization for the year             |                                  | (253)        |                                  | (176)        | (429)              |
| <b>Intangibles, December 31, 2017</b> | <b>\$</b>                        | <b>1,215</b> | <b>\$</b>                        | <b>1,282</b> | <b>\$ 2,497</b>    |
| Additions                             |                                  |              |                                  |              |                    |
| Amortization for the period           |                                  | (152)        |                                  | (150)        | (302)              |
| <b>Intangibles, June 30, 2018</b>     | <b>\$</b>                        | <b>1,063</b> | <b>\$</b>                        | <b>1,132</b> | <b>\$ 2,195</b>    |

The intangible for the above market value of time charter contract associated with the *Tordis Knutsen* is amortized to time charter revenue on a straight line basis over the remaining term of the contract of approximately 4.8 years as of the acquisition date. The intangible for the above market value of time charter contract associated with the *Vigdis Knutsen* is amortized to time charter revenue on a straight line basis over the remaining term of the contract of approximately 4.9 years as of the acquisition date. Also see Note 15 Acquisitions.

**11) Long-Term Debt**

As of June 30, 2018 and December 31, 2017, the Partnership had the following debt amounts outstanding:

| <i>(U.S. Dollars in thousands)</i>  | <b>Vessel</b>                          | <b>June 30,<br/>2018</b> | <b>December 31,<br/>2017</b> |
|---|--|--------------------------|------------------------------|
| \$220 million loan facility   | <i>Windsor Knutsen, Bodil Knutsen,</i> |                          |                              |
|   | <i>Carmen Knutsen</i>                  | \$ 157,142               | \$ 165,000                   |
| \$35 million revolving credit facility  | <i>Windsor Knutsen, Bodil Knutsen,</i> |                          |                              |
|   | <i>Carmen Knutsen</i>                  | 22,000                   |                              |
| Fortaleza and Recife loan facility  | <i>Fortaleza Knutsen &amp;</i>         |                          |                              |
|   | <i>Recife Knutsen</i>                  | 105,000                  | 109,375                      |
| Hilda loan facility   | <i>Hilda Knutsen</i>                   | 93,846                   | 96,923                       |
| \$117 million loan facility   | <i>Torill Knutsen</i>                  |                          | 73,177                       |
| Torill loan facility  | <i>Torill Knutsen</i>                  | 98,333                   |                              |
| \$172.5 million loan facility   | <i>Dan Cisne, Dan Sabia</i>            | 86,739                   | 91,339                       |
| Ingrid loan facility  | <i>Ingrid Knutsen</i>                  | 57,802                   | 61,085                       |
| Raquel loan facility  | <i>Raquel Knutsen</i>                  | 65,799                   | 68,414                       |
| Tordis loan facility  | <i>Tordis Knutsen</i>                  | 88,521                   | 91,051                       |
| Vigdis loan facility  | <i>Vigdis Knutsen</i>                  | 89,786                   | 92,316                       |
| Lena loan facility  | <i>Lena Knutsen</i>                    | 88,200                   | 90,650                       |
| Brasil loan facility  | <i>Brasil Knutsen</i>                  | 66,485                   | 69,000                       |
| Anna loan facility  | <i>Anna Knutsen</i>                    | 72,392                   |                              |
| \$25 million revolving credit facility  |  | 25,000                   | 25,000                       |
| <b>Total long-term debt</b>   |  | <b>1,117,045</b>         | <b>1,033,330</b>             |
| Less: current installments  |  | 82,823                   | 95,176                       |
| Less: unamortized deferred loan issuance costs  |  | 2,617                    | 2,191                        |
| <b>Current portion of long-term debt</b>  |  | <b>80,206</b>            | <b>92,985</b>                |
| Amounts due after one year  |  | 1,034,222                | 938,154                      |
| Less: unamortized deferred loan issuance costs  |  | 5,169                    | 4,524                        |
| <b>Long-term debt, less current installments and unamortized deferred loan issuance costs</b> |  | <b>\$ 1,029,053</b>      | <b>\$ 933,630</b>            |

The Partnership's outstanding debt of \$1,117.0 million as of June 30, 2018 is repayable as follows:

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| <i>(U.S. Dollars in thousands)</i> | <b>Period<br/>repayment</b> | <b>Balloon<br/>repayment</b> |
|------------------------------------|-----------------------------|------------------------------|
| Remainder of 2018 (1)              | \$ 41,362                   | \$ 18,427                    |
| 2019 (2)                           | 71,903                      | 284,678                      |
| 2020                               | 61,083                      |                              |
| 2021                               | 61,683                      | 70,811                       |
| 2022                               | 46,347                      | 236,509                      |
| 2023 and thereafter                | 62,341                      | 161,901                      |
| <b>Total</b>                       | <b>\$ 344,719</b>           | <b>\$ 772,326</b>            |

- (1) Although \$18.4 million of the \$77.5 million loan facility financing *Ingrid Knutsen* is due to mature in December 2018, the Partnership has classified \$18.4 million of the loan facility as long-term debt on the face of the consolidated balance sheet as a result of the September 2018 refinancing transaction discussed under Note 18 Subsequent Events.

- (2) Although \$141.4 million of the \$220 million loan facility and \$22 million of the \$35 million revolving credit facility financing *Windsor Knutsen*, *Carmen Knutsen* and *Bodil Knutsen* is due to mature in June 2019, the Partnership has classified \$163.4 million of such facilities as long-term debt on the face of the consolidated balance sheet as a result of the September 2018 refinancing transaction discussed under Note 18 Subsequent Events. In addition \$96.3 million of the \$140 million loan facility financing *Fortaleza Knutsen* and *Recife Knutsen* is due to mature in June 2019, the Partnership has classified \$96.3 million of such facilities as long-term debt on the face of the consolidated balance sheet as a result of the September 2018 refinancing transaction discussed under Note 18 Subsequent Events.

As of June 30, 2018, the interest rates on the Partnership's loan agreements (other than tranche two of the Ingrid loan facility) were LIBOR plus a fixed margin ranging from 1.8% to 2.5%. On the export credit loan of \$39.4 million which is tranche two of the Ingrid loan facility, the annual rate is 3.85% composed of a 2.5% bank facility rate plus a commission of 1.35% to the export credit guarantor. The guarantee commission of 1.35% is classified as other finance expense.

On January 30, 2018, the Partnership's subsidiary, KNOT Shuttle Tankers 15 AS, which owns the vessel *Torill Knutsen*, closed a new \$100 million senior secured term loan facility (the Torill Facility) with a consortium of banks, in which The Bank of Tokyo-Mitsubishi UFJ acted as agent. The Torill Facility is repayable in twenty-four (24) consecutive quarterly installments with a balloon payment of \$60.0 million due at maturity. The Torill Facility bears interest at a rate per annum equal to LIBOR plus a margin of 2.1%. The facility will mature in January 2024 and is guaranteed by the Partnership. The Torill Facility refinanced a \$73.2 million loan facility associated with the *Torill Knutsen* that bore interest at a rate of LIBOR plus 2.5% and was due to be paid in full in November 2018.

In September 2016, KNOT Shuttle Tankers 30 AS, the subsidiary owning the *Anna Knutsen*, as the borrower, entered into a secured loan facility (the Anna Facility). As of the time of the acquisition of the *Anna Knutsen* on March 1, 2018, the aggregate amount outstanding under the facility was \$74.4 million. The Anna Facility is repayable in quarterly installments with a final balloon payment of \$57.1 million due at maturity in March 2022. The Anna Facility bears interest at an annual rate equal to LIBOR plus a margin of 2.0%. The facility is secured by a vessel mortgage on the *Anna Knutsen*. The *Anna Knutsen*, assignments of earnings, charterparty contracts and insurance proceeds are pledged as collateral for the Anna Facility. The Partnership and KNOT Shuttle Tankers AS are the sole guarantors.

## 12) Related Party Transactions

### (a) Related Parties

Net expenses (income) from related parties included in the unaudited condensed consolidated statements of operations for the three and six months ended June 30, 2018 and 2017 are as follows:

| <i>(U.S. Dollars in thousands)</i>       | <b>Three Months Ended</b> |             | <b>Six Months Ended</b> |             |
|--|---------------------------|-------------|-------------------------|-------------|
|  | <b>June 30,</b>           |             | <b>June 30,</b>         |             |
|  | <b>2018</b>               | <b>2017</b> | <b>2018</b>             | <b>2017</b> |
| <b>Statements of operations:</b>         |                           |             |                         |             |
| Other income:                            |                           |             |                         |             |
| Guarantee income from KNOT (1)           | \$ 94                     | \$ 593      | \$ 749                  | \$ 687      |
| Operating expenses:                      |                           |             |                         |             |
| Technical and operational management fee |                           |             |                         |             |
| from KNOT Management to Vessels (2)      | 1,509                     | 1,079       | 3,019                   | 2,028       |



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General and administrative expenses:

|   |          |          |          |          |
|---|----------|----------|----------|----------|
| Administration fee from KNOT Management (3)     | 449      | 430      | 812      | 783      |
| Administration fee from KOAS (3)                | 148      | 111      | 290      | 223      |
| Administration fee from KOAS UK (3)             | 30       | 31       | 60       | 62       |
| Administration and management fee from KNOT (4) | 41       | 52       | 80       | 94       |
| <i>Finance income (expense):</i>                |          |          |          |          |
| Interest expense charged from KNOT (5)          |          |          |          | 52       |
| <b>Total</b>                                    | \$ 2,083 | \$ 1,110 | \$ 3,512 | \$ 2,555 |

| <i>(U.S. Dollars in thousands)</i>       | <b>At June 30,<br/>2018</b> | <b>At December 31,<br/>2017</b> |
|--|-----------------------------|---------------------------------|
| <b>Balance Sheet:</b>                    |                             |                                 |
| Vessels:                                 |                             |                                 |
| Drydocking supervision fee from KNOT (6) | \$ 128                      | \$ 89                           |
| Drydocking supervision fee from KOAS (6) |                             | 8                               |
| <b>Total</b>                             | <b>\$ 128</b>               | <b>\$ 97</b>                    |

- (1) *Guarantee income from KNOT*: Pursuant to the Omnibus Agreement, KNOT agreed to guarantee the payments of the hire rate under the initial charter of the *Bodil Knutsen* and *Windsor Knutsen* for a period of five years from the closing date of the IPO (until April 15, 2018). In October 2015, the *Windsor Knutsen* commenced on a new Shell time charter with a hire rate below the hire rate in the initial charter. The difference between the new hire rate and the initial rate was paid by KNOT until April 15, 2018. The *Vigdis Knutsen* suffered damages to its hull in connection with a ship-to-ship loading on May 24, 2017 and the vessel went off-hire 6 days in June 2017 due to repairs of the damage. In connection with the *Vigdis Knutsen* acquisition, KNOT agreed to pay for the repair cost and charter hire lost in connection with the incident. The reimbursement from KNOT for lost charter hire is accounted for as guarantee income. See Note 12(b) Related Party Transactions Guarantees and Indemnifications.
  - (2) *Technical and operational management fee from KNOT Management to Vessels*: KNOT Management provides technical and operational management of the vessels on time charter including crewing, purchasing, maintenance and other operational service. In addition, there is also a charge for 24-hour emergency response services provided by KNOT Management for all vessels managed by KNOT Management.
  - (3) *Administration fee from KNOT Management and Knutsen OAS Shipping AS ( KOAS ) and Knutsen OAS (UK) Ltd. ( KOAS UK )*: Administration costs include the compensation and benefits of KNOT Management's management and administrative staff as well as other general and administration expenses. Some benefits are also provided by KOAS and KOAS UK. Net administration costs are total administration cost plus a 5% margin, reduced for the total fees for services delivered by the administration staffs and the estimated shareholder costs for KNOT that have not been allocated. As such, the level of net administration costs as a basis for the allocation can vary from year to year based on the administration and financing services offered by KNOT to all the vessels in its fleet each year. KNOT Management also charges each subsidiary a fixed annual fee for the preparation of the statutory financial statement.
  - (4) *Administration and management fee from KNOT*: For bareboat charters, the shipowner is not responsible for providing crewing or other operational services and the customer is responsible for all vessel operating expenses and voyage expenses. However, each of the vessels under bareboat charters is subject to a management and administration agreement with either KNOT Management or KNOT Management Denmark, pursuant to which these companies provide general monitoring services for the vessels in exchange for an annual fee.
  - (5) *Interest expense charged from KNOT*: KNOT invoiced interest (expense) income for any outstanding payables to (receivable from) owners and affiliates to the vessel-owning subsidiaries.
  - (6) *Drydocking supervision fee from KNOT and KOAS*: KNOT and KOAS provide supervision and hire out service personnel during drydocking of the vessels. The fee is calculated as a daily fixed fee.
- (b) Guarantees and Indemnifications**

Pursuant to the Omnibus Agreement, KNOT agreed to guarantee the payments of the hire rate under the initial charters of each of the *Windsor Knutsen* and the *Bodil Knutsen* for a period of five years from the closing date of the IPO (until April 15, 2018).

In April 2014, the Partnership was notified that Shell would not exercise its option to extend the *Windsor Knutsen* time charter after the expiration of its initial term. The vessel was re-delivered on July 28, 2014. In order to comply with its obligations under the Omnibus Agreement, on July 29, 2014, KNOT and the Partnership entered into a time charter for the vessel at a rate of hire that would have been in effect during the option period under the previous Shell time charter. This charter was effective until the new Shell time charter commenced in October, 2015. The new Shell charter has a hire rate that is lower than the hire rate in the initial charter. The difference between the new hire rate and the initial rate was paid by KNOT until April 15, 2018.

On June 1, 2017, the Partnership acquired KNOT's 100% interest in KNOT Shuttle Tankers 25 AS, the company that owns and operate the *Vigdis Knutsen*. Shortly before the closing of the acquisition and on May 24, 2017, the *Vigdis Knutsen* suffered damages to its hull in connection with a ship-to-ship loading and the vessel went off-hire 6 days in June 2017 due to repairs of the damage. In connection with the *Vigdis Knutsen* acquisition, KNOT agreed to pay for the repair cost and charter hire lost in connection with the incident.

Under the Omnibus Agreement, KNOT agreed to indemnify the Partnership until April 15, 2018 (or for a period of at least three years after the purchase of the *Hilda Knutsen*, the *Torill Knutsen*, the *Ingrid Knutsen* and the *Raquel Knutsen*, as applicable), against certain environmental and toxic tort liabilities with respect to certain assets that KNOT contributed or sold to the Partnership to the extent arising prior to the time they were contributed or sold. However, claims are subject to a deductible of \$0.5 million and an aggregate cap of \$5 million.

**(c) Transactions with Management and Directors**

See the footnotes to Note 12(a) Related Party Transactions for a discussion of the allocation principles for KNOT's administrative costs, including management and administrative staff, included in the consolidated statements of operations.

**(d) Amounts Due from (to) Related Parties**

Balances with related parties consisted of the following:

| <i>(U.S. Dollars in thousands)</i>            | <b>At June 30,<br/>2018</b> | <b>At December 31,<br/>2017</b> |
|---|-----------------------------|---------------------------------|
| <b>Balance Sheet:</b>                         |                             |                                 |
| Trading balances due from KOAS                | \$ 232                      | \$ 24                           |
| Trading balances due from KNOT and affiliates | 1,149                       | 547                             |
| Amount due from related parties               | \$ 1,381                    | \$ 571                          |
| Trading balances due to KOAS                  | \$ 354                      | \$ 898                          |
| Trading balances due to KNOT and affiliates   | 1,412                       | 4,552                           |
| Amount due to related parties                 | \$ 1,766                    | \$ 5,450                        |

Amounts due from (to) related parties are unsecured and intended to be settled in the ordinary course of business. They primarily relate to vessel management and other fees due to KNOT, KNOT Management, KOAS UK and KOAS.

**(e) Trade accounts payables**

Trade accounts payables to related parties are included in total trade accounts payables in the balance sheet. The balances to related parties consisted of the following:

| <i>(U.S. Dollars in thousands)</i>          | <b>At June 30,<br/>2018</b> | <b>At December 31,<br/>2017</b> |
|---|-----------------------------|---------------------------------|
| <b>Balance Sheet:</b>                       |                             |                                 |
| Trading balances due to KOAS                | \$ 660                      | \$ 864                          |
| Trading balances due to KNOT and affiliates | 624                         | 548                             |
| Trade accounts payables to related parties  | \$ 1,284                    | \$ 1,412                        |

**(f) Acquisitions from KNOT**

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On March 1, 2017, the Partnership acquired KNOT's 100% interest in KNOT Shuttle Tankers 24 AS, the company that owns and operates the *Tordis Knutsen*. This acquisition was accounted for as an acquisition of a business.

On June 1, 2017, the Partnership acquired KNOT's 100% interest in KNOT Shuttle Tankers 25 AS, the company that owns and operates the *Vigdis Knutsen*. This acquisition was accounted for as an acquisition of a business.

On September 30, 2017, the Partnership acquired KNOT's 100% interest in KNOT Shuttle Tankers 26 AS, the company that owns and operates the *Lena Knutsen*. This acquisition was accounted for as an acquisition of a business.

On December 15, 2017, the Partnership acquired KNOT's 100% interest in KNOT Shuttle Tankers 32 AS, the company that owns and operates the *Brasil Knutsen*. This acquisition was accounted for as an acquisition of a business.

On March 1, 2018, the Partnership acquired KNOT's 100% interest in KNOT Shuttle Tankers 30 AS, the company that owns and operates the *Anna Knutsen*. This acquisition was accounted for as an acquisition of assets.

The board of directors of the Partnership (the Board) and the conflicts committee of the Board (the Conflicts Committee) approved the purchase price for each transaction described above. The Conflicts Committee retained a financial advisor to assist with its evaluation of each of the transactions. See Note 15 Acquisitions.

### 13) Commitments and Contingencies

#### *Assets Pledged*

As of June 30, 2018 and December 31, 2017, Vessels with a book value of \$ 1,803 million and \$1,723 million, respectively, were pledged as security held as guarantee for the Partnership's long-term debt and interest rate swap obligations. See Note 6 Derivative Instruments and Note 11 Long-Term Debt.

#### *Claims and Legal Proceedings*

From time to time, the Partnership is involved in various claims and legal actions arising in the ordinary course of business. In the opinion of management, the ultimate disposition of these matters will not have a material adverse effect on the consolidated financial position, results of operations or cash flows.

#### *Insurance*

The Partnership maintains insurance on all the Vessels to insure against marine and war risks, which include damage to or total loss of the Vessels, subject to deductible amounts that average \$0.15 million per Vessel, and loss of hire.

Under the loss of hire policies, the insurer will pay a compensation for the lost hire rate agreed in respect of each Vessel for each day, in excess of 14 deductible days, for the time that the Vessel is out of service as a result of damage, for a maximum of 180 days. In addition, the Partnership maintains protection and indemnity insurance, which covers third-party legal liabilities arising in connection with the Vessels' activities, including, among other things, the injury or death of third-party persons, loss or damage to cargo, claims arising from collisions with other vessels and other damage to other third-party property, including pollution arising from oil or other substances. This insurance is unlimited, except for pollution, which is limited to \$1 billion per vessel per incident. The protection and indemnity insurance is maintained through a protection and indemnity association, and as a member of the association, the Partnership may be required to pay amounts above budgeted premiums if the member claims exceed association reserves, subject to certain reinsured amounts. If the Partnership experiences multiple claims each with individual deductibles, losses due to risks that are not insured or claims for insured risks that are not paid, it could have a material adverse effect on the Partnership's results of operations and financial condition.

### 14) Earnings per Unit and Cash Distributions

The calculations of basic and diluted earnings per unit (1) are presented below:

| <i>(U.S. Dollars in thousands, except per unit data)</i>     | <b>Three Months Ended<br/>June 30,</b> |             | <b>Six Months Ended<br/>June 30,</b> |             |
|--|--|-------------|--------------------------------------|-------------|
|  | <b>2018</b>                            | <b>2017</b> | <b>2018</b>                          | <b>2017</b> |
| Net income   | \$ 21,681                              | \$ 16,915   | \$ 52,405                            | \$ 28,344   |
| Less: Series A Preferred unitholders' interest in net income | 1,800                                  | 1,009       | 3,600                                | 1,653       |

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|  |          |          |          |          |
|--|----------|----------|----------|----------|
| Net income attributable to the unitholders of KNOT Offshore Partners LP                    | 19,881   | 15,906   | 48,805   | 26,691   |
| Less: Distributions (2)  | 18,034   | 16,379   | 36,068   | 32,758   |
| Under (over) distributed earnings  | 1,847    | (473)    | 12,737   | (6,067)  |
| Under (over) distributed earnings attributable to:   |          |          |          |          |
| Common unitholders (3)   | 1,813    | (464)    | 12,502   | (5,955)  |
| General Partner  | 34       | (9)      | 235      | (112)    |
| Weighted average units outstanding (basic) (in thousands):                                 |          |          |          |          |
| Common units   | 32,694   | 29,694   | 32,694   | 29,570   |
| General Partner units  | 615      | 559      | 615      | 559      |
| Weighted average units outstanding (diluted) (in thousands):                               |          |          |          |          |
| Common units   | 36,355   | 31,798   | 36,360   | 31,296   |
| General Partner units  | 615      | 559      | 615      | 559      |
| Earnings per unit (basic)  |          |          |          |          |
| Common units   | \$ 0.597 | \$ 0.526 | \$ 1.465 | \$ 0.886 |
| General Partner units  | 0.597    | 0.526    | 1.465    | 0.882    |
| Earnings per unit (diluted):   |          |          |          |          |
| Common units   | \$ 0.585 | \$ 0.522 | \$ 1.415 | \$ 0.886 |
| General Partner units  | 0.597    | 0.526    | 1.465    | 0.882    |
| Cash distributions declared and paid in the period per unit (4)                            | 0.520    | 0.520    | 1.040    | 1.040    |
| Subsequent event: Cash distributions Declared and paid per unit relating to the period (5) | 0.520    | 0.520    | 1.040    | 0.520    |

- (1) Earnings per unit have been calculated in accordance with the cash distribution provisions set forth in the Partnership Agreement.
- (2) This refers to distributions made or to be made in relation to the period irrespective of the declaration and payment dates and based on the number of units outstanding at the record date. This includes cash distributions to the IDR holder (KNOT) for the three months ended June 30, 2018 and 2017 of \$0.7 million and of \$0.6 million, respectively, and for the six months ended June 30, 2018 and 2017 of \$1.4 million and of \$1.3 million, respectively.

- (3) This includes the net income attributable to the IDR holder. The net income attributable to IDRs for the three months ended June 30, 2018 and 2017 was \$0.7 million and \$0.6 million, respectively, and for the six months ended June 30, 2018 and 2017 was \$1.4 million and \$1.3 million, respectively.
- (4) Refers to cash distributions declared and paid during the period.
- (5) Refers to cash distributions declared and paid subsequent to the period end.

As of June 30, 2018, the Partnership had 32,694,094 common units outstanding, of which 24,036,226 are held by the public and 8,567,500 are held by KNOT. In addition, KNOT, through its ownership of the General Partner, held 615,117 general partner units and 90,368 common units. The Partnership also has 3,750,000 Series A Convertible Preferred Units (the Series A Preferred Units ) outstanding.

Earnings per unit basic is determined by dividing net income, after deducting the amount of net income attributable to the Series A Preferred Units and the distribution paid or to be made in relation to the period, by the weighted-average number of units outstanding during the applicable period.

The computation of limited partners interest in net income per common unit diluted assumes the issuance of common units for all potentially dilutive securities consisting of the Series A Preferred Units. Consequently, the net income attributable to limited partners interest is exclusive of any distributions on the Series A Preferred Units. In addition, the weighted average number of common units outstanding has been increased assuming the Series A Preferred Units have been converted to common units using the if-converted method. The computation of limited partners interest in net income per common unit diluted does not assume the issuance of Series A Preferred Units if the effect would be anti-dilutive.

The General Partner s and common unitholders interest in net income was calculated as if all net income was distributed according to the terms of the Partnership Agreement, regardless of whether those earnings would or could be distributed. The Partnership Agreement does not provide for the distribution of net income. Rather, it provides for the distribution of available cash, which is a contractually defined term that generally means all cash on hand at the end of each quarter less the amount of cash reserves established by the Board to provide for the proper conduct of the Partnership s business, including reserves for maintenance and replacement capital expenditures, anticipated credit needs and capital requirements and any accumulated distributions on, or redemptions of, the Series A Preferred Units. In addition, KNOT, as the initial holder of all IDRs, has the right, at the time when it has received incentive distributions at the highest level to which it is entitled (48.0% for each of the prior four consecutive fiscal quarters), to reset the initial cash target distribution levels at higher levels based on the distribution at the time of the exercise of the reset election. Unlike available cash, net income is affected by non-cash items, such as depreciation and amortization, unrealized gains and losses on derivative instruments and unrealized foreign currency gains and losses.

## 15) Acquisitions

In March 2017, June 2017, September 2017, December 2017 and March 2018, the Partnership acquired from KNOT equity interests in certain subsidiaries which own and operate the *Tordis Knutsen*, the *Vigdis Knutsen*, the *Lena Knutsen* the *Brasil Knutsen* and the *Anna Knutsen*, respectively.



The Board and the Conflicts Committee approved the purchase price for each transaction. The Conflicts Committee retained a financial advisor to assist with its evaluation of each of the transactions. The details of each transaction are as follows:

| <i>(U.S. Dollars in thousands)</i>  | <b>Final<br/>Anna Knutsen<br/>March 1,<br/>2018</b> | <b>Final<br/>Brasil Knutsen<br/>December 15,<br/>2017</b> | <b>Final<br/>Lena<br/>Knutsen<br/>September 30,<br/>2017</b> | <b>Final<br/>Vigdis Knutsen<br/>June 1,<br/>2017</b> | <b>Final<br/>Tordis Knutsen<br/>March 1,<br/>2017</b> |
|---|---|---|--|--|---|
| Purchase consideration (1)  | \$ 19,913   | \$ 5,764  | \$ 33,235  | \$ 31,759  | \$ 32,983   |
| Less: Fair value of net assets acquired:                                    |   |   |  |  |   |
| Vessels and equipment (2)   | 120,274   | 96,000  | 142,457  | 145,772  | 145,754   |
| Intangibles: Above market time charter                                      |   |   |  | 1,458  | 1,468   |
| Cash  | 4,537   | 5,217   | 470  | 3,438  | 609   |
| Inventories   | 257   | 146   | 243  | 190  | 129   |
| Derivative assets   | 1,839   |   | 1,729  | 226  | 1,377   |
| Others current assets   | 111   | 125   | 193  | 128  | 1,348   |
| Amounts due from related parties  | 520   | 2   | 23,599   | 18,374   | 20,834  |
| Long-term debt  | (84,217)  | (59,000)  | (111,068)  | (114,411)  | (114,411)   |
| Long-term debt from related parties   | (22,535)  |   | (22,706)   | (22,703)   | (22,960)  |
| Deferred debt issuance  | 1,228   | 618   | 867  | 928  | 795   |
| Trade accounts payable  | (971)   | (154)   | (256)  | (187)  | (106)   |
| Accrued expenses  | (1,013)   | (1,185)   | (224)  | (1,082)  | (503)   |
| Prepaid charter and deferred revenue  |   |   | (1,758)  |  |   |
| Amounts due to related parties  | (117)   | (36,005)  | (186)  | (372)  | (1,351)   |
| Income tax payable  |   |   | (125)  |  |   |
| Subtotal  | 19,913  | 5,764   | 33,235   | # 31,759   | 32,983  |
| Difference between the purchase price and fair value of net assets acquired |   |   |  |  |   |
| Goodwill  |   |   |  |  |   |
| Difference between the purchase price and allocated values                  | \$  | \$  | \$   | \$   | \$  |

(1) The purchase price is comprised of the following:

|   | <b>Final<br/>Anna Knutsen<br/>March 1,<br/>2018</b> | <b>Final<br/>Brasil Knutsen<br/>December 15,<br/>2017</b> | <b>Final<br/>Lena<br/>Knutsen<br/>September 30,<br/>2017</b> | <b>Final<br/>Vigdis Knutsen<br/>June 1,<br/>2017</b> | <b>Final<br/>Tordis Knutsen<br/>March 1,<br/>2017</b> |
|---|---|---|--|--|---|
| <i>(U.S. Dollars in thousands)</i>          |   |   |  |  |   |
| Cash consideration paid to KNOT (from KNOT) | \$ 14,637   | \$ 2,383  | \$ 33,343  | \$ 28,109  | \$ 31,242   |
| Purchase price adjustments                  | 5,276   | 3,381   | (108)  | 3,650  | 1,741   |
| Seller's credit                             |   |   |  |  |   |
| Seller's loan                               |   |   |  |  |   |
| Purchase price                              | \$ 19,913   | \$ 5,764  | \$ 33,235  | \$ 31,759  | \$ 32,983   |

(2) Vessel and equipment includes allocation to drydocking for the following vessels (in thousands): *Anna Knutsen* of \$2,329, *Brasil Knutsen* of \$260, *Lena Knutsen* of \$2,741, *Vigdis Knutsen* of \$2,709 and *Tordis Knutsen* of \$2,753.

***Anna Knutsen***

On March 1, 2018, the Partnership's wholly owned subsidiary, KNOT Shuttle Tankers AS, acquired KNOT's 100% interest in KNOT Shuttle Tankers 30 AS ( KNOT 30 ), the company that owns and operates the *Anna Knutsen*. The purchase price for the vessel was \$120.0 million, less \$106.8 million of outstanding indebtedness, plus approximately \$1.4 million for certain capitalized fees related to the financing of the vessel and plus other purchase price adjustments of \$5.3 million.

Following adoption of ASU 2017-01, *Business Combinations: Clarifying the Definition of a Business*, the Partnership accounted for this acquisition as an acquisition of an asset. The cost of the group of assets acquired in the asset acquisition has been allocated to the individual assets acquired or liabilities assumed based on their relative fair values.

***Brasil Knutsen***

On December 15, 2017, the Partnership's wholly owned subsidiary, KNOT Shuttle Tankers AS, acquired KNOT's 100% interest in KNOT Shuttle Tankers 32 AS ( KNOT 32 ), the company that owns and operates the *Brasil Knutsen*. The purchase price was \$96.0 million, less \$59.0 million of outstanding indebtedness, less approximately \$35.2 million for a loan owed by KNOT 32 to KNOT (the Company Liquidity Loan ), plus approximately \$0.6 million for certain capitalized fees related to the financing of the *Brasil Knutsen*, and plus \$3.4 million of post-closing adjustments for working capital. The cash portion of the purchase price was financed with the proceeds from the Partnership's public offering of 3,000,000 common units which closed on November 9, 2017. See Note 16 Equity Offerings and Sale of Series A Preferred Units. The Partnership accounted for this acquisition as an acquisition of a business. The purchase price of the acquisition has been allocated to the identifiable assets acquired. The allocation of the purchase price to acquired identifiable assets was based on their fair values at the date of acquisition.

***Revenue and profit contributions***

The *Brasil Knutsen* business contributed revenues of \$0.7 million and net income of \$0.3 million to the Partnership for the period from December 15, 2017 to December 31, 2017.

***Pro forma financial information***

The table below shows comparative summarized consolidated pro forma financial information for the Partnership for the year ended December 31, 2017, giving effect to the Partnership's acquisition and financing of the *Brasil Knutsen* as if this acquisition had taken place on January 1, 2017. KNOT acquired the *Brasil Knutsen* from Chevron in July 2017 and the vessel was not operating on any contract at the time KNOT bought the vessel. From July 2017, the *Brasil Knutsen* operated on short term contracts until it commenced its time charter contract with Galp Sinopec Brazil Services B.V. in November 2017.

|                                    | <b>Year Ended</b>        |
|------------------------------------|--------------------------|
|                                    | <b>December 31, 2017</b> |
| <i>(U.S. Dollars in thousands)</i> |                          |
| Revenue                            | \$ 223,220               |
| Net income                         | 64,034                   |

Included in the pro forma adjustments is depreciation related to the purchase price allocations performed on the acquired identifiable assets as if the acquisition had taken place on January 1, 2017. In addition, the pro forma adjustments reflect changes in guarantors.

***Lena Knutsen***

On September 30, 2017, KNOT Shuttle Tankers AS acquired KNOT's 100% interest in KNOT Shuttle Tankers 26 AS ( KNOT 26 ), the company that owns and operates the *Lena Knutsen*. The purchase price was \$142.0 million, less approximately \$133.8 million of outstanding indebtedness, plus approximately \$24.1 million for a receivable owed by KNOT to KNOT 26, plus approximately \$1.0 million for certain capitalized fees related to the financing of the *Lena Knutsen* and less \$0.1 million of post-closing adjustments for working capital and interest rate swaps. The Partnership accounted for this acquisition as an acquisition of a business. The purchase price of the acquisition has been allocated to the identifiable assets acquired. The allocation of the purchase price to acquired identifiable assets was based on their fair values at the date of acquisition.

*Revenue and profit contributions*

The *Lena Knutsen* business contributed revenues of \$5.2 million and net loss of \$0.1 million to the Partnership for the period from September 30, 2017 to December 31, 2017.

*Pro forma financial information*

The table below shows comparative summarized consolidated pro forma financial information for the Partnership for the year ended December 31, 2017, giving effect to the Partnership's acquisition and financing of the *Lena Knutsen* as if this acquisition had taken place on January 1, 2017.

| <i>(U.S. Dollars in thousands)</i> | <b>Year Ended<br/>December 31, 2017</b> |
|------------------------------------|---|
| Revenue                            | \$ 220,904                              |
| Net income                         | 62,999                                  |

Included in the pro forma adjustments is depreciation related to the purchase price allocations performed on the acquired identifiable assets as if the acquisition had taken place on January 1, 2017. In addition, the pro forma adjustments reflect changes in guarantors as if the acquisition had taken place from the date of delivery of the vessel.

*Vigdis Knutsen*

On June 1, 2017, KNOT Shuttle Tankers AS, acquired KNOT's 100% interest in KNOT Shuttle Tankers 25 AS (KNOT 25), the company that owns and operates the *Vigdis Knutsen*. The purchase price was \$147.0 million, less approximately \$137.7 million of outstanding indebtedness, plus approximately \$17.9 million for a receivable owed by KNOT to KNOT 25, plus approximately \$0.9 million for certain capitalized fees related to the financing of the *Vigdis Knutsen* and plus \$3.7 million of post-closing adjustments for working capital and interest rate swaps. The Partnership accounted for this acquisition as an acquisition of a business. The purchase price of the acquisition has been allocated to the identifiable assets acquired. The allocation of the purchase price to acquired identifiable assets was based on their fair values at the date of acquisition.

*Revenue and profit contributions*

The *Vigdis Knutsen* business contributed revenues of \$11.8 million and net income of \$2.6 million to the Partnership for the period from June 1, 2017 to December 31, 2017.

*Pro forma financial information*

The table below shows comparative summarized consolidated pro forma financial information for the Partnership for the year ended December 31, 2017, giving effect to the Partnership's acquisition and financing of the *Vigdis Knutsen* as if this acquisition had taken place on January 1, 2017.

| <i>(U.S. Dollars in thousands)</i> | <b>Year Ended<br/>December 31, 2017</b> |
|------------------------------------|---|
| Revenue                            | \$ 222,354                              |
| Net income                         | 63,225                                  |

Included in the pro forma adjustments is depreciation related to the purchase price allocations performed on the acquired identifiable assets as if the acquisition had taken place on January 1, 2017. In addition, the pro forma adjustments reflect changes in guarantors and amortization of the above market time charter as if the acquisition had taken place from the date of delivery of the vessel.

***Tordis Knutsen***

On March 1, 2017, the Partnership's wholly owned subsidiary, KNOT Shuttle Tankers AS, acquired KNOT's 100% interest in KNOT Shuttle Tankers 24 AS ( KNOT 24 ), the company that owns and operates the *Tordis Knutsen*. The purchase price was \$147.0 million, less approximately \$137.7 million of outstanding indebtedness, plus approximately \$21.1 million for a receivable owed by KNOT to KNOT 24, plus approximately \$0.8 million for certain capitalized fees related to the financing of the *Tordis Knutsen* and plus \$1.7 million of post-closing adjustments for working capital and interest rate swaps. The cash portion of the purchase price was financed with the proceeds from the Partnership's sale and issuance of (i) 2,083,333 Series A Preferred Units which closed on February 2, 2017 and (ii) 3,000,000 common units which took place on January 10, 2017. See Note 16 Equity Offerings and Sale of Series A Preferred Units. The Partnership accounted for this acquisition as an acquisition of a business. The purchase price of the acquisition has been allocated to the identifiable assets acquired. The allocation of the purchase price to acquired identifiable assets was based on their fair values at the date of acquisition.

*Revenue and profit contributions*

The *Tordis Knutsen* business contributed revenues of \$17.2 million and net income of \$3.2 million to the Partnership for the period from March 1, 2017 to December 31, 2017.

*Pro forma financial information*

The table below shows comparative summarized consolidated pro forma financial information for the Partnership for the year ended December 31, 2017, giving effect to the Partnership's acquisition and financing of the *Tordis Knutsen* as if this acquisition had taken place on January 1, 2017.

| <i>(U.S. Dollars in thousands)</i> | <b>Year Ended<br/>December 31, 2017</b> |
|------------------------------------|---|
| Revenue                            | \$ 221,198                              |
| Net income                         | 66,584                                  |

Included in the pro forma adjustments is depreciation related to the purchase price allocations performed on the acquired identifiable assets as if the acquisition had taken place on January 1, 2017. In addition, the pro forma adjustments reflect changes in guarantors and amortization of the above market time charter as if the acquisition had taken place from the date of delivery of the vessel.

**16) Equity Offerings and Sale of Series A Preferred Units***Equity Offerings*

| <i>(U.S. Dollars in thousands)</i> | <b>January 2017<br/>Offering</b> | <b>November 2017<br/>Offering</b> | <b>Total<br/>2017<br/>Offering</b> |
|------------------------------------|----------------------------------|-----------------------------------|------------------------------------|
| Gross proceeds received            | \$ 56,125                        | \$ 66,936(1)                      | \$ 123,061                         |
| Less: Underwriters' discount       | 925                              | 660                               | 1,585                              |
| Less: Offering expenses            | 300                              | 230                               | 530                                |
| Net proceeds received              | \$ 54,900                        | \$ 66,046                         | \$ 120,946                         |

(1) Includes the General Partner's 1.85% proportional capital contribution.

On November 9, 2017, the Partnership sold 3,000,000 common units in a public offering. In connection with the offering, the General Partner contributed a total of \$1.2 million in order to maintain its 1.85% general partner interest in the Partnership. The total net proceeds from the offering and the related General Partner's contribution were \$66.0 million. The Partnership used the net proceeds from the offering to fund the cash portion of the purchase price of the *Brasil Knutsen* and to repay \$43.5 million of borrowings under the revolving credit facility.

On January 10, 2017, the Partnership sold 2,500,000 common units in a public offering. The Partnership's total net proceeds from the offering were \$54.9 million. The Partnership used the net proceeds from the offering to fund the cash portion of the purchase price of the *Tordis Knutsen* and to repay debt and for general partnership purposes.

*Sale of Series A Preferred units*

|                                    | <b>February 2017</b>   | <b>June 2017</b>       | <b>Total</b>           |
|------------------------------------|------------------------|------------------------|------------------------|
|                                    | <b>Series A</b>        | <b>Series A</b>        | <b>Series A</b>        |
| <i>(U.S. Dollars in thousands)</i> | <b>Preferred Units</b> | <b>Preferred Units</b> | <b>Preferred Units</b> |
| Gross proceeds received            | \$ 50,000              | \$ 40,000              | \$ 90,000              |
| Less: Fee                          | 1,000                  | 1,000                  | 2,000                  |
| Less: Expenses                     | 386                    | 150                    | 536                    |
| Net proceeds received              | \$ 48,614              | \$ 38,850              | \$ 87,464              |



On February 2, 2017, the Partnership issued and sold in a private placement 2,083,333 Series A Preferred Units at a price of \$24.00 per unit. After deducting fees and expenses, the net proceeds from the sale were \$48.6 million. The Partnership used the net proceeds from the sale to fund the cash portion of the purchase price of the *Tordis Knutsen* and to repay debt and for general partnership purposes.

On June 30, 2017, the Partnership (i) issued and sold in a second private placement 1,666,667 additional Series A Preferred Units at a price of \$24.00 per unit and (ii) amended and restated its Partnership Agreement to make certain amendments to the terms of the Series A Preferred Units, including the 2,083,333 Series A Preferred Units issued on February 2, 2017. After deducting estimated fees and expenses, the net proceeds of the sale were \$38.9 million. The Partnership used \$30.0 million of the net proceeds to repay the revolving credit facility, which was drawn in connection with acquisition of the *Vigdis Knutsen*.

## 17) Unit Activity

The following table shows the movement in the number of common units, general partner units and Series A Preferred Units from December 31, 2016 until June 30, 2018.

| <i>(in units)</i>                                  | Common Units      | General Partner Units | Convertible Preferred Units |
|--|-------------------|-----------------------|-----------------------------|
| <b>December 31, 2016</b>                           | <b>27,194,094</b> | <b>558,674</b>        |                             |
| January 6, 2017: Public offering                   | 2,500,000         |                       |                             |
| February 2, 2017: Sale of Series A Preferred Units |                   |                       | 2,083,333                   |
| June 30, 2017: Sale of Series A Preferred Units    |                   |                       | 1,666,667                   |
| November 9, 2017: Public offering                  | 3,000,000         | 56,443                |                             |
| <b>December 31, 2017</b>                           | <b>32,694,094</b> | <b>615,117</b>        | <b>3,750,000</b>            |
| <b>June 30, 2018</b>                               | <b>32,694,094</b> | <b>615,117</b>        | <b>3,750,000</b>            |

On August 12, 2015, the Board authorized a program for the Partnership to repurchase up to 666,667 of its common units. The board of directors of the General Partner concurrently authorized the General Partner to purchase up to 333,333 common units of the Partnership. On August 10, 2016, the Board and the board of directors of the General Partner authorized an extension of the common unit purchase program to August 31, 2017, and on August 9, 2017, the Board and the board of directors of the General Partner authorized a further extension of the program to August 31, 2018. No common units were purchased by the Partnership or the General Partner in 2017 or to date in 2018.

All purchases are made pursuant to a single program and are allocated approximately two-thirds to the Partnership and one-third to the General Partner. There is no obligation to purchase any specific number of common units and the program may be modified, suspended, extended or terminated at any time. Common units repurchased by the Partnership under the program have been cancelled.

## 18) Subsequent Events

The Partnership has evaluated subsequent events from the balance sheet date through September 6, 2018, the date at which the unaudited condensed consolidated interim financial statements were available to be issued, and determined that there are no other items to disclose, except as follows:

On July 13, 2018, a subsidiary of Royal Dutch Shell ( Shell ) exercised its option to extend the time charter of the *Windsor Knutsen* by one additional year until October 2019.

On August 3, 2018, the Partnership entered into amended time charter with Eni Trading & Shipping S.p.A. ( Eni ), extending the duration of the *Hilda Knutsen* time charter for four years and three one-year extension options.

On August 14, 2018, the Partnership paid a quarterly cash distribution of \$0.52 per common unit with respect to the quarter ended June 30, 2018 to all common unitholders of record on August 1, 2018. On August 14, 2018, the Partnership also paid a cash distribution to holders of Series A Preferred Units with respect to the quarter ended June 30, 2018 in an aggregate amount equal to \$1.8 million.

On September 4, 2018 the Partnership's subsidiaries which own the *Windsor Knutsen*, the *Bodil Knutsen*, the *Fortaleza Knutsen*, the *Recife Knutsen*, the *Carmen Knutsen* and the *Ingrid Knutsen* (the Vessels ), entered into new senior secured credit facilities in order to refinance their existing long term bank debt. The senior secured credit facilities consist of a term loan of \$320 million and a \$55 million revolving credit facility. The term loan is repayable in 20 consecutive quarterly installments, with a balloon payment of \$ 177 million due at maturity in September 2023. The term loan bears interest at a rate per annum equal to LIBOR plus a margin of 2.125%. The revolving credit 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 facility. The loans are guaranteed by the Partnership and secured by mortgages on the Vessels. The senior secured credit facilities will refinance the previously existing term loans of \$320.0 million and \$35 million revolver credit capacity secured by the Vessels which were due to mature between December 2018 and June 2019. Closing of the senior secured credit facilities is anticipated to occur in mid-September 2018.

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## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

*Unless the context otherwise requires, references in this report to the Partnership, we, our, us or like terms, refer to KNOT Offshore Partners LP and its subsidiaries. Those statements in this section that are not historical in nature should be deemed forward-looking statements that are inherently uncertain. See*

*Forward-Looking Statements* on page 45 for a discussion of the factors that could cause actual results to differ materially from those projected in these statements.

*This section should be read in conjunction with our unaudited condensed consolidated financial statements for the interim periods presented elsewhere in this report, as well as our historical consolidated financial statements and notes thereto included in our Annual Report on Form 20-F for the year ended December 31, 2017 (the 2017 20-F ). Under our Partnership Agreement, KNOT Offshore Partners GP LLC, the general partner of the Partnership (the General Partner ), has irrevocably delegated to the Partnership's board of directors the power to oversee and direct the operations of, and to manage and determine the strategies and policies of, the Partnership. During the period from the Partnership's initial public offering ( IPO ) in April 2013 until the time of the Partnership's first annual general meeting ( AGM ) on June 25, 2013, the General Partner retained the sole power to appoint, remove and replace all members of the Partnership's board of directors. From the first AGM, four of the seven board members became electable by the common unitholders and accordingly, from this date, the General Partner no longer retained the power to control the Partnership's board of directors and, hence, the Partnership. As a result, the Partnership is no longer considered to be under common control with Knutsen NYK Offshore Tankers AS ( KNOT ) and as a consequence, the Partnership no longer accounts for any vessel acquisitions from KNOT as transfer of a business between entities under common control.*

### **General**

We are a limited partnership formed to own, operate and acquire shuttle tankers under long-term charters, which we define as charters of five years or more. Our fleet of shuttle tankers has been contributed to us by KNOT or purchased by us from KNOT. KNOT is jointly owned by TS Shipping Invest AS ( TSSI ) and Nippon Yusen Kaisha ( NYK ). TSSI is controlled by our Chairman and is a private Norwegian company with ownership interests in shuttle tankers, LNG tankers and product/chemical tankers. NYK is a Japanese public company with a fleet of approximately 800 vessels, including bulk carriers, containerships, tankers and specialized vessels.

As of June 30, 2018, we had a modern fleet of sixteen shuttle tankers that operate under charters with major oil and gas companies engaged in offshore production. We intend to operate our vessels under long-term charters with stable cash flows and to grow our position in the shuttle tanker market through acquisitions from KNOT and third parties. Pursuant to the Omnibus Agreement we have entered into with KNOT in connection with the IPO (the Omnibus Agreement ), we have the right to purchase from KNOT any shuttle tankers operating under charters of five or more years. This right will continue throughout the entire term of the Omnibus Agreement.

### **Recent Developments**

#### ***Refinancing of Torill Knutsen***

On January 30, 2018, the Partnership's subsidiary, KNOT Shuttle Tankers 15 AS, which owns the vessel *Torill Knutsen*, closed a new \$100 million senior secured term loan facility with a consortium of banks, in which The Bank of Tokyo-Mitsubishi UFJ acted as agent (the *Torill Facility* ). The *Torill Facility* refinanced a \$117 million loan facility associated with the *Torill Knutsen* that bore interest at a rate of LIBOR plus 2.5% and was due to be paid in full in November 2018. The *Torill Facility* is repayable in twenty-four (24) consecutive quarterly installments with a

balloon payment of \$60.0 million due at maturity. The Torill Facility bears interest at a rate per annum equal to LIBOR plus a margin of 2.1%. The facility matures in January 2024.

***Anna Knutsen Acquisition***

On March 1, 2018, the Partnership's wholly owned subsidiary, KNOT Shuttle Tankers AS, acquired KNOT Shuttle Tankers 30 AS ( KNOT 30 ), the company that owns the shuttle tanker *Anna Knutsen*, from KNOT for a purchase price of \$120.0 million less \$106.8 million of outstanding indebtedness plus approximately \$1.4 million for certain capitalized fees related to the financing of the *Anna Knutsen* and plus other purchase price adjustments of \$5.3 million. On the closing of the acquisition, KNOT 30 repaid \$32.3 million of the indebtedness, leaving an aggregate of approximately \$74.4 million of debt outstanding under the secured credit facility related to the vessel. The purchase price was settled in cash.

### ***Cash Distributions***

On May 15, 2018, the Partnership paid a quarterly cash distribution of \$0.52 per common unit with respect to the quarter ended March 31, 2018 to all common unitholders of record on May 2, 2018. On May 15, 2018, the Partnership also paid a cash distribution to holders of Series A Convertible Preferred Units (the Series A Preferred Units ) with respect to the quarter ended March 31, 2018 in an aggregate amount equal to \$1.8 million.

On August 14, 2018, the Partnership paid a cash distribution of \$0.52 per common unit with respect to the quarter ended June 30, 2018 to all common unitholders of record on August 1, 2018. On August 14, 2018, the Partnership also paid a cash distribution to holders of Series A Preferred Units with respect to the quarter ended June 30, 2018 in an aggregate amount equal to \$1.8 million.

### ***Extension of Windsor Knutsen Charter***

On July 13, 2018, a subsidiary of Royal Dutch Shell ( Shell ) exercised its option to extend the time charter of the vessel *Windsor Knutsen* by one additional year until October 2019. Following the extension, Shell has four remaining one-year options to extend the time charter until October 2023.

### ***Extension of Hilda Knutsen Charter***

On August 3, 2018, the Partnership entered into amended time charter with Eni Trading & Shipping S.p.A. ( Eni ), extending the duration of the *Hilda Knutsen* time charter for four years. Eni has three one-year options to extend the time charter.

### ***Multi-Vessel Refinancing***

On September 4, 2018 the Partnership's subsidiaries which own the *Windsor Knutsen*, the *Bodil Knutsen*, the *Fortaleza Knutsen*, the *Recife Knutsen*, the *Carmen Knutsen* and the *Ingrid Knutsen* (the Vessels ), entered into new senior secured credit facilities in order to refinance their existing long term bank debt. The senior secured credit facilities consist of a term loan of \$320 million and a \$55 million revolving credit facility. The term loan is repayable in 20 consecutive quarterly installments, with a balloon payment of \$177 million due at maturity in September 2023. The term loan bears interest at a rate per annum equal to LIBOR plus a margin of 2.125%. The revolving credit 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 facility. The loans are guaranteed by the Partnership and secured by mortgages on the Vessels. The senior secured credit facilities will refinance the previously existing term loan of \$320.0 million and \$35 million revolver credit capacity secured by the Vessels which was due to mature between December 2018 and June 2019. Closing of the senior secured credit facilities is anticipated to occur in mid-September 2018.

### ***Partnership Matters***

On September 4, 2018, the Partnership held its 2018 annual meeting of limited partners at which Edward A. Waryas, Jr. was elected as a Class I director of the Partnership whose term will expire at the 2022 annual meeting of limited partners.

## Results of Operations

### Three Months Ended June 30, 2018 Compared with the Three Months Ended June 30, 2017

| (U.S. Dollars in thousands)                                   | Three Months Ended<br>June 30, |               | \$<br>Change | % Change   |
|---|--------------------------------|---------------|--------------|------------|
|   | 2018                           | 2017          |              |            |
| Time charter and bareboat revenues                            | \$ 69,221                      | \$ 51,537     | \$ 17,684    | 34%        |
| Loss of hire insurance recoveries                             | 450                            | 2,276         | (1,826)      | -80%       |
| Other income  | 94                             | 593           | (499)        | -84%       |
| Vessel operating expenses                                     | 13,974                         | 9,427         | 4,547        | 48%        |
| Depreciation  | 22,332                         | 17,372        | 4,960        | 29%        |
| General and administrative expenses                           | 1,350                          | 1,493         | (143)        | -10%       |
| Interest income   | 161                            | 44            | 117          | 266%       |
| Interest expense  | (12,526)                       | (7,252)       | (5,274)      | 73%        |
| Other finance expense   | (288)                          | (328)         | 40           | -12%       |
| Realized and unrealized gain (loss) on derivative instruments | 1,968                          | (1,536)       | 3,504        | -228%      |
| Net gain (loss) on foreign currency transactions              | 260                            | (124)         | 384          | -310%      |
| Income tax benefit (expense)                                  | (3)                            | (3)           |              | 0%         |
| <b>Net income</b>   | <b>21,681</b>                  | <b>16,915</b> | <b>4,766</b> | <b>28%</b> |

**Time Charter and Bareboat Revenues:** Time charter and bareboat revenues increased by \$17.7 million to \$69.2 million for the three months ended June 30, 2018 compared to \$51.5 million for the three months ended June 30, 2017. The increase was mainly due to increased time charter revenues from the *Vigdis Knutsen*, the *Lena Knutsen*, the *Brasil Knutsen* and the *Anna Knutsen* being included in the results of operations from June 1, 2017, September 30, 2017, December 15, 2017 and March 1, 2018, respectively, and increased revenue from the *Raquel Knutsen*, which was offhire for 15 days in the second quarter of 2017.

**Loss of hire insurance recoveries:** Loss of hire insurance recoveries for the three months ended June 30, 2018 were \$0.5 million compared to \$2.3 million for the three months ended June 30, 2017. The loss of hire insurance recoveries in the three months ended June 30, 2018 were related to a technical default with *Carmen Knutsen*'s controllable pitch propeller which was found when the vessel undertook her 5-years special survey drydocking during the fourth quarter of 2017. As a result, the vessel went to a different yard to complete the repair. Repairs were completed, and the vessel was back on hire on January 1, 2018. The loss of hire insurance recoveries in the three months ended June 30, 2017 were related to a technical default with *Raquel Knutsen*'s propeller hub. The *Raquel Knutsen* was offhire from February 22, 2017 to May 15, 2017. Under our loss of hire policies, our insurer will pay us the hire rate under the time-charter in respect of each vessel for each day, in excess of 14 deductible days, for the time that the vessel is out of service as a result of damage, for a maximum of 180 days.

**Other income:** Other income for the three months ended June 30, 2017 was \$0.1 million compared to \$0.6 million for the three months ended June 30, 2017. \$0.2 million of the decrease relates to the KNOT guarantee income regarding the *Windsor Knutsen*, which expired April 15, 2018 and \$0.3 million of the decrease relates to guarantee income from KNOT due to offhire and repairs for the *Vigdis Knutsen* in the second quarter of 2017.

**Vessel operating expenses:** Vessel operating expenses for the three months ended June 30, 2018 were \$14.0 million, an increase of \$4.6 million from \$9.4 million in the three months ended June 30, 2017. The increase is mainly

attributable to the increase of \$5.6 million due to the *Vigdis Knutsen*, the *Lena Knutsen*, the *Brasil Knutsen* and the *Anna Knutsen* being included in the results of operations from June 1, 2017, September 30, 2017, December 15, 2017 and March 1, 2018, respectively. The increase was partially offset by a \$2.2 million in received insurance recoveries in the three months ended June 30, 2018 in connection with the propeller repairs of the *Carmen Knutsen*.

**Depreciation:** Depreciation expense for the three months ended June 30, 2018 was \$22.3 million, an increase of \$4.9 million from \$17.4 million in the three months ended June 30, 2017. This increase was mainly due to the *Vigdis Knutsen*, the *Lena Knutsen*, the *Brasil Knutsen* and the *Anna Knutsen* being included in the results of operations from June 1, 2017, September 30, 2017, December 15, 2017 and March 1, 2018, respectively.

**General and administrative expenses:** General and administrative expenses for the three months ended June 30, 2018 were \$1.4 million, compared to \$1.5 million for the same period in 2017.

**Interest income:** Interest income for the three months ended June 30, 2018 was \$161,000, compared to \$44,000 for the three months ended June 30, 2017.

**Interest expense:** Interest expense for the three months ended June 30, 2018 was \$12.5 million, an increase of \$5.2 million from \$7.3 million for the three months ended June 30, 2017. The increase was mainly due to additional debt incurred in connection with the acquisitions of the *Vigdis Knutsen*, the *Lena Knutsen*, the *Brasil Knutsen*, the *Anna Knutsen*, increased leverage as a result of refinancing of the *Hilda Knutsen* and *Torill Knutsen* and higher LIBOR during the three months ended June 30, 2018 compared to the three months ended June 30, 2017.

**Other finance expense:** Other finance expense was \$0.3 million for the three months ended June 30, 2017 and 2018. Other finance expense is primarily related to bank fees and guarantee commissions.

**Realized and unrealized gain (loss) on derivative instruments:** Realized and unrealized gain on derivative instruments for the three months ended June 30, 2018 was \$2.0 million, compared to a loss of \$1.5 million for the three months ended June 30, 2017, as set forth in the table below:

| (U.S. Dollars in thousands)  | Three Months Ended |            |           |
|--|--------------------|------------|-----------|
|  | June 30,           |            |           |
|  | 2018               | 2017       | \$ Change |
| <b>Realized gain (loss):</b>   |                    |            |           |
| Interest rate swap contracts   | \$ 57              | \$ (938)   | \$ 995    |
| Foreign exchange forward contracts                                   | 134                | (97)       | 231       |
| Total realized gain (loss):  | 191                | (1,035)    | 1,226     |
| <b>Unrealized gain (loss):</b>                                       |                    |            |           |
| Interest rate swap contracts   | 2,995              | (1,334)    | 4,329     |
| Foreign exchange forward contracts                                   | (1,218)            | 833        | (2,051)   |
| Total unrealized gain (loss):  | 1,777              | (501)      | 2,278     |
| Total realized and unrealized gain (loss) on derivative instruments: | \$ 1,968           | \$ (1,536) | \$ 3,504  |

As of June 30, 2018, the total notional amount of the Partnership's outstanding interest rate swap contracts that were entered into in order to hedge outstanding or forecasted debt obligations was \$539.5 million and the Partnership had entered into foreign exchange forward contracts, selling a total notional amount of \$25.0 million against the NOK at an average exchange rate of NOK 8.09 per 1.0 U.S. Dollar, which are economic hedges for certain vessel operating expenses and general expenses in NOK. Of the unrealized gain for the three months ended June 30, 2018, \$3.0 million related to mark-to-market gains on interest rate swaps and an unrealized loss of \$1.2 million related to foreign exchange. The unrealized gains in the three months ended June 30, 2018 were as a result of an increase in the US swap rate.

**Net loss on foreign currency transactions:** Net gain on foreign currency transactions for the three months ended June 30, 2018 was \$0.3 million compared to a loss of \$0.1 million for the three months ended June 30, 2017.

**Income tax (expense):** Income tax expense for the three months ended June 30, 2018 and 2017 remained consistent at \$3,000.



**Net income:** As a result of the foregoing, we earned net income of \$21.7 million for the three months ended June 30, 2018 compared to net income of \$16.9 million for the three months ended June 30, 2017.

## Six Months Ended June 30, 2018 Compared with the Six Months Ended June 30, 2017

| (U.S. Dollars in thousands)                                   | Six Months Ended<br>June 30, |               |               |            |
|---|------------------------------|---------------|---------------|------------|
|   | 2018                         | 2017          | \$ Change     | % Change   |
| Time charter and bareboat revenues                            | \$ 136,608                   | \$ 95,284     | \$ 41,324     | 43%        |
| Loss of hire insurance recoveries                             | 450                          | 3,426         | (2,976)       | -87%       |
| Other income  | 750                          | 687           | 63            | 9%         |
| Vessel operating expenses                                     | 27,221                       | 19,709        | 7,512         | 38%        |
| Depreciation  | 43,906                       | 33,125        | 10,781        | 33%        |
| General and administrative expenses                           | 2,695                        | 2,962         | (267)         | -9%        |
| Interest income   | 296                          | 80            | 216           | 270%       |
| Interest expense  | (23,119)                     | (13,466)      | (9,653)       | 72%        |
| Other finance expense   | (626)                        | (630)         | 4             | -1%        |
| Realized and unrealized gain (loss) on derivative instruments | 11,944                       | (1,017)       | 12,961        | 1,274%     |
| Net gain (loss) on foreign currency transactions              | (70)                         | (218)         | 148           | -68%       |
| Income tax benefit (expense)                                  | (6)                          | (6)           |               | 0%         |
| <b>Net income</b>   | <b>52,405</b>                | <b>28,344</b> | <b>24,061</b> | <b>85%</b> |

**Time Charter and Bareboat Revenues:** Time charter and bareboat revenues increased by \$41.3 million to \$136.6 million for the six months ended June 30, 2018 compared to \$95.3 million for the six months ended June 30, 2017. This was principally due to (i) increased revenues from the *Tordis Knutsen*, the *Vigdis Knutsen*, the *Lena Knutsen*, the *Brasil Knutsen* and the *Anna Knutsen* being included in the results of operations from March 1, 2017, June 1, 2017, September 30, 2017, December 15, 2018 and March 1, 2018, respectively, (ii) full earnings from the *Windsor Knutsen* during the six months ended June 30, 2018 compared to reduced earnings due to planned drydocking in the six months ended June 30, 2017 and (iii) increased earnings for the *Raquel Knutsen* during the six months ended June 30, 2018 compared to reduced earnings due to technical off hire in the six months ended June 30, 2017.

**Loss of hire insurance recoveries:** Loss of hire insurance recoveries for the six months ended June 30, 2018 were \$0.5 million compared to \$3.4 million for the six months ended June 30, 2017. The loss of hire insurance recoveries in the six months ended June 30, 2018 were related to a technical default with *Carmen Knutsen*'s controllable pitch propeller. The loss of hire insurance recoveries in the six months ended June 30, 2017 were related to a technical default with *Raquel Knutsen*'s propeller hub.

**Other income:** Other income for the six months ended June 30, 2018 was \$0.8 million compared to \$0.7 million for the six months ended June 30, 2017. The increase was primarily due to an increase of guarantee income from KNOT related to the *Windsor Knutsen*, as the vessel undertook her planned drydocking in the six months ended June 30, 2017. The increase was partly offset by the reimbursement for repairs and lost hire from KNOT for the *Vigdis Knutsen* due to the hull damage incident in June 2017.

**Vessel operating expenses:** Vessel operating expenses for the six months ended June 30, 2018 were \$27.2 million, an increase of \$7.5 million from \$19.7 million in the six months ended June 30, 2017. The increase was primarily due to (i) an increase of \$9.3 million from the *Tordis Knutsen*, the *Vigdis Knutsen*, the *Lena Knutsen*, the *Brasil Knutsen* and the *Anna Knutsen* being included in the results of operations from March 1, 2017, June 1, 2017, September 30, 2017,

December 15, 2017 and March 1, 2018, respectively, and (ii) an increase of \$0.8 million related to bunkers consumption in connection with the drydocking of the *Brasil Knutsen* in the six months ended June 30, 2018. The increase was partially offset by \$0.6 million related to bunkers consumption in connection with the drydocking of the *Windsor Knutsen* in the six months ended June 30, 2017 and by \$2.3 million received insurance recovery in connection with the propeller repairs of the *Carmen Knutsen* in the six months ended June 30, 2018.

**Depreciation:** Depreciation expense for the six months ended was \$43.9 million, an increase of \$10.8 million from \$33.1 million in the six months ended June 30, 2017. This increase was mainly due to the *Tordis Knutsen*, the *Vigdis Knutsen*, the *Lena Knutsen*, the *Brasil Knutsen* and the *Anna Knutsen* being included in the results of operations from March 1, 2017, June 1, 2017, September 30, 2017, December 15, 2017 and March 1, 2018, respectively.

**General and administrative expenses:** General and administrative expenses for the six months ended June 30, 2018 were \$2.7 million, compared to \$3.0 million for the same period in 2017. The decrease is mainly due to lower activity during the six months ended June 30, 2018 compared to the same period last year.

**Interest income:** Interest income for the six months ended June 30, 2018 was \$0.3 million, compared to \$0.1 million for the six months ended June 30, 2017.

**Interest expense:** Interest expense for the six months ended June 30, 2018 was \$23.1 million, an increase of \$9.6 million from \$13.5 million in the six months ended June 30, 2017. The increase was mainly due to additional debt incurred in connection with the acquisitions of the *Tordis Knutsen*, the *Vigdis Knutsen*, the *Lena Knutsen*, the *Brasil Knutsen* and the *Anna Knutsen*, increased leverage as a result of the refinancing of the *Hilda Knutsen* and the *Torill Knutsen* and higher LIBOR during the six months ended June 30, 2018 compared to the six months ended June 30, 2017.

**Other finance expense:** Other finance expense was \$0.6 million for the six months ended June 30, 2018 and June 30, 2017. Other finance expense is primarily related to bank fees and guarantee commissions.

**Realized and unrealized gain (loss) on derivative instruments:** Realized and unrealized gain on derivative instruments for the six months ended June 30, 2018 was \$11.9 million, compared to a loss of \$1.0 million for the six months ended June 30, 2017 as set forth in the table below:

| <i>(U.S. Dollars in thousands)</i>                                   | Six Months Ended |            | \$ Change |
|--|------------------|------------|-----------|
|  | 2018             | 2017       |           |
| Realized gain (loss):  |                  |            |           |
| Interest rate swap contracts   | \$ (247)         | \$ (1,607) | \$ 1,360  |
| Foreign exchange forward contracts                                   | 1,239            | (166)      | 1,405     |
| Total realized gain (loss):  | 992              | (1,773)    | 2,765     |
| Unrealized gain (loss):  |                  |            |           |
| Interest rate swap contracts   | 11,942           | (275)      | 12,217    |
| Foreign exchange forward contracts                                   | (990)            | 1,031      | (2,021)   |
| Total unrealized gain (loss):  | 10,952           | 756        | 10,196    |
| Total realized and unrealized gain (loss) on derivative instruments: | \$ 11,944        | \$ (1,017) | \$ 12,961 |

The increase in net realized and unrealized gain on derivative instruments was mainly due to an increased US swap interest rate.

**Net loss on foreign currency transactions:** Net loss on foreign currency transactions for the six months ended June 30, 2018 was \$0.1 million, compared to \$0.2 million loss for the six months ended June 30, 2017.

**Income tax expense:** Income tax expense for the six months ended June 30, 2018 and 2017 was \$6,000.

**Net income:** As a result of the foregoing, we earned net income of \$52.4 million for the six months ended June 30, 2018 compared to net income of \$28.3 million for the six months ended June 30, 2017.

## Liquidity and Capital Resources

## **Liquidity and Cash Needs**

We operate in a capital-intensive industry, and we expect to finance the purchase of additional vessels and other capital expenditures through a combination of borrowings from commercial banks, cash generated from operations and debt and equity financings. In addition to paying distributions, our other liquidity requirements relate to servicing our debt, funding investments (including the equity portion of investments in vessels), funding working capital and maintaining cash reserves against fluctuations in operating cash flows. We believe our current resources are sufficient to meet our working capital requirements for our current business. Generally, our long-term sources of funds are cash from operations, long-term bank borrowings and other debt and equity financings. Because we distribute our available cash, we expect to rely upon external financing sources, including bank borrowings and the issuance of debt and equity securities, to fund acquisitions and other expansion capital expenditures.

Our funding and treasury activities are intended to maximize investment returns while maintaining appropriate liquidity. Cash and cash equivalents are held primarily in U.S. Dollars with some balances held in Norwegian kroner ( NOK ), British Pounds and Euros. We have not made use of derivative instruments other than for interest rate and currency risk management purposes. We expect to continue to economically hedge our exposure to interest rate fluctuations in the future by entering into interest rate swap contracts.

We estimate that we will spend in total approximately \$29.4 million for drydocking and classification surveys for the twelve vessels under time charters in our fleet as of June 30, 2018 between 2018 and 2022. As our fleet matures and expands, our drydocking expenses will likely increase. Ongoing costs for compliance with environmental regulations are primarily included as part of our drydocking and society classification survey costs or are a component of our vessel operating expenses. We are not aware of any regulatory changes or environmental liabilities that we anticipate will have a material impact on our current or future operations. There will be further costs related to voyages to and from the drydocking yard that will depend on the distance from the vessel's ordinary trading area to the drydocking yard.

As of June 30, 2018, the Partnership had available liquidity of \$58.1 million, which consisted of cash and cash equivalents of \$45.1 million and an undrawn revolving credit facility of \$13.0 million.

The consolidated financial statements have been prepared assuming that the Partnership will continue as a going concern. As of June 30, 2018, the Partnership's net current liabilities were \$50.1 million. Included in current liabilities are \$80.2 million short term loan obligations that mature before June 30, 2019 and are therefore, presented as current debt.

As described above under *Recent Developments Multi-Vessel Refinancing*, on September 4, 2018 the Partnership's subsidiaries which own the *Windsor Knutsen*, the *Bodil Knutsen*, the *Fortaleza Knutsen*, the *Recife Knutsen*, the *Carmen Knutsen* and the *Ingrid Knutsen* (the *Vessels*), entered into new senior secured credit facilities in order to refinance their existing long term bank debt. The senior secured credit facilities consist of a term loan of \$320 million and a \$55 million revolving credit facility. The senior secured credit facilities will refinance the previously existing term loans of \$320.0 million and \$35 million revolver credit capacity secured by the *Vessels* which were due to mature between December 2018 and June 2019.

The Partnership expects that its primary future sources of funds will be available cash, cash from operations, borrowings under any new loan agreements and the proceeds of any equity financings. The Partnership believes that these sources of funds (assuming the current rates earned from existing charters) will be sufficient to cover operational cash outflows and ongoing obligations under the Partnership's financing commitments to pay loan interest and make scheduled loan repayments and to make distributions on its outstanding units. Accordingly, the Partnership believes that its current resources, including amounts available to be drawn under the revolving credit facilities are sufficient to meet working capital requirements for its current business for at least the next twelve months. The Partnership's liquidity is further strengthened due to the multi-vessel refinancing described above.

The following table summarizes our net cash flows from operating, investing and financing activities and our cash and cash equivalents for the periods presented:

**Six Months Ended June 30, 2018 Compared with the Six Months Ended June 30, 2017**

| <i>(U.S. Dollars in thousands)</i>                       | <b>Six Months Ended June 30,</b> |             |
|--|----------------------------------|-------------|
|  | <b>2018</b>                      | <b>2017</b> |
| Net cash provided by (used in) operating activities      | \$ 78,234                        | \$ 98,021   |
| Net cash provided by (used in) investing activities      | (15,386)                         | (60,875)    |
| Net cash provided by (used in) financing activities      | (63,823)                         | (344)       |
| Effect of exchange rate changes on cash                  | (44)                             | 35          |
| Net increase in cash and cash equivalents                | (1,019)                          | 36,837      |
| Cash and cash equivalents at the beginning of the period | 46,104                           | 27,664      |
| Cash and cash equivalents at the end of the period       | 45,085                           | 64,501      |

***Net cash provided by operating activities***

Net cash provided by operating activities decreased by \$19.8 million to \$78.2 million in the six months ended June 30, 2018 compared to \$98.0 million in the six months ended June 30, 2017. This was primarily due to a decrease of working capital mainly as a result of decrease in amounts due from related parties and an increase in unrealized loss on derivative instruments. The decrease was partially offset by higher earnings from the *Tordis Knutsen*, the *Vigdis Knutsen*, the *Lena Knutsen*, the *Brasil Knutsen* and the *Anna Knutsen* being included in the results of operations from March 1, 2017, June 1, 2017, September 30, 2017, December 15, 2017 and March 1, 2018, respectively.

***Net cash used in investing activities***

Net cash used in investing activities was \$15.4 million in the six months ended June 30, 2018 compared to \$60.9 million in the six months ended June 30, 2017. Net cash used in investing activities for the six months ended June 30, 2018 has decreased compared to the six months ended June 30, 2017 due to fewer vessel acquisitions in 2018.

***Net cash used in financing activities***

Net cash used in financing activities during the six months ended June 30, 2018 of \$63.8 million mainly related to the following:

Proceeds of \$100 million from the refinancing of the *Torill Knutsen*; and

Proceeds from drawdowns under the two revolving credit facilities of \$45.5 million.

This was offset by the following:

Repayment of long-term debt of \$146.0 million, of which \$73.2 million was repaid in connection with refinancing of the *Torill Knutsen*;

Repayment of long-term debt from related parties of \$22.5 million; and

Payment of cash distributions of \$39.7 million.

Net cash used in financing activities during the six months ended June 30, 2017 of \$0.3 million mainly related to the following:

The net proceeds from a public offering of common units in January 2017 of \$54.9 million;

The net proceeds from issuance of Series A Preferred Units of \$87.4 million;

Proceeds of \$100.0 million from the refinancing of the *Hilda Knutsen*; and

Proceeds from drawdowns under our revolving credit facility of \$30.0 million.

This was offset by the following;



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Repayment of long-term debt of \$167.5 million, of which \$75.6 million was repaid in connection with refinancing of the *Hilda Knutsen*;

Repayment of long-term debt from related parties of \$70.7 million; and

Payment of cash distributions of \$33.4 million.

**Borrowing Activities**

**Long-Term Debt**

As of June 30, 2018, and December 31, 2017, the Partnership had the following debt amounts outstanding:

| <i>(U.S. Dollars in thousands)</i>             | <b>Vessel</b>   | <b>June 30, 2018</b> | <b>December 31, 2017</b> |
|--|---|----------------------|--------------------------|
| \$220 million loan facility                    | <i>Windsor Knutsen, Bodil Knutsen, Carmen Knutsen</i> | \$ 157,142           | \$ 165,000               |
| \$35 million revolving credit facility         | <i>Windsor Knutsen, Bodil Knutsen, Carmen Knutsen</i> | 22,000               |                          |
| Fortaleza and Recife loan facility             | <i>Fortaleza Knutsen &amp; Recife Knutsen</i>         | 105,000              | 109,375                  |
| Hilda loan facility                            | <i>Hilda Knutsen</i>                                  | 93,846               | 96,923                   |
| \$117 million loan facility                    | <i>Torill Knutsen</i>                                 |                      | 73,177                   |
| Torill loan facility                           | <i>Torill Knutsen</i>                                 | 98,333               |                          |
| \$172.5 million loan facility                  | <i>Dan Cisne, Dan Sabia</i>                           | 86,739               | 91,339                   |
| Ingrid loan facility                           | <i>Ingrid Knutsen</i>                                 | 57,802               | 61,085                   |
| Raquel loan facility                           | <i>Raquel Knutsen</i>                                 | 65,799               | 68,414                   |
| Tordis loan facility                           | <i>Tordis Knutsen</i>                                 | 88,521               | 91,051                   |
| Vigdis loan facility                           | <i>Vigdis Knutsen</i>                                 | 89,786               | 92,316                   |
| Lena loan facility                             | <i>Lena Knutsen</i>                                   | 88,200               | 90,650                   |
| Brasil loan facility                           | <i>Brasil Knutsen</i>                                 | 66,485               | 69,000                   |
| Anna loan facility                             | <i>Anna Knutsen</i>                                   | 72,392               |                          |
| \$25 million revolving credit facility         |   | 25,000               | 25,000                   |
| <b>Total long-term debt</b>                    |   | <b>1,117,045</b>     | <b>1,033,330</b>         |
| Less: current installments                     |   | 82,823               | 95,176                   |
| Less: unamortized deferred loan issuance costs |   | 2,617                | 2,191                    |
| <b>Current portion of long-term debt</b>       |   | <b>80,206</b>        | <b>92,985</b>            |
| Amounts due after one year                     |   | 1,034,222            | 938,154                  |
| Less: unamortized deferred loan issuance costs |   | 5,169                | 4,524                    |

**Long-term debt, less current installments and unamortized deferred loan issuance costs** **\$ 1,029,053** **\$ 933,630**

The Partnership's outstanding debt of \$1,117.0 million as of June 30, 2018 is repayable as follows:

| <i>(U.S. Dollars in thousands)</i> | <b>Period<br/>repayment</b> | <b>Balloon<br/>repayment</b> |
|------------------------------------|-----------------------------|------------------------------|
| Remainder of 2018 (1)              | \$ 41,362                   | \$ 18,427                    |
| 2019 (2)                           | 71,903                      | 284,678                      |
| 2020                               | 61,083                      |                              |
| 2021                               | 61,683                      | 70,811                       |
| 2022                               | 46,347                      | 236,509                      |
| 2023 and thereafter                | 62,341                      | 161,901                      |
| <b>Total</b>                       | <b>\$ 344,719</b>           | <b>\$ 772,326</b>            |

- (1) Although \$18.4 million of the \$77.5 million loan facility financing *Ingrid Knutsen* is due to mature in December 2018, the Partnership has classified \$18.4 million of the loan facility as long-term debt on the face of the consolidated balance sheet as a result of the September 2018 refinancing transaction.
- (2) Although \$141.4 million of the \$220 million loan facility and \$22 million of the \$35 million revolving credit facility financing *Windsor Knutsen*, *Carmen Knutsen* and *Bodil Knutsen* is due to mature in June 2019, the Partnership has classified \$163.4 million of such loan facilities as long-term debt on the face of the consolidated balance sheet as a result of the September 2018 refinancing transaction. In addition \$96.3 million of the \$140 million loan facility financing *Fortaleza Knutsen* and *Recife Knutsen* is due to mature in June 2019, the Partnership has classified \$96.3 million of such loan facilities as long-term debt on the face of the consolidated balance sheet as a result of the September 2018 refinancing transaction.

As of June 30, 2018, the interest rates on our loan agreements (other than tranche two of the Ingrid loan facility) were LIBOR plus a fixed margin ranging from 1.8% to 2.5%. On the export credit loan of \$39.4 million, which is tranche two of the Ingrid loan facility, the annual rate is 3.85% composed of a 2.5% bank facility rate plus a commission of 1.35% to the export credit guarantor. The guarantee commission of 1.35% is classified as other finance expense.

***\$220 Million Term Loan Facility and \$35 Million Revolving Credit Facilities***

In June 2014, the Partnership's subsidiaries KNOT Shuttle Tankers 18 AS, KNOT Shuttle Tankers 17 AS and Knutsen Shuttle Tankers 13 AS entered into a senior syndicate secured loan facility in an aggregate amount of \$240 million (the Senior Secured Loan Facility). The Senior Secured Loan Facility consisted of (i) a \$220 million term loan (the Term Loan Facility) and (ii) a \$20 million revolving credit facility (the Revolving Credit Facility).

The Revolving Credit Facility matures in June 2019, bears interest at LIBOR plus a fixed margin of 2.125%, and has a commitment fee equal to 40% of the margin of the Revolving Credit Facility calculated on the daily undrawn portion of the Revolving Credit Facility. As of June 30, 2018, \$20 million had been drawn under the Revolving Credit Facility. The Term Loan Facility is repayable in quarterly installments over five years with a final balloon payment due at maturity at June 2019. The Term Loan Facility bears interest at LIBOR plus a margin of 2.125%.

On June 30, 2016, the Partnership's subsidiaries KNOT Shuttle Tankers 18 AS, KNOT Shuttle Tankers 17 AS and Knutsen Shuttle Tankers 13 AS, as borrowers, entered into an amended and restated senior secured credit facility (the Amended Senior Secured Loan Facility), which amended the Senior Secured Loan Facility. The Amended Senior Secured Loan Facility included a new revolving credit facility tranche of \$15 million, bringing the total revolving credit commitments under the facility to \$35 million. The new revolving credit facility matures in June 2019, bears interest at LIBOR plus a fixed margin of 2.5% and has a commitment fee equal to 40% of the margin of the revolving facility tranche calculated on the daily undrawn portion of such tranche. As June 30, 2018, \$2.0 million had been drawn under the new revolving credit facility.

The *Windsor Knutsen*, the *Bodil Knutsen* and the *Carmen Knutsen*, assignments of earnings, charterparty contracts and insurance proceeds are pledged as collateral for the Amended Senior Secured Loan Facility. The Amended Senior Secured Loan Facility is guaranteed by the Partnership and KNOT Shuttle Tankers AS, and secured by vessel mortgages on the *Windsor Knutsen*, the *Bodil Knutsen* and the *Carmen Knutsen*.

The Amended Senior Secured Loan Facility contains the following financial covenants:

The aggregate market value of the *Windsor Knutsen*, *Bodil Knutsen* and *Carmen Knutsen* shall not be less than 110% of the outstanding balance under the Amended Senior Secured Loan Facility for the first two years, 120% for the third and fourth years, and 125% thereafter;

Positive working capital of the borrowers and the Partnership;

Minimum liquidity of the Partnership of \$23 million plus increments of \$1 million for each additional vessel acquired by the Partnership and \$1.5 million for each owned vessel with less than 12 months remaining tenor on its employment contract;

Minimum book equity ratio for the Partnership of 30%; and

Minimum EBITDA to interest ratio for the Partnership of 2.50.

The Amended Senior Secured Loan Facility also identifies various events that may trigger mandatory reduction, prepayment and cancellation of the facility, including total loss or sale of a vessel and customary events of default. As of June 30, 2018, the borrowers and the guarantors were in compliance with all covenants under this facility.

***Fortaleza and Recife Loan Facility***

In June 2014, the Partnership's subsidiary Knutsen Shuttle Tankers XII KS, as the borrower, entered into a senior syndicate secured loan facility in the amount of \$140 million (the Fortaleza and Recife Facility). The Fortaleza and Recife Facility was drawn in November 2014 and replaced a \$160 million loan facility previously secured by the *Fortaleza Knutsen* and the *Recife Knutsen*. The Fortaleza and Recife Facility is repayable in quarterly installments over five years with a final balloon payment due at maturity in June 2019. The facility bears interest at LIBOR plus a margin of 2.125%. The *Fortaleza Knutsen* and the *Recife Knutsen*, assignments of earnings, charterparty contracts and insurance proceeds are pledged as collateral for the Fortaleza and Recife Facility. The facility is guaranteed by the Partnership and KNOT Shuttle Tankers AS and is secured by vessel mortgages on the *Fortaleza Knutsen* and the *Recife Knutsen*.

The Fortaleza and Recife Facility contains the following financial covenants:

The aggregate market value of the *Fortaleza Knutsen* and *Recife Knutsen* shall not be less than 110% of the outstanding balance under the Fortaleza and Recife Facility for the first two years, 120% for the third and fourth year, and 125% thereafter;

Positive working capital of the borrower and the Partnership;

Minimum liquidity of the Partnership of \$23 million plus increments of \$1 million for each additional vessel acquired by the Partnership and \$1.5 million for each owned vessel with less than 12 months remaining tenor on its employment contract;

Minimum book equity ratio for the Partnership of 30%; and

Minimum EBITDA to interest ratio for the Partnership of 2.50.

The Fortaleza and Recife Facility also identifies various events that may trigger mandatory reduction, prepayment and cancellation of the facility, including total loss or sale of a vessel and customary events of default. As of June 30, 2018, the borrower and the guarantors were in compliance with all covenants under this facility.

#### ***Hilda Loan Facility***

On May 26, 2017, the Partnership's subsidiary, KNOT Shuttle Tankers 14 AS, which owns the vessel *Hilda Knutsen*, entered into a new \$100 million senior secured term loan facility with Mitsubishi UFJ Lease & Finance (Hong Kong) Limited (the *Hilda Facility*). The *Hilda Facility* replaced the \$117 million loan facility, which was due to be paid in full in August 2018. The *Hilda Facility* is repayable in 28 consecutive quarterly installments with a balloon payment of \$58.5 million due at maturity. The *Hilda Facility* bears interest at a rate per annum equal to LIBOR plus a margin of 2.2%. The Partnership and KNOT Shuttle Tankers AS are the sole guarantors. The facility matures in May 2024.

The *Hilda Facility* contains the following primary financial covenants:

Market value of the *Hilda Knutsen* shall not be less than 110% of the outstanding balance under the *Hilda Facility* for the first two years, 120% for the third and fourth year, and 125% thereafter;

Positive working capital of the borrower and the Partnership;

Minimum liquidity of the Partnership of \$23 million plus increments of \$1 million for each additional vessel acquired by the Partnership and \$1.5 million for each owned vessel with less than 12 months remaining tenor on its employment contract;

Minimum book equity ratio for the Partnership of 30%; and

Minimum EBITDA to interest ratio for the Partnership of 2.50.

The Hilda Facility also identifies various events that may trigger mandatory reduction, prepayment and cancellation of the facility, including total loss or sale of a vessel and customary events of default. As of June 30, 2018, the borrower and the guarantors were in compliance with all covenants under this facility.

### ***Torill Loan Facility***

On January 30, 2018, Knutsen Shuttle Tankers 15 AS closed a new \$100 million senior secured term loan facility (the Torill Facility ) with a consortium of banks, in which The Bank of Tokyo-Mitsubishi UFJ acted as agent. The Torill Facility is repayable in 24 consecutive quarterly installments with a balloon payment of \$60.0 million due at maturity. The Torill Facility bears interest at a rate per annum equal to LIBOR plus a margin of 2.1%. The facility will mature in January 2024 and is guaranteed by the Partnership. The Torill Facility contains the following primary financial covenants:

Market value of the *Torill Knutsen* shall not be less than 110% of the outstanding balance under the Torill Facility for the first two years, 120% for the third and fourth year, and 125% thereafter;

Positive working capital of the borrower and the Partnership;

Minimum liquidity of the Partnership of \$23 million plus increments of \$1 million for each additional vessel acquired by the Partnership and \$1.5 million for each owned vessel with less than 12 months remaining tenor on its employment contract;

Minimum book equity ratio for the Partnership of 30%; and

Minimum EBITDA to interest ratio for the Partnership of 2.50.

The Torill Facility also identifies various events that may trigger mandatory reduction, prepayment and cancellation of the facility, including total loss or sale of a vessel and customary events of default. As of June 30, 2018, the borrower and the guarantors were in compliance with all covenants under this facility.

### ***\$172.5 Million Secured Loan Facility***

In April 2014, KNOT Shuttle Tankers 20 AS and KNOT Shuttle Tankers 21 AS, the subsidiaries owning the *Dan Cisne* and *Dan Sabia*, as the borrowers, entered into a \$172.5 million senior secured loan facility. In connection with the Partnership's acquisition of the *Dan Cisne*, in December 2014, the \$172.5 million senior secured loan facility was split into a tranche related to the *Dan Cisne* (the *Dan Cisne Facility*) and a tranche related to *Dan Sabia* (the *Dan Sabia Facility*).

The *Dan Cisne Facility* and the *Dan Sabia Facility* are guaranteed by the Partnership and secured by a vessel mortgage on the *Dan Cisne* and *Dan Sabia*. The *Dan Cisne Facility* and the *Dan Sabia Facility* bear interest at LIBOR plus a margin of 2.4% and are repayable in semiannual installments with a final balloon payment due at maturity in September 2023 and January 2024, respectively.

The *Dan Cisne Facility* and *Dan Sabia Facility* contain the following financial covenants:

Market value of each of the *Dan Cisne* and *Dan Sabia* shall not be less than 100% of the outstanding balance under the *Dan Cisne Facility* and *Dan Sabia Facility*, respectively, for the first three years, and 125% thereafter;

Minimum liquidity of the Partnership of \$23 million plus increments of \$1 million for each additional vessel acquired by the Partnership and \$1.5 million for each owned vessel with less than 12 months remaining tenor on its employment contract; and

Minimum book equity ratio for the Partnership of 30%.

The facility also identifies various events that may trigger mandatory reduction, prepayment and cancellation of the facility, including total loss or sale of a vessel and customary events of default. As of June 30, 2018, the borrowers and the guarantor were in compliance with all covenants under this facility.

### ***Ingrid Loan Facility***

In June 2012, Knutsen NYK Shuttle Tankers 16 AS, the subsidiary owning the *Ingrid Knutsen*, as the borrower, entered into a secured loan facility in an aggregate amount of \$90.0 million (the *Ingrid Facility*). The *Ingrid Facility* includes two tranches. Tranche one is a commercial bank loan of \$19.1 million, repayable in semi-annual installments with a final balloon payment due at maturity in December 2018. Tranche one bears interest at LIBOR, plus a margin of 2.25%.

Tranche two is an export credit loan of \$42.0 million, repayable in semi-annual installments and maturing in November 2025. Tranche two bears interest at an annual fixed rate of 3.85%, composed of a 2.5% bank facility rate plus a commission of 1.35% to the export credit guarantor. The facility is secured by a vessel mortgage on the *Ingrid Knutsen*. The *Ingrid Knutsen*, assignments of earnings, charterparty contracts and insurance proceeds are pledged as collateral for the *Ingrid Facility*. The Partnership and KNOT Shuttle Tankers AS are the sole guarantors.

The *Ingrid Facility* contains the following financial covenants:



Market value of the *Ingrid Knutsen* shall not be less than 125% of the outstanding balance under the Ingrid Facility;

Positive working capital of the borrower and the Partnership;

Minimum liquidity of the Partnership of \$23 million plus increments of \$1 million for each additional vessel acquired by the Partnership and \$1.5 million for each owned vessel with less than 12 months remaining tenor on its employment contract;

Minimum book equity ratio for the Partnership of 30%; and

Minimum EBITDA to interest ratio for the Partnership of 2.50.

The Ingrid Facility also identifies various events that may trigger mandatory reduction, prepayment and cancellation of the facility, including total loss or sale of a vessel and customary events of default. As of June 30, 2018, the borrower and the guarantors were in compliance with all covenants under this facility.

### ***Raquel Loan Facility***

In December 2014, Knutsen Shuttle Tankers 19 AS, the subsidiary owning the *Raquel Knutsen*, as the borrower, entered into a secured loan facility in an aggregate amount of \$90.0 million (the *Raquel Facility*). The *Raquel Facility* is repayable in quarterly installments with a final balloon payment of \$30.5 million due at maturity in March 2025. The *Raquel Facility* bears interest at an annual rate equal to LIBOR plus a margin of 2.0%. The facility is secured by a vessel mortgage on the *Raquel Knutsen*. The *Raquel Knutsen*, assignments of earnings, charterparty contracts and insurance proceeds are pledged as collateral for the *Raquel Facility*. The Partnership and KNOT Shuttle Tankers AS are the sole guarantors.

The *Raquel Facility* contains the following financial covenants:

Market value of the *Raquel Knutsen* shall not be less than 100% of the of the outstanding balance under the *Raquel Facility* for the first three years, and 125% thereafter;

Minimum liquidity of the Partnership of \$23 million plus increments of \$1 million for each additional vessel acquired by the Partnership and \$1.5 million for each owned vessel with less than 12 months remaining tenor on its employment contract; and

Minimum book equity ratio for the Partnership of 30%.

The *Raquel Facility* also identifies various events that may trigger mandatory reduction, prepayment and cancellation of the facility, including total loss or sale of a vessel and customary events of default. As of June 30, 2018, the borrower and the guarantors were in compliance with all covenants under this facility.

### ***Tordis Loan Facility***

In April 2015, KNOT Shuttle Tankers 24 AS, the subsidiary owning the *Tordis Knutsen*, as the borrower, entered into a secured loan facility (the *Tordis Facility*). As of the time of the acquisition of the *Tordis Knutsen* on March 1, 2017, the aggregate amount outstanding under the facility was \$114.4 million. The *Tordis Facility* is repayable in quarterly installments with a final balloon payment of \$70.8 million due at maturity in November 2021. The *Tordis Facility* bears interest at an annual rate equal to LIBOR plus a margin of 1.9%. The facility is secured by a vessel mortgage on the *Tordis Knutsen*. The *Tordis Knutsen*, assignments of earnings, charterparty contracts and insurance proceeds are pledged as collateral for the *Tordis Facility*. The Partnership and KNOT Shuttle Tankers AS are the sole guarantors.

The *Tordis Facility* contains the following financial covenants:

Aggregate market value of the *Tordis Knutsen*, the *Vigdis Knutsen* and the *Lena Knutsen* shall not be less than 130% of the aggregate outstanding balance under the *Tordis Facility*, the *Vigdis Facility* and the *Lena Facility* at any time;

Positive working capital of the borrower and the Partnership;

Minimum liquidity of the Partnership of \$23 million plus increments of \$1 million for each additional vessel acquired by the Partnership and \$1.5 million for each owned vessel with less than 12 months remaining tenor on its employment contract;

Minimum book equity ratio for the Partnership of 30%; and

Minimum EBITDA to interest ratio for the Partnership of 2.50.

The Tordis Facility also identifies various events that may trigger mandatory reduction, prepayment and cancellation of the facility, including total loss or sale of a vessel and customary events of default. As of June 30, 2018, the borrower and the guarantors were in compliance with all covenants under this facility.

### ***Vigdis Loan Facility***

In April 2015, KNOT Shuttle Tankers 25 AS, the subsidiary owning the *Vigdis Knutsen*, as the borrower, entered into a secured loan facility (the *Vigdis Facility* ). At the time of the acquisition of the *Vigdis Knutsen* on June 1, 2017, the aggregate amount outstanding under the facility was \$114.4 million. The *Vigdis Facility* is repayable in quarterly installments with a final balloon payment of \$70.8 million due at maturity in February 2022. The *Vigdis Facility* bears interest at an annual rate equal to LIBOR plus a margin of 1.9%. The facility is secured by a vessel mortgage on the *Vigdis Knutsen*. The *Vigdis Knutsen*, assignments of earnings, charterparty contracts and insurance proceeds are pledged as collateral for the *Vigdis Facility*. The Partnership and KNOT Shuttle Tankers AS are the sole guarantors.

The Vigdis Facility contains the following financial covenants:

Aggregate market value of the *Tordis Knutsen*, the *Vigdis Knutsen* and the *Lena Knutsen* shall not be less than 130% of the aggregate outstanding balance under the Tordis Facility, the Vigdis Facility and the Lena Facility at any time;

Positive working capital of the borrower and the Partnership;

Minimum liquidity of the Partnership of \$23 million plus increments of \$1 million for each additional vessel acquired by the Partnership and \$1.5 million for each owned vessel with less than 12 months remaining tenor on its employment contract;

Minimum book equity ratio for the Partnership of 30%; and

Minimum EBITDA to interest ratio for the Partnership of 2.50.

The Vigdis Facility also identifies various events that may trigger mandatory reduction, prepayment and cancellation of the facility, including total loss or sale of a vessel and customary events of default. As of June 30, 2018, the borrower and the guarantors were in compliance with all covenants under this facility.

#### ***Lena Loan Facility***

In April 2015, KNOT Shuttle Tankers 26 AS, the subsidiary owning the *Lena Knutsen*, as the borrower, entered into a secured loan facility (the *Lena Facility* ). The *Lena Facility* is repayable in quarterly installments with a final balloon payment of \$68.6 million due at maturity in June 2022. The *Lena Facility* bears interest at an annual rate equal to LIBOR plus a margin of 1.9%. The facility is secured by a vessel mortgage on the *Lena Knutsen*. The *Lena Knutsen*, assignments of earnings, charterparty contracts and insurance proceeds are pledged as collateral for the *Lena Facility*. The Partnership and KNOT Shuttle Tankers AS are the sole guarantors.

The *Lena Facility* contains the following financial covenants:

Aggregate market value of the *Tordis Knutsen*, the *Vigdis Knutsen* and the *Lena Knutsen* shall not be less than 130% of the aggregate outstanding balance under the Tordis Facility, the Vigdis Facility and the *Lena Facility* at any time;

Positive working capital of the borrower and the Partnership;

Minimum liquidity of the Partnership of \$23 million plus increments of \$1 million for each additional vessel acquired by the Partnership and \$1.5 million for each owned vessel with less than 12 months remaining tenor on its employment contract;

Minimum book equity ratio for the Partnership of 30%; and

Minimum EBITDA to interest ratio for the Partnership of 2.50.

The Lena Facility also identifies various events that may trigger mandatory reduction, prepayment and cancellation of the facility, including total loss or sale of a vessel and customary events of default. As of June 30, 2018, the borrower and the guarantors were in compliance with all covenants under this facility.

### ***Brasil Loan Facility***

In June 2017, KNOT Shuttle Tankers 32 AS, the subsidiary owning the *Brasil Knutsen*, as the borrower, entered into a secured loan facility (the Brasil Facility). The Brasil Facility is repayable in quarterly installments with a final balloon payment of \$41.0 million due at maturity in July 2022. The Brasil Facility bears interest at an annual rate equal to LIBOR plus a margin of 2.3%. The facility is secured by a vessel mortgage on the *Brasil Knutsen*. The *Brasil Knutsen*, assignments of earnings, charterparty contracts and insurance proceeds are pledged as collateral for the Brasil Facility. The Partnership and KNOT Shuttle Tankers AS are the sole guarantors.

The Brasil Facility contains the following financial covenants:

Market value of the *Brasil Knutsen* shall not be less than 125% of the of the outstanding balance under the Brasil Facility for the first four years, and 135% thereafter;

Positive working capital of the borrower and the Partnership;

Minimum liquidity of the Partnership of \$23 million plus increments of \$1 million for each additional vessel acquired by the Partnership and \$1.5 million for each owned vessel with less than 12 months remaining tenor on its employment contract;

Minimum book equity ratio for the Partnership of 30%; and

Minimum EBITDA to interest ratio for the Partnership of 2.50.

The Brasil Facility also identifies various events that may trigger mandatory reduction, prepayment and cancellation of the facility, including total loss or sale of a vessel and customary events of default. As of June 30, 2018, the borrower and the guarantors were in compliance with all covenants under this facility.

### ***Anna Loan Facility***

In September 2016, KNOT Shuttle Tankers 30 AS, the subsidiary owning the *Anna Knutsen*, as the borrower, entered into a secured loan facility (the *Anna Facility*). The *Anna Facility* is repayable in quarterly installments with a final balloon payment of \$57.1 million due at maturity in March 2022. The *Anna Facility* bears interest at an annual rate equal to LIBOR plus a margin of 2.0%. The facility is secured by a vessel mortgage on the *Anna Knutsen*. The *Anna Knutsen*, assignments of earnings, charterparty contracts and insurance proceeds are pledged as collateral for the *Anna Facility*. The Partnership and KNOT Shuttle Tankers AS are the sole guarantors.

The *Anna Facility* contains the following financial covenants:

Market value of the *Anna Knutsen* shall not be less than 130% of the aggregate outstanding balance under the *Anna Facility* at any time;

Positive working capital of the borrower and the Partnership;

Minimum liquidity of the Partnership of \$23 million plus increments of \$1 million for each additional vessel acquired by the Partnership and \$1.5 million for each owned vessel with less than 12 months remaining tenor on its employment contract;

Minimum book equity ratio for the Partnership of 30%; and

Minimum EBITDA to interest ratio for the Partnership of 2.50.

The *Anna Facility* also identifies various events that may trigger mandatory reduction, prepayment and cancellation of the facility, including total loss or sale of a vessel and customary events of default. As of June 30, 2018, the borrower and the guarantors were in compliance with all covenants under this facility.

### ***\$25 Million Revolving Credit Facility***

On August 31, 2017, KNOT Shuttle Tankers AS entered into an unsecured revolving credit facility of \$25 million with NTT Finance Corporation. The facility will mature in August 2019, bears interest at LIBOR plus a margin of 1.8% and has a commitment fee of 0.5% on the undrawn portion of the facility.

### **Derivative Instruments and Hedging Activities**

We use derivative instruments to reduce the risks associated with fluctuations in interest rates. We have a portfolio of interest rate swap contracts that exchange or swap floating rate interest to fixed rates, which, from a financial perspective, hedges our obligations to make payments based on floating interest rates. As of June 30, 2018, the Partnership's net exposure to floating interest rate fluctuations on its outstanding debt was approximately \$493.0 million based on total interest bearing debt outstanding of \$1,117.0 million, less interest rate swaps of

\$539.5 million, less a 3.85% fixed rate export credit loan of \$39.4 million and less cash and cash equivalents of \$45.1 million. Our interest rate swap contracts mature between August 2018 and August 2027. Under the terms of the interest rate swap agreements, we will receive from the counterparty interest on the notional amount based on three-month and six-month LIBOR and will pay to the counterparty a fixed rate. For the interest rate swap agreements above, we will pay to the counterparty a weighted average interest rate of 1.82%.

We enter into foreign exchange forward contracts in order to manage our exposure to the risk of movements in foreign currency exchange rate fluctuations. As of June 30, 2018, the total contract amount in foreign currency of our outstanding foreign exchange forward contracts that were entered into to economically hedge our outstanding future payments in currencies other than the U.S. Dollar was NOK 202.1 million. We do not apply hedge accounting for derivative instruments.

### **Contractual Obligations**

The following table summarizes our long-term contractual obligations as of June 30, 2018:

| <i>(U.S. Dollars in thousands)</i>         | <b>Payments Due by Period</b> |                             |                  |                  |                              |
|--|-------------------------------|-----------------------------|------------------|------------------|------------------------------|
|  | <b>Total</b>                  | <b>Less than<br/>1 Year</b> | <b>1-3 Years</b> | <b>4-5 Years</b> | <b>More than<br/>5 Years</b> |
| Long-term debt                             | \$ 1,117,045                  | \$ 360,929                  | \$ 147,065       | \$ 403,909       | \$ 205,142                   |
| Interest commitments on long-term debt (1) | 147,742                       | 45,941                      | 58,771           | 34,837           | 8,193                        |
| Interest rate swaps (2)                    | (5,741)                       | (842)                       | (371)            | (1,352)          | (3,176)                      |
| Total                                      | \$ 1,259,046                  | \$ 406,028                  | \$ 205,465       | \$ 437,394       | \$ 210,159                   |

- (1) The interest commitments on long-term debt have been calculated assuming interest rates based on the 6-month LIBOR as of June 30, 2018, plus the applicable margin for all periods presented.
- (2) We have entered into interest rate swap contracts and under the terms of the interest rate swap contracts, we receive LIBOR-based variable interest and payments and make fixed interest rate payments. The interest commitments on interest rate swaps have been calculated assuming interest rates based on the 6-month LIBOR as of June 30, 2018.

#### **Off-Balance Sheet Arrangements**

Currently, we do not have any off-balance sheet arrangements.

#### **Critical Accounting Estimates**

The preparation of the unaudited condensed consolidated interim financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosures about contingent assets and liabilities. We base these estimates and assumptions on historical experience and on various other information and assumptions that we believe to be reasonable. Our critical accounting estimates are important to the portrayal of both our financial condition and results of operations and require us to make subjective or complex assumptions or estimates about matters that are uncertain. For a description of our material accounting policies that involve higher degree of judgment, please read Note 2 – Summary of Significant Accounting Policies of our consolidated financial statements included in our 2017 20-F filed with the Securities and Exchange Commission ( SEC ).

#### **Quantitative and Qualitative Disclosures About Market Risk**

We are exposed to various market risks, including interest rate, foreign currency exchange rate and concentration of credit risks. Historically, we have entered into certain derivative instruments and contracts to maintain the desired level of exposure arising from interest rate and certain foreign currency exchange rate risks. Our policy is to economically hedge our exposure to risks, where possible, within boundaries deemed appropriate by management.

#### ***Interest Rate Risk***

A portion of our debt obligations and surplus funds placed with financial institutions are subject to movements in interest rates. It is our policy to obtain the most favorable interest rates available without increasing our foreign currency exposure. In keeping with this, our surplus funds may in the future be placed in fixed deposits with reputable financial institutions that yield better returns than bank deposits. The deposits generally have short-term maturities so as to provide us with the flexibility to meet working capital and capital investments.

We have historically used interest rate swap contracts to manage our exposure to interest rate risks. Interest rate swap contracts were used to convert floating rate debt obligations based on LIBOR to a fixed rate in order to achieve an overall desired position of fixed and floating rate debt. The extent to which interest rate swap contracts are used is



determined by reference to our net debt exposure and our views regarding future interest rates. Our interest rate swap contracts do not qualify for hedge accounting, and movements in their fair values are reflected in the statements of operations under Realized and unrealized gain (loss) on derivative instruments. Interest rate swap contracts that have a positive fair value are recorded as Other current assets, while swaps with a negative fair value are recorded as Derivative liabilities.

As of June 30, 2018, we were party to interest rate swap contracts with a combined notional amount of approximately \$539.5 million. Under the terms of the interest rate swap contracts, we receive LIBOR-based variable interest rate payments and make fixed interest rate payments at fixed rates between 1.38% per annum and 2.49% per annum for all periods. The interest rate swap contracts mature between August 2018 and August 2027. The notional amount and fair value of our interest rate swap contracts recognized as net derivative liabilities as of June 30, 2018 are as follows:

| <i>(U.S. Dollars in thousands)</i> | <b>June 30, 2018</b>       |                               |
|------------------------------------|----------------------------|-------------------------------|
|                                    | <b>Notional<br/>Amount</b> | <b>Fair Value<br/>(asset)</b> |
| Interest rate swap contracts       | \$ 539,532                 | \$ 23,455                     |

As of June 30, 2018, our net exposure to floating interest rate fluctuations on our outstanding debt was approximately \$493.0 million, based on our total interest bearing debt of approximately \$1,117.0 million, less the notional amount of our floating to fixed interest rate swap contracts of approximately \$539.5 million, less a 3.85% fixed rate export credit loan of \$39.4 million and less cash and cash equivalents of \$45.1 million. A 1% change in short-term interest rates would result in an increase or decrease to our interest expense of approximately \$4.9 million on an annual basis as of June 30, 2018.

### ***Foreign Currency Exchange Rate Risk***

We and our subsidiaries have the U.S. Dollar as our functional and reporting currency, because all of our revenues and the majority of our expenditures, including the majority of our investments in vessels and our financing transactions, are denominated in U.S. Dollars. We could, however, earn revenue in other currencies, and we currently incur a portion of our expenses in other currencies. Therefore, there is a risk that currency fluctuations could have an adverse effect on the value of our cash flows.

Our foreign currency risk arises from:

the measurement of monetary assets and liabilities denominated in foreign currencies converted to U.S. Dollars, with the resulting gain or loss recorded as Net loss on foreign currency transactions; and

the impact of fluctuations in exchange rates on the reported amounts of our revenues, if any, and expenses that are denominated in foreign currencies.

As of June 30, 2018, we had entered into foreign exchange forward contracts, selling a total notional amount of \$25.0 million against NOK at an average exchange rate of NOK 8.09 per 1 U.S. Dollar, which are economic hedges for certain vessel operating expenses and general expenses in NOK. We did not apply hedge accounting to our foreign exchange forward contracts.

### ***Concentration of Credit Risk***

The market for our services is the offshore oil transportation industry, and our customers consist primarily of major oil and gas companies, independent oil and gas producers and government-owned oil companies. As of June 30, 2018, and December 31, 2017, seven and six customers, respectively, accounted for substantially all of our revenues. Ongoing credit evaluations of our customers are performed and generally do not require collateral in our business agreements. Typically, under our time charters and bareboat charters, the customer pays for the month's charter the first day of each month, which reduces our level of credit risk. Provisions for potential credit losses are maintained when necessary.

We have bank deposits that expose us to credit risk arising from possible default by the counterparty. We manage the risk by using credit-worthy financial institutions.

### ***Retained Risk***

For a description of our insurance coverage, including the risks retained by us related to our insurance policies, please read Item 4. Information on the Partnership Business Overview Risk of Loss, Insurance and Risk Management in our 2017 20-F.

## FORWARD-LOOKING STATEMENTS

This Report on Form 6-K contains certain forward-looking statements concerning future events and our operations, performance and financial condition and assumptions related thereto. Forward-looking statements include, without limitation, any statement that may predict, forecast, indicate or imply future results, performance or achievements, and may contain the words believe, anticipate, expect, estimate, project, will be, will continue, will likely result, intend or words or phrases of similar meanings. These statements involve known and unknown risks and are based upon a number of assumptions and estimates that are inherently subject to significant uncertainties and contingencies, many of which are beyond our control. Actual results may differ materially from those expressed or implied by such forward-looking statements. Forward-looking statements include statements with respect to, among other things:

market trends in the shuttle tanker or general tanker industries, including hire rates, factors affecting supply and demand, and opportunities for the profitable operations of shuttle tankers;

KNOT's and our ability to build shuttle tankers and the timing of the delivery and acceptance of any such vessels by their respective charterers;

forecasts of our ability to make or increase distributions on our common units and to make distributions on the Series A Preferred Units and the amount of any such distributions;

our ability to integrate and realize the expected benefits from acquisitions.

our anticipated growth strategies;

the effects of a worldwide or regional economic slowdown;

turmoil in the global financial markets;

fluctuations in currencies and interest rates;

fluctuations in the price of oil;

general market conditions, including fluctuations in hire rates and vessel values;

changes in our operating expenses, including drydocking and insurance costs and bunker prices;

our future financial condition or results of operations and future revenues and expenses;

the repayment of debt and settling of any interest rate swaps;

our ability to make additional borrowings and to access debt and equity markets;

planned capital expenditures and availability of capital resources to fund capital expenditures;

our ability to maintain long-term relationships with major users of shuttle tonnage;

our ability to leverage KNOT's relationships and reputation in the shipping industry;

our ability to purchase vessels from KNOT in the future;

our continued ability to enter into long-term charters, which we define as charters of five years or more;

our ability to maximize the use of our vessels, including the re-deployment or disposition of vessels no longer under long-term charter;

the financial condition of our existing or future customers and their ability to fulfill their charter obligations;

timely purchases and deliveries of newbuilds;

future purchase prices of newbuilds and secondhand vessels;

any impairment of the value of our vessels;

our ability to compete successfully for future chartering and newbuild opportunities;

acceptance of a vessel by its charterer;

termination dates and extensions of charters;

the expected cost of, and our ability to comply with, governmental regulations, maritime self-regulatory organization standards, as well as standard regulations imposed by our charterers applicable to our business;

availability of skilled labor, vessel crews and management;

our general and administrative expenses and fees and expenses payable under the technical management agreements, management and administration agreements and the administrative services agreement;

the anticipated taxation of KNOT Offshore Partners and distributions to our unitholders;

estimated future maintenance and replacement capital expenditures;

our ability to retain key employees;

customers' increasing emphasis on environmental and safety concerns;

potential liability from any pending or future litigation;

potential disruption of shipping routes due to accidents, political events, piracy or acts by terrorists;

future sales of our securities in the public market;

our business strategy and other plans and objectives for future operations; and

other factors listed from time to time in the reports and other documents that we file with the SEC. Forward-looking statements in this Report on Form 6-K are based upon management's current plans, expectations, estimates, assumptions and beliefs concerning future events impacting us and therefore involve a number of risks and uncertainties, including those risks discussed in this Form 6-K and our 2017 Form 20-F. New factors emerge from time to time, and it is not possible for us to predict all of these factors. Further, we cannot assess the impact of each such factor on our business or the extent to which any factor, or combination of factors, may cause actual results to be materially different from those contained in any forward-looking statement. We do not intend to release publicly any updates or revisions to any forward-looking statements contained herein to reflect any change in our expectations with respect thereto or any change in events, conditions or circumstances on which any such statement is based.

## EXHIBITS

The following exhibits are filed as part of this report:

### Exhibit

#### Number

#### Description

- |     |   |
|-----|---|
| 4.1 | Term Loan and Revolving Credit Facilities Agreement, dated September 4, 2018, among Knutsen Shuttle Tankers XII KS, Knutsen Shuttle Tankers 13 AS, Knutsen NYK Shuttle Tankers 16 AS, KNOT Shuttle Tankers 17 AS and KNOT Shuttle Tankers 18 AS, as borrowers, and the other parties thereto.   |
| 101 | The following financial information from KNOT Offshore Partners LP's Report on Form 6-K for the quarter ended June 30, 2018 formatted in XBRL (eXtensible Business Reporting Language):<br><br>(i) Unaudited Condensed Consolidated Statements of Operations for the Three and Six Months Ended June 30, 2018 and 2017;<br><br>(ii) Unaudited Condensed Consolidated Statements of Comprehensive Income for the Three and Six Months Ended June 30, 2018 and 2017;<br><br>(iii) Unaudited Condensed Consolidated Balance Sheets as of June 30, 2018 and December 31, 2017;<br><br>(iv) Unaudited Condensed Consolidated Statements of Changes in Partners' Capital for the Six Months Ended June 30, 2018 and the Year Ended December 31, 2017;<br><br>(v) Unaudited Condensed Consolidated Statements of Cash Flows for the Six Months Ended June 30, 2018 and 2017; and<br><br>(vi) Notes to Unaudited Condensed Consolidated Financial Statements. |

**SIGNATURE**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**KNOT OFFSHORE PARTNERS LP**

Date: September 4, 2018

By: /s/ John Costain

Name: John Costain  
Chief Executive Officer and Chief Financial  
Officer