

KNOT Offshore Partners LP
Form 6-K
June 29, 2015
[Table of Contents](#)

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
OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2015
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

(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 ☒

Table of Contents

KNOT OFFSHORE PARTNERS LP

REPORT ON FORM 6-K FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2015

Table of Contents

	Page
<u>Unaudited Condensed Consolidated and Combined Carve-Out Statements of Operations for the Three Months Ended March 31, 2015 and 2014</u>	3
<u>Unaudited Condensed Consolidated and Combined Carve-Out Statements of Comprehensive Income for the Three Months Ended March 31, 2015 and 2014</u>	4
<u>Unaudited Condensed Consolidated and Combined Carve-Out Balance Sheets as of March 31, 2015 and December 31, 2014</u>	5
<u>Unaudited Condensed Consolidated and Combined Carve-Out Statements of Changes in Partners' Capital for the Three Months Ended March 31, 2015 and 2014</u>	6
<u>Unaudited Condensed Consolidated and Combined Carve-Out Statements of Cash Flows for the Three Months Ended March 31, 2015 and 2014</u>	7
<u>Notes to Unaudited Condensed Consolidated and Combined Carve-Out Financial Statements</u>	8
<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	20
<u>Forward-Looking Statements</u>	30
<u>Exhibits</u>	32
<u>Signatures</u>	33
THIS REPORT ON FORM 6-K IS HEREBY INCORPORATED BY REFERENCE INTO THE REGISTRATION STATEMENT ON FORM F-3 (NO. 333-195976) ORIGINALLY FILED WITH THE SEC ON MAY 15, 2014.	

Table of Contents**KNOT OFFSHORE PARTNERS LP**

Unaudited Condensed Consolidated and Combined Carve-Out Statements of Operations

For the Three Months Ended March 31, 2015 and 2014

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

	Three Months Ended March 31, 2015 2014	
Operating revenues: (Notes 3 and 8)		
Time charter and bareboat revenues	\$ 36,071	\$ 21,766
Other income	149	8
Total revenues	36,220	21,774
Operating expenses: (Note 8)		
Vessel operating expenses	6,807	4,597
Depreciation	11,400	6,780
General and administrative expenses	1,068	1,043
Total operating expenses	19,275	12,420
Operating income	16,945	9,354
Finance income (expense): (Note 8)		
Interest income	1	1
Interest expense	(4,186)	(2,713)
Other finance expense	(20)	(221)
Realized and unrealized (loss) gain on derivative instruments (Note 4)	(5,623)	46
Net gain (loss) on foreign currency transactions	72	(24)
Total finance expense	(9,756)	(2,911)
Income before income taxes	7,189	6,443
Income tax expense (Note 7)	(3)	(19)
Net income	\$ 7,186	\$ 6,424
General partner's interest in net income	136	128
Limited partners' interest in net income	7,050	6,296
Earnings per unit: (Note 10)		
Common units (basic and diluted)	\$ 0.297	\$ 0.367
Subordinated units (basic and diluted)	\$ 0.345	\$ 0.368

Edgar Filing: KNOT Offshore Partners LP - Form 6-K

General partner units (basic and diluted)	\$ 0.297	\$ 0.367
Cash distributions declared and paid per unit (Note 10)	\$ 0.510	\$ 0.435

The accompanying notes are an integral part of the unaudited condensed consolidated and combined carve-out interim financial statements.

Table of Contents

KNOT OFFSHORE PARTNERS LP

Unaudited Condensed Consolidated and Combined Carve-Out Statements of Comprehensive Income

for the Three Months Ended March 31, 2015 and 2014

(U.S. Dollars in thousands)

	Three Months Ended March 31,	
	2015	2014
Net income	\$ 7,186	\$ 6,424
Other comprehensive income, net of tax		
Comprehensive income	\$ 7,186	\$ 6,424

The accompanying notes are an integral part of the unaudited condensed consolidated and combined carve-out interim financial statements.

Table of Contents**KNOT OFFSHORE PARTNERS LP**

Unaudited Condensed Consolidated and Combined Carve-Out Balance Sheets

As of March 31, 2015 and December 31, 2014

(U.S. Dollars in thousands)

	March 31, 2015	December 31, 2014
Assets		
Current assets:		
Cash and cash equivalents (Note 5)	\$ 32,746	\$ 30,746
Amounts due from related parties (Note 8)	173	130
Inventories	1,079	915
Other current assets	4,597	3,958
Total current assets	38,595	35,749
Long-term assets:		
Vessels and equipment:		
Vessels	1,131,253	1,131,321
Less accumulated depreciation and amortization	(120,847)	(109,464)
Vessels and equipment, net	1,010,406	1,021,857
Goodwill	6,217	6,217
Deferred debt issuance cost	3,683	3,959
Derivative assets (Notes 4 and 5)	370	2,966
Total assets	\$ 1,059,271	\$ 1,070,748
Liabilities and Partners Capital/Owners Equity		
Current liabilities:		
Trade accounts payable	\$ 1,743	\$ 1,869
Accrued expenses	3,812	2,735
Current portion of long-term debt (Notes 5 and 6)	38,718	38,718
Current portion of derivative liabilities (Notes 5 and 6)	8,967	7,450
Income taxes payable (Note 7)	137	362
Current portion of contract liabilities	1,518	1,518
Prepaid charter and deferred revenue	6,595	6,751
Amount due to related parties (Note 8)	401	628
Total current liabilities	61,891	60,031

Long-term liabilities:

Edgar Filing: KNOT Offshore Partners LP - Form 6-K

Long-term debt (Notes 5 and 6)	553,924	562,503
Derivative liabilities (Note 5)	483	
Contract liabilities	10,896	11,275
Deferred tax liabilities (Note 7)	1,293	1,402
Long-term debt from related parties (Note 6)	12,000	12,000
Other long-term liabilities	3,693	4,172
Total liabilities	644,180	651,383
Commitments and contingencies (Note 9)		
Equity:		
Partners' capital:		
Common unitholders	304,877	307,544
Subordinated unitholders	102,161	103,680
General partner interest	8,053	8,141
Total partners' capital	415,091	419,365
Total liabilities and equity	\$ 1,059,271	\$ 1,070,748

The accompanying notes are an integral part of the unaudited condensed consolidated and combined carve-out interim financial statements.

Table of Contents**KNOT OFFSHORE PARTNERS LP**

Unaudited Condensed Consolidated and Combined Carve-Out

Statements of Changes in Partners' Capital

for the Three Months Ended March 31, 2015 and 2014

(U.S. Dollars in thousands)

	Partners' Capital		Accumulated Other Comprehensive Income	Total Partners Capital
	Common Units	Subordinated Units	General Partner	
Consolidated balance at December 31, 2013	\$ 168,773	\$ 107,857	\$ 5,297	\$ 281,927
Net income	3,143	3,153	128	6,424
Other comprehensive income				
Cash distributions (1)	(3,727)	(3,737)	(152)	(7,616)
Consolidated balance at March 31, 2014	168,189	107,273	5,273	280,735
Consolidated balance at December 31, 2014	307,544	103,680	8,141	419,365
Net income	4,098	2,952	136	7,186
Other comprehensive income				
Cash Distribution(1)	(6,765)	(4,471)	(224)	(11,460)
Consolidated balance at March 31, 2015	\$ 304,877	\$ 102,161	\$ 8,053	\$ 415,091

(1) This includes cash distributions to holders of the incentive distribution rights (IDRs) for the three months ended March 31, 2015 and 2014.

The accompanying notes are an integral part of the unaudited condensed consolidated and combined carve-out interim financial statements.

Table of Contents**KNOT OFFSHORE PARTNERS LP**

Unaudited Condensed Consolidated and Combined Carve-Out Statements of Cash Flows

for the Three Months Ended March 31, 2015 and 2014

(U.S. Dollars in thousands)

	Three Months Ended March 31,	
	2015	2014
Cash flows provided by operating activities:		
Net income	\$ 7,186	\$ 6,424
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation	11,400	6,780
Amortization of contract intangibles / liabilities	(379)	(379)
Amortization of deferred revenue	(479)	(107)
Amortization of deferred debt issuance cost	284	279
Income tax expense	3	19
Income taxes paid	(214)	
Unrealized loss (gain) on derivative instruments	4,597	(99)
Unrealized loss on foreign currency transactions	15	44
Other items		33
Changes in operating assets and liabilities		
(Increase) decrease in amounts due from related parties	(43)	(114)
(Increase) decrease in inventories	(164)	(80)
(Increase) decrease in other current assets	(639)	(349)
(Decrease) increase in trade accounts payable	(130)	(171)
Increase in accrued expenses	1,077	63
Decrease in prepaid revenue	(156)	(58)
Decrease in amounts due to related parties	(227)	(70)
Net cash provided by operating activities	22,131	12,215
Cash flows from investing activities:		
Disposals to vessel and equipment	52	80
Net cash provided by investing activities	52	80
Cash flows from financing activities:		
Accumulated interest expense on long-term debt from related parties		263
Repayment of long-term debt	(8,579)	(7,397)
Payments of debt issuance cost	(8)	
Cash distribution	(11,460)	(7,616)
Change in restricted cash		(998)

Net cash used in financing activities	(20,047)	(15,748)
Effect of exchange rate changes on cash	(136)	(45)
Net increase (decrease) in cash and cash equivalents	2,000	(3,498)
Cash and cash equivalents at the beginning of the year	30,746	28,836
Cash and cash equivalents at the end of the year	\$ 32,746	\$ 25,338

The accompanying notes are an integral part of the unaudited condensed consolidated and combined carve-out interim financial statements.

Table of Contents**KNOT OFFSHORE PARTNERS LP****Notes to Unaudited Condensed Consolidated and Combined Carve-Out 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 March 31, 2015, the Partnership had a fleet of eight shuttle tankers, the *Windsor Knutsen*, the *Bodil Knutsen*, the *Recife Knutsen*, the *Fortaleza Knutsen*, the *Carmen Knutsen*, the *Hilda Knutsen*, the *Torill Knutsen*, and the *Dan Cisne*, each referred to as a Vessel and, collectively, as the Vessels. The Vessels operate under fixed long-term charter contracts to charterers, except for the *Windsor Knutsen*. In April 2014, the Partnership was notified that BG Group Plc (BG Group) would not exercise its option to extend the *Windsor Knutsen* time charter after the expiration of its initial term. In July 2014, the vessel was re-delivered. In June 2014, the Partnership entered into a new two-year time charter contract, which was subsequently amended in June 2015, with BG Group for the *Windsor Knutsen* that will commence in the fourth quarter of 2015. The time charter with BG Group has six one-year extension options. Prior to the commencement of its time charter with BG Group, the *Windsor Knutsen* will be employed under a time-charter with KNOT. The time charter for the *Bodil Knutsen* expires in 2016 and contains customer options for extension through 2019. 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 2018 and contains customer options for extension through 2021. The time charters for the *Hilda Knutsen* and the *Torill Knutsen* each expire in 2018 and contain a customer option for extension through 2023. The *Dan Cisne* is under a bareboat charter contract that expires in 2023.

2) Summary of Significant Accounting Policies**(a) Basis of Preparation**

The accompanying unaudited condensed consolidated and combined carve-out 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. All intercompany balances and transactions are eliminated. The unaudited condensed consolidated and combined carve-out 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 and combined carve-out financial statements should be read in conjunction with the audited consolidated and combined carve-out financial statements for the year ended December 31, 2014, which are included in the Partnership's Annual Report on Form 20-F (the 20-F).

Under the Partnership's First 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 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, KNOT, as the owner of the General Partner, no longer retains 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 will not account for any vessel acquisitions from KNOT after June 25, 2013 as a transfer of equity interests between entities under common control.

In June 2014 and December 2014, the Partnership acquired from KNOT a 100% interest in the subsidiaries that own and operate the *Hilda Knutsen* and the *Torill Knutsen*, and the *Dan Cisne*, respectively. Accordingly, the results of these acquisitions are consolidated into the Partnership's results from the respective dates of their acquisition. The Partnership accounted for these acquisitions as an acquisition of a business.

(b) Significant accounting policies

The accounting policies adopted in the preparation of the unaudited condensed consolidated and combined carve-out interim financial statements are consistent with those followed in the preparation of the Partnership's audited consolidated and combined carve-out financial statements for the year ended December 31, 2014, as contained in the Partnership's 20-F.

(c) Accounting pronouncement not yet adopted

In May 2014, the Financial Accounting Standards Board (or FASB) and the International Accounting Standards Board (IASB) issued a comprehensive revenue recognition standard that will supersede existing revenue guidance under US GAAP and IFRS, Accounting Standards Update 2014-09, *Revenue from Contracts with Customers*, (or ASU 2014-09) for U.S. GAAP. ASU 2014-09 will require an entity to recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This update creates a five-step model that requires an entity to exercise judgment when

Table of Contents

considering the terms of the contract(s) which include (i) identifying the contract(s) with the customer, (ii) identifying the separate performance obligations in the contract, (iii) determining the transaction price, (iv) allocating the transaction price to the separate performance obligations, and (v) recognizing revenue when each performance obligation is satisfied. ASU 2014-09 is effective for interim and annual periods beginning after December 15, 2016 and shall be applied retrospectively to each period presented or as a cumulative-effect adjustment as of the date of adoption. Early adoption is not permitted under U.S. GAAP. The Partnership is evaluating the effect of adopting this new accounting guidance.

In August 2014, FASB issued Presentation of Financial Statements – Going Concern (Subtopic 205-40), *Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern* (ASU 2014-15). ASU 2014-15 requires management to evaluate whether there are conditions and events that raise substantial doubt about the entity's ability to continue as a going concern within one year after the financial statements are issued (or available to be issued when applicable) and, if so, disclose that fact. Management will be required to make this evaluation for both annual and interim reporting periods, if applicable. Management also is required to evaluate and disclose whether its plans alleviate that doubt. The standard is effective for annual periods after December 15, 2016 and interim periods within annual periods beginning after December 15, 2016. Early adoption is permitted. The Partnership is evaluating the effect of adopting this new accounting guidance. The Partnership does not expect the adoption of this standard to have a material impact on the consolidated and combined financial statements.

In April 2015, the FASB issued ASU 2015-03, Interest – Imputation of Interest (Subtopic 835-30): *Simplifying the Presentation of Debt Issuance Costs*. ASU 2015-03 requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. For KNOT Offshore Partners LP as a public business entity, the guidance is effective for annual and interim periods beginning after 15 December 2015. Early adoption is permitted. The Partnership has not yet adopted ASU 2015-03, Interest – Imputation of Interest (Subtopic 835-30): *Simplifying the Presentation of Debt Issuance Costs*. The adoption of the new standard will have an impact on the balance sheets and reduce total assets and total liabilities. Also the implementation will be applied retrospectively.

Table of Contents**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. At March 31, 2015, the Partnership's fleet consisted of eight vessels and operated under five time charters and three bareboat charters. At March 31, 2014, the Partnership's fleet consisted of five vessels and operated under three time charters and two 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 percentage of consolidated and combined revenues for customers that accounted for more than 10% of the Partnership's consolidated and combined revenues during the three months ended March 31, 2015 and 2014. All of these customers are subsidiaries of major international oil companies, except KNOT, which is currently chartering the *Windsor Knutsen* until she is delivered to BG Group in fourth quarter of 2015.

(U.S. Dollars in thousands)	Three Months Ended March 31,			
	2015		2014	
Fronape International Company, a subsidiary of Petrobras Transporte S.A.	\$ 8,676	24%	\$ 6,224	29%
Eni Trading and Shipping S.p.A	11,504	32%		
Statoil ASA	5,698	16%	5,466	25%
Repsol Sinopec Brasil, S.A., a subsidiary of Repsol Sinopec Brasil, B.V.	5,015	14%	5,015	23%
Brazil Shipping I Limited, a subsidiary of BG Group Plc			5,061	23%
Knutsen NYK Offshore Tankers AS (Guarantee)	5,178	14%		

4) Derivative Instruments

The unaudited condensed consolidated and combined carve-out 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 vessel construction or conversions. 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 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 March 31, 2015, the Partnership had entered into various interest swap agreements for a total notional amount of \$382.3 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 1.47%.

As of March 31, 2015 and December 2014, 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 \$382.3 million and \$382.3 million, respectively. As of March 31, 2015 and December 31, 2014, the carrying amount of the interest rate swaps contracts were net liabilities of \$4.8 million and \$1.7 million. See Note 5 Fair Value Measurements.

Table of Contents

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. The Partnership's predecessor also from time to time contracted vessels with contractual obligations to pay the yards in currencies other than the U.S. Dollar. 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 March 31, 2015 and December 31, 2014, 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 127.9 million and NOK 127.9 million, respectively. As of March 31, 2015 and December 31, 2014, the carrying amount of the Partnership's foreign exchange forward contracts was a liability of \$4.3 million and \$2.7 million, respectively. See Note 5 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 months ended March 31, 2015 and 2014:

<i>(U.S. Dollars in thousands)</i>	Three Months Ended March 31,	
	2015	2014
Realized gain (loss)		
Interest rate swap contracts	\$ (1,026)	\$ (554)
Foreign exchange forward contracts		252
Unrealized gain (loss)		
Interest rate swap contracts	(3,075)	348
Foreign exchange forward contracts	(1,522)	
Total realized and unrealized (loss) gain	\$ (5,623)	\$ 46

5) 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 March 31, 2015 and December 31, 2014. 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.

<i>(U.S. Dollars in thousands)</i>	March 31, 2015 Fair Value	December 31, 2014 Fair Value
------------------------------------	--------------------------------------	---

	Carrying Amount		Carrying Amount	
Financial assets:				
Cash and cash equivalents	\$ 32,746	\$ 32,746	\$ 30,746	\$ 30,746
Non-current derivative assets:				
Interest rate swap contracts	370	370	2,966	2,966
Financial liabilities:				
Current derivative liabilities:				
Interest rate swap contracts	4,703	4,703	4,708	4,708
Foreign exchange forward contract	4,264	4,264	2,742	2,742
Non-current derivative liabilities:				
Interest rate swap contracts	483	483		
Long-term debt, current and non-current	604,642	604,642	613,221	613,221

The carrying amounts shown in the table above are included in the consolidated and combined carve-out balance sheets under the indicated captions. The carrying value of trade accounts receivable, trade accounts payable and receivables/payables to owners and affiliates approximate their fair value.

Table of Contents

The fair values of the financial instruments shown in the above table as of March 31, 2015 and December 31, 2014 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.

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.

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.

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. As all long-term debt of the Partnership was refinanced in the period from June 2014 to November 2014, the fair value is based on the margin obtained in the refinancing and therefore the fair value equals the carrying value as of March 31, 2015 and December 31, 2014.

(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 March 31, 2015 and December 31, 2014:

(U.S. Dollars in thousands)	Fair Value Measurements at Reporting Date Using			
	March 31, 2015	Quoted Price in Active Markets for Identical	Significant Other Observable Inputs	Significant Unobservable Inputs (Level

		Assets (Level 1)	(Level 2)	3)
Financial assets:				
Cash and cash equivalents	\$ 32,746	\$ 32,746	\$	\$
<i>Non-current derivative assets:</i>				
Interest rate swap contracts	370		370	
Financial liabilities:				
<i>Current derivative liabilities:</i>				
Interest rate swap contracts	4,703		4,703	
Foreign exchange forward contracts	4,264		4,264	
<i>Non-current derivative liabilities:</i>				
Interest rate swap contracts	483		483	
Long-term debt, current and non-current	604,642		604,642	

Table of Contents

		Fair Value Measurements at Reporting Date Using		
		Quoted Price in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
(U.S. Dollars in thousands)	December 31, 2014			
Financial assets:				
Cash and cash equivalents	\$ 30,746	\$ 30,746	\$	\$
<i>Non-current derivative assets:</i>				
Interest rate swap contracts	2,966		2,966	
Financial liabilities:				
<i>Current derivative liabilities:</i>				
Interest rate swap contracts	4,708		4,708	
Foreign exchange forward contracts	2,742		2,742	
<i>Non-current derivative liabilities:</i>				
Interest rate swap contracts				
Long-term debt, current and non-current	613,221		613,221	

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 March 31, 2015 and December 31, 2014.

6) Long-Term Debt

As of March 31, 2015 and December 31, 2014, the Partnership had the following debt amounts outstanding:

(U.S. Dollars in thousands)	Vessel	March 31, 2015	December 31, 2014
\$220 million loan facility	<i>Windsor Knutsen, Bodil Knutsen,</i>		
	<i>Carmen Knutsen</i>	\$ 208,214	\$ 212,142
\$20 million revolving credit facility	<i>Windsor Knutsen, Bodil Knutsen,</i>		
	<i>Carmen Knutsen</i>	20,000	20,000
\$140 million loan facility	<i>Fortaleza Knutsen & Recife Knutsen</i>	133,438	135,625
\$117 million loan facility	<i>Hilda Knutsen</i>	85,492	86,724
\$117 million loan facility	<i>Torill Knutsen</i>	86,728	87,960
\$58.8 million loan facility	<i>Dan Cisne</i>	58,770	58,770
\$12.0 million Seller's Credit		12,000	12,000
Total long-term debt		604,642	613,221
Less current installments		38,718	38,718
Less \$12.0 million Seller's Credit		12,000	12,000

Long-term debt, excluding current installments and Seller's Credit	\$ 553,924	\$ 562,503
--	------------	------------

The Partnership's outstanding debt of \$604.6 million as of March 31, 2015 is repayable as follows:

<i>(US \$ in thousands)</i>	Period repayment	Balloon repayment
Remainder of 2015	\$ 30,139	\$
2016	39,018	
2017	39,318	
2018	38,387	136,500
2019	18,132	269,678
2020 and thereafter	27,000	6,470
Total	\$ 191,994	\$ 412,648

As of March 31, 2015, the interest rates on the Partnership's loan agreements were LIBOR plus a fixed margin ranging from 2.125% to 4.5%.

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 secured loan facility in an aggregate amount of \$240 million (the Senior Secured Loan Facility). The Senior Secured Loan Facility consists of (i) a \$220 million term loan (the Term Loan Facility) and (ii) a \$20 million revolving credit facility (the Revolving Credit Facility). In June 2014, the Partnership's subsidiary Knutsen Shuttle Tankers XII AS entered into a senior secured loan facility in the amount of \$140 million (the New Fortaleza and Recife Facility). The New Fortaleza and Recife Facility was drawn in November 2014. The \$117 million secured loan facility (the Hilda Facility) was entered into in 2011 in connection with financing the building of *Hilda Knutsen*. In connection with the Partnership's acquisition of Knutsen Shuttle Tankers 14 AS, the company that owns the *Hilda Knutsen*, on June 30, 2014, the

Table of Contents

\$117 million senior secured loan facility was amended prior to the acquisition. The \$117 million secured loan facility (the *Torill Facility*) was entered into in 2011 in connection with financing the building of *Torill Knutsen*. In connection with the Partnership's acquisition of Knutsen Shuttle Tankers 14 AS, the company that owns the *Torill Knutsen*, on June 30, 2014, the \$117 million senior secured loan facility was amended prior to the acquisition. In April 2014, KNOT's 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 purchase of the vessels from J. Lauritzen. In connection with the Partnership's acquisition of KNOT Shuttle Tankers 20 AS, the company that owns the *Dan Cisne*, in December 2014, the \$172.5 million senior secured loan facility was split into a tranche which was related to the *Dan Cisne* of \$58.8 million (the *Dan Cisne Facility*). The Partnership and KNOT Shuttle Tankers AS have guaranteed the facilities listed above. As of March 31, 2014, the Borrowers and the Partnership were in compliance with all covenants under the facilities listed above.

As part of the financing for the purchase of the *Dan Cisne*, KNOT provided a \$12.0 million Seller's Credit that was guaranteed by the Partnership. The acquisition was completed on December 15, 2014.

7) 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 Norwegian Tonnage Tax regime (the tonnage tax regime). The consequence of the reorganization was a one-time entrance tax into the Norwegian 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 and combined carve-out 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 effected by the change in tax rate which was reduced to 27 % in 2014 from 28 % in 2013 and the fluctuation in currency rates. Approximately \$0.6 million of the estimated entrance tax was paid during 2014 and \$0.2 million was paid during first quarter of 2015, and approximately \$0.1 million is estimated to be payable in the second quarter of 2015 and is presented as income taxes payable, while \$1.3 million is presented as non-current deferred taxes payable.

Profit and loss from continuing operation before income taxes was taxable to Norway and significant components of current and deferred income tax expense attributable to income from continuing operations for the three months ended March 31, 2015 and 2014 as follows:

(U.S. Dollars in thousands, except tax rate)	Three Months Ended, March 31,	
	2015	2014
Income before income taxes	\$ 7,189	\$ 6,443
Income tax expense	(3)	(19)

Effective tax rate	0%	0%
--------------------	----	----

A valuation allowance for deferred tax assets is recorded when it is more likely than not that some of or all of the benefit from the deferred tax assets will not be realized. The valuation allowances relate to the financial loss carry forwards and other deferred tax assets for tonnage tax that, in the judgment of the Partnership, are more-likely-than-not to be realized reflecting the Partnership's cumulative loss position for tonnage tax. In assessing the realizability of deferred tax assets, 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, and there are no deferred tax assets recognized as of March 31, 2015 and December 31, 2014.

Table of Contents**8) Related Party Transactions****(a) Related Parties**

Net expenses (income) from related parties included in the unaudited condensed consolidated and combined carve-out statements of operations for the three months ended March 31, 2015 and 2014 are as follows:

(U.S. Dollars in thousands)	Three Months Ended March 31,	
	2015	2014
Statements of operations:		
<i>Time charter and bareboat revenues:</i>		
Charter revenues from KNOT (1)	\$ 5,178	\$
<i>Operating expenses:</i>		
Technical and operational management fee from KNOT to Vessels (2)	584	329
<i>General and administrative expenses:</i>		
Administration fee from KNOT (3)	187	161
Administration fee from KOAS (3)	84	107
Administration fee from KOAS UK (3)	37	37
Administration and management fee from KNOT (4)	35	22
Accounting service fee from KNOT (5)		25
<i>Finance income (expense):</i>		
Interest expense charged from KNOT (6)	(146)	(128)
Total income (expenses)	\$ 4,105	\$ (809)

- (1) *Charter revenue from KNOT*: Pursuant to the Omnibus Agreement, KNOT agreed to guarantee the payments of the hire rate under the initial charters of each of the *Bodil Knutsen* and the *Windsor Knutsen* for a period of five years from the closing date of the IPO. BG Group, the charterer of the *Windsor Knutsen*, did not exercise its option to extend the *Windsor Knutsen* time charter after the expiration of its initial term, and 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 BG Group time charter. See Note 8(b) Related Party Transactions Guarantees and Indemnifications.
- (2) *Technical and operational management fee from KNOT to Vessels*: KNOT provides technical and operational management of the vessels on time charter including crewing, purchasing, maintenance and other operational services. In addition, there is also a charge for 24-hour emergency response services provided by KNOT for all vessels managed by KNOT.
- (3) *Administration fee from KNOT and Knutsen OAS Shipping AS (KOAS) and Knutsen OAS (UK) Ltd. (KOAS UK)*: Administration costs include the compensation and benefits of KNOT management and administrative staff as well as other general and administration expenses. Net administration costs are total administration cost plus a 5% margin, reduced for the total fees for services delivered by the administration staffs (the accounting service fees (see (5) below).
- (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 expense. For the bareboat vessels the shipowner has administration and management agreement with KNOT for general monitoring and follow up of the vessels.

- (5) *Accounting service fee from KNOT:* KNOT invoiced each subsidiary a fixed fee for the preparation of the statutory financial statements.
- (6) *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.

(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 *Bodil Knutsen* and the *Windsor Knutsen* for a period of five years from the closing date of the IPO.

In April 2014, the Partnership was notified that BG Group 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 BG Group time charter. This charter will be effective until the new BG Group time charter commences in the fourth quarter of 2015.

Under the Omnibus Agreement, KNOT has agreed to indemnify the Partnership until April 15, 2018, 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.

In addition, pursuant to the Omnibus Agreement, KNOT agreed to indemnify the Partnership for any defects in title to certain assets contributed or sold to the Partnership and any failure to obtain, prior to April 15, 2013, certain consents and permits necessary to conduct the Partnership's business, which liabilities arise within three years after the closing of the IPO on April 15, 2013.

(c) Transactions with Management and Directors

See Note 8(a) for a discussion of the allocation principles for KNOT's administrative costs, including management and administrative staff, included in the consolidated and combined carve-out statements of operations.

Table of Contents***(d) Amounts Due from (to) Related Parties***

Balances with related parties consisted of the following:

<i>(U.S. Dollars in thousands)</i>	At March 31, 2015	At December 31, 2014
Balance Sheets:		
Trading balances due from KOAS	\$	\$ 77
Trading balances due from KNOT and affiliates	172	53
Trading balances due from TSSI and affiliates	1	
 Amount due from related parties	 \$ 173	 \$ 130
 Trading balances due to KOAS	 \$ 344	 \$ 423
Trading balances due to KNOT and affiliates	56	205
Trading balances due to TSSI	1	
 Amount due to related parties	 \$ 401	 \$ 628

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 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>	At March 31, 2015	At December 31, 2014
Balance Sheets:		
Trading balances due to KOAS	\$ 146	\$ 792
Trading balances due to KNOT and affiliates	190	241
 Trade accounts payables to related parties	 \$ 336	 \$ 1,033

9) Commitments and Contingencies***Assets Pledged***

As of March 31, 2015 and December 31, 2014, Vessels with a book value of \$1,010 million and \$1,022 million, respectively, were pledged as security held as guarantee for the Partnership's long-term debt and interest rate swap obligations. See Note 4 Derivative Instruments and Note 6 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 and combined carve-out 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 \$0.150 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.

Table of Contents**10) Earnings per Unit and Cash Distributions**

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

	Three Months Ended March 31,	
<i>(U.S. Dollars in thousands)</i>	2015	2014
Post IPO net income attributable to the partners of KNOT Offshore Partners LP	7,186	6,424
Less: Distribution paid (2)	12,053	7,616
Under (over) distributed earnings	\$ (4,867)	\$ (1,192)
Under (over) distributed earnings attributable to:		
Common unitholders	(2,944)	(584)
Subordinated unitholders	(1,826)	(584)
General Partner	(97)	(24)
Weighted average units outstanding (basic and diluted) (in thousands):		
Common unitholders	13,808	8,568
Subordinated unitholders	8,568	8,568
General Partner	457	350
Earnings per unit (basic and diluted):		
Common unitholders	0.297	0.367
Subordinated unitholders (3)	0.345	0.368
General Partner	0.297	0.367
Cash distributions declared and paid in the period per unit (4)	0.490	0.435
Subsequent event: Cash distributions declared and paid per unit relating to the period (5)	0.510	0.435

- (1) Earnings per unit have been calculated in accordance with the cash distribution provisions set forth in the Partnership's 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 March 31, 2015 and 2014 of \$0.4 million and of \$0.0 million, respectively.
- (3) This includes the net income attributable to the IDR holder. The IDRs generally may not be transferred by KNOT until March 31, 2018. The net income attributable to IDRs for the three months ended March 31, 2015 and 2014 is \$0.4 million and \$0.0 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 March 31, 2015, 60.5% of the Partnership's total number of units outstanding representing limited partner interests were held by the public (in the form of 13,807,500 common units, representing 100% of the Partnership's common units) and 37.5% of such units were held by KNOT (in the form of 8,567,500 subordinated units, representing 100% of the Partnership's subordinated units). In addition, KNOT, through its ownership of the General Partner, held the 2% general partner interest (in the form of 456,633 general partner units).

Earnings per unit are determined by dividing net income by the weighted-average number of units outstanding during the applicable period. The General Partner's, common unitholders' and subordinated unitholders' interest in net income are 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 Partnership's board of directors to provide for the proper conduct of the Partnership's business, including reserves for maintenance and replacement capital expenditures and anticipated capital requirements. In addition, KNOT, as the initial holder of all IDRs, has the right, at the time when there are no subordinated units outstanding and 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.

Under the Partnership Agreement, during the subordination period, the common units will have the right to receive distributions of available cash from operating surplus in an amount equal to the minimum quarterly distribution of \$0.375 per unit per quarter, plus arrearages in the payment of the minimum quarterly distribution on the common units from prior quarters, before any distributions of available cash from operating surplus may be made on the subordinated units.

Distributions of available cash from operating surplus will be made in the following manner for any quarter during the subordination period:

first, 98.0% to the common unitholders, pro rata, and 2.0% to the General Partner, until each outstanding common unit has received a minimum quarterly distribution of \$0.375;

second, 98.0% to the common unitholders, pro rata, and 2.0% to the General Partner, until each outstanding common unit has received an amount equal to any arrearages in payment of the minimum quarterly distribution on the common units for prior quarters during the subordination period; and

Table of Contents

third, 98.0% to the subordinated unitholders, pro rata, and 2.0% to the General Partner until each subordinated unit has received a minimum quarterly distribution of \$0.375.

In addition, KNOT currently holds all of the IDRs in the Partnership. IDRs represent the rights to receive an increasing percentage of quarterly distributions of available cash from operating surplus after the minimum quarterly distribution and the target distribution levels have been achieved.

If for any quarter:

the Partnership has distributed available cash from operating surplus to the common and subordinated unitholders in an amount equal to the minimum quarterly distribution; and

the Partnership has distributed available cash from operating surplus on outstanding common units in an amount necessary to eliminate any cumulative arrearages in payment of the minimum quarterly distribution. then, the Partnership will distribute any additional available cash from operating surplus for that quarter among the unitholders and the General Partner in the following manner:

first, 98.0% to all unitholders, pro rata, and 2.0% to the General Partner, until each unitholder receives a total of \$0.43125 per unit for that quarter (the first target distribution);

second, 85.0% to all unitholders, pro rata, 2.0% to the General Partner and 13.0% to the holders of the IDRs, pro rata, until each unitholder receives a total of \$0.46875 per unit for that quarter (the second target distribution);

third, 75.0% to all unitholders, pro rata, 2.0% to the General Partner and 23.0% to the holders of the IDRs, pro rata, until each unitholder receives a total of \$0.5625 per unit for that quarter (the third target distribution); and

thereafter, 50.0% to all unitholders, pro rata, 2.0% to the General Partner and 48.0% to the holders of the IDRs, pro rata.

In each case, the amount of the target distribution set forth above is exclusive of any distributions to common unitholders to eliminate any cumulative arrearages in payment of the minimum quarterly distribution. The percentage interests set forth above assume that the General Partner maintains its 2.0% general partner interest and that the Partnership does not issue additional classes of equity securities.

11) Equity Offerings

On June 27, 2014, the Partnership completed the sale of 4,600,000 common units, representing limited partner interests, in an underwritten public offering. In connection with the offering, the Partnership granted the underwriters a 30-day option to purchase an additional 690,000 common units. In connection with this closing, General Partner contributed \$2.7 million in order to maintain its 2% general partner interest in the Partnership.

In connection with the partial exercises by the underwriters of their option to purchase additional common units, on July 14, 2014 and July 24, 2014, the Partnership issued and sold 150,000 common units and 490,000 common units, respectively, and the General Partner made an additional \$0.4 million aggregate capital contribution to the Partnership in order to maintain its 2% general partner interest in the Partnership. The Partnership's total net proceeds from the public offering and the related General Partner's contribution were \$146.7 million. Following this offering, KNOT's ownership interest in the Partnership (including the General Partner's interest) was 39.5%.

The Partnership used the net proceeds from the offering and related capital contribution by the General Partner to fund the cash portion of the purchase prices of the *Hilda Knutsen* and the *Torill Knutsen* and for general partnership purposes.

The following table shows the movement in the number of common units, subordinated units and general partner units from the time of the IPO until March 31, 2015.

(in units)	Common Units	Subordinated Units	General Partner Units
April 2013, Initial Public Offering (IPO)	8,567,500	8,567,500	349,694
December 31, 2013	8,567,500	8,567,500	349,694
June 2014	4,600,000		93,877
July 2014	640,000		13,062
December 31, 2014	13,807,500	8,567,500	456,633
March 31, 2015	13,807,500	8,567,500	456,633

12) Subsequent Events

The Partnership has evaluated subsequent events from the balance sheet date through June 29, 2015, the date at which the unaudited condensed consolidated and combined carve-out financial statements were available to be issued, and determined that there are no other items to disclose, except as follows:

Table of Contents

On May 14, 2015, the Partnership paid a quarterly cash distribution of \$0.51 per unit with respect to the quarter ended March 31, 2015. The aggregate amount of the paid distribution was \$12.1 million.

On June 2, 2015, the Partnership completed the sale of 5,000,000 common units, representing limited partner interests, in an underwritten public offering (the June 2015 Offering). In connection with the June 2015 Offering, the General Partner contributed a total of \$2.4 million in order to maintain its 2% general partner interest in the Partnership. The Partnership's total net proceeds from the June 2015 Offering and the related General Partner's contribution were \$116.3 million. The Partnership used the net proceeds from the offering and related capital contribution by the General Partner to fund the cash portion of the purchase price of the *Dan Sabia* and to repay the \$20.0 million revolving credit facility, the \$12.0 million Seller's Credit and \$7.5 million of the Dan Sabia facility, as described below. The remainder of the net proceeds will be available for general partnership purposes.

On June 15, 2015, the Partnership's wholly owned subsidiary, KNOT Shuttle Tankers AS, completed its acquisition of all of the interests in Knutsen Shuttle Tanker 21 AS, which owns and operates the *Dan Sabia*, from KNOT for a purchase price of \$103.0 million, net of \$64.5 million of outstanding indebtedness related to the vessel. The Partnership funded the cash portion of the purchase price with net proceeds from the June 2015 Offering.

On June 15, 2015 the Partnership repaid the \$12.0 million Seller's Credit and \$7.5 million of the Dan Sabia facility with a portion of the net proceeds from the June 2015 Offering.

On June 23, 2015, the Partnership repaid the revolving credit facility of \$20.0 million with a portion of the net proceeds from the June 2015 Offering.

Table of Contents

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

Unless the context otherwise requires, references in this report to the Predecessor, the Partnership, we, our, us terms, when used in a historical context (periods prior to April 15, 2013), refer to our predecessor for accounting purposes. References when used in the present tense or prospectively (after April 15, 2013), refer to KNOT Offshore Partners LP and its subsidiaries, also referred to as the Partnership or we. 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 30 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 and combined carve-out financial statements for the interim periods presented elsewhere in this report, as well as our historical consolidated and combined carve-out financial statements and notes thereto included in our Annual Report on Form 20-F for the year ended December 31, 2014 (the 2014 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 retains 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 will not account 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 offshore 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, or TSSI, and Nippon Yusen Kaisha, or 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 March 31, 2015, we have a modern fleet of eight shuttle tankers that operate under long-term 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

Dan Sabia Acquisition

On June 15, 2015, the Partnership's wholly owned subsidiary, KNOT Shuttle Tankers AS, completed its acquisition of all of the interests in Knutsen Shuttle Tanker 21 AS, which owns and operates the *Dan Sabia*, from KNOT for a purchase price of \$103.0 million, net of \$64.5 million of outstanding indebtedness related to the vessel. The Partnership funded the cash portion of the purchase price with net proceeds from the June 2015 Offering described below.

Equity Offering

On June 2, 2015, the Partnership completed the sale of 5,000,000 common units, representing limited partner interests, in an underwritten public offering (the June 2015 Offering). In connection with the June 2015 Offering, the General Partner contributed a total of \$2.4 million in order to maintain its 2% general partner interest in the Partnership. The Partnership's total net proceeds from the June 2015 Offering and the related General Partner's contribution were \$116.3 million. The Partnership used the net proceeds from the offering and related capital contribution by the General Partner to fund the cash portion of the purchase price of the *Dan Sabia* and to repay the \$20.0 million revolving credit facility, the \$12.0 million Seller's Credit related to the acquisition of the *Dan Cisne* and \$7.5 million of the *Dan Sabia* facility. The remainder of the net proceeds will be available for general partnership purposes.

Windsor Knutsen Charter Amendment

In April 2014, the Partnership was notified that BG Group Plc (BG Group) would not exercise its option to extend the *Windsor Knutsen* time charter after the expiration of its initial term. In July 2014, the vessel was re-delivered. In June 2014, the Partnership entered into a new two-year time charter contract, which was subsequently amended in June 2015 (the June 2015 Amendment), with BG Group for the *Windsor Knutsen* that will commence in the fourth quarter of 2015. The June 2015 Amendment, among other things, provides that BG Group will have three more one-year extension options, in addition to its existing three one-year extension options (for a total of six one-year extension options), and reduces

Table of Contents

the time charter rate for the initial term of the charter by 3.4%. As a result of the June 2015 Amendment, the Partnership estimates that the next drydocking of the *Windsor Knutsen* will take place in the first half of 2017, instead of the previously estimated August or September of 2015. KNOT's agreement to compensate the Partnership for any difference between the original time charter rate and the new time charter rate pursuant to the Omnibus Agreement will remain in effect until April 2018.

Cash Distributions

On February 13, 2015, we paid a quarterly cash distribution of \$0.49 per unit with respect to the quarter ended December 31, 2014. This cash distribution amounted to \$11.5 million.

On May 14, 2015, we paid a quarterly cash distribution of \$0.51 per unit with respect to the quarter ended March 31, 2015. This cash distribution amounted to \$12.1 million.

Changes in Board and Management

On May 7, 2015, John Costain resigned from our board of directors. On June 1, 2015, Mr. Costain became our Chief Executive Officer and Chief Financial Officer. On May 7, 2015, Simon Bird was appointed by the remaining elected directors to replace Mr. Costain as the Class III elected director to serve until the annual meeting of unitholders in 2016. On May 7, 2015, Mr. Edward Waryas was appointed chairman of the conflicts committee and Mr. Hans Petter Aas was appointed as a member of the conflicts committee. Mr. Aas was also appointed chairman of the audit committee and Mr. Waryas was appointed as a new member of the audit committee in addition to the existing member, Mr. Andrew Beveridge.

Mr. Simon Bird has served as the Chief Executive of Bristol Port Company since 2000. From 1997 to 1999, Mr. Bird served as Commercial Director at Mersey Docks & Harbour Company plc. From 1995 to 1997, he was Joint Managing Director and Executive Director at International Water Ltd. Prior to 1995, Mr. Bird held various positions at British Aerospace plc, Thorn EMI plc, Philips, the Royal Navy and Her Majesty's Diplomatic Service. Mr. Bird is also a director of Bristol Bulk Company, the chairman of UK Major Ports Group, a vice chairman of Maritime UK and a member of the Strategic Advisory Group of the Royal Navy.

Table of Contents**Results of Operations****Three Months Ended March 31, 2015 Compared with the Three Months Ended March 31, 2014**

(US \$ in thousands)	Three Months Ended March 31,		Change	% Change
	2015	2014		
Time charter and bareboat revenues	\$ 36,071	\$ 21,766	\$ 14,305	66%
Other income	149	8	141	1,763%
Vessel operating expenses	6,807	4,597	2,210	48%
Depreciation	11,400	6,780	4,620	68%
General and administrative expenses	1,068	1,043	25	2%
Interest income	1	1		
Interest expense	(4,186)	(2,713)	(1,473)	54%
Other finance expense	(20)	(221)	201	(91)%
Realized and unrealized gain (loss) on derivative instruments	(5,623)	46	(5,669)	(12,324)%
Net gain (loss) on foreign currency transactions	72	(24)	96	(400)%
Income tax expense	(3)	(19)	16	(84)%
Net income	7,186	6,424	762	12%

Time Charter and Bareboat Revenues: Time charter and bareboat revenues increased by \$14.3 million to \$36.1 million for the three months ended March 31, 2015 compared to \$21.8 million for the same period in 2014. This was mainly due to increased time charter earnings from the *Hilda Knutsen* and *Torill Knutsen* being included in our results of operations from July 1, 2014 and the *Dan Cisne* being included in our results of operations from December 31, 2014.

Other income: Other income increased by \$0.1 million during the three months ended March 31, 2015 compared to the three months ended March 31, 2014. This is mainly due to increased handling fee for reimbursed expenses against the charterer.

Vessel operating expenses: Vessel operating expenses for the three months ended March 31, 2015 were \$6.8 million, an increase of \$2.2 million from \$4.6 million in the three months ended March 31, 2014. The increase was primarily due to an increase of \$2.9 million due to the *Hilda Knutsen* and *Torill Knutsen* being included in our results of operations as of July 1, 2014, partially offset by decrease of \$0.8 million due to lower operating expenses for the *Windsor Knutsen* and the *Bodil Knutsen* for the three months ended March 31, 2015 compared to the same period in 2014.

Depreciation: Depreciation expenses for the three months ended March 31, 2015 were \$11.4 million, an increase of \$4.6 million from \$6.8 million in the three months ended March 31, 2014. This increase was mainly due to the *Hilda Knutsen* and the *Torill Knutsen* being included in our results of operations from July 1, 2014 and the *Dan Cisne* being included in our results of operations as of December 15, 2014.

General and administrative expenses: General and administrative expenses are not materially different during the three months ended March 31, 2015 and 2014.

Interest income: Interest income for the three months ended March 31, 2015 was \$1,000 compared to \$1,000 for the same period in 2014.

Interest expense: Interest expense for the three months ended March 31, 2015 was \$4.2 million, an increase of \$1.5 million from \$2.7 million for the three months ended March 31, 2014. This is principally due to (i) increased interest expenses of \$1.2 million due to increased indebtedness related to the acquisitions of the *Hilda Knutsen* and the *Torill Knutsen* on June 30, 2014; and (ii) increased interest expenses of \$0.4 million due to increased indebtedness related to the acquisition of the *Dan Cisne* on December 15, 2015.

Other finance expense: Other finance expense decreased by \$0.2 million during the three months ended March 31, 2015 compared to the three months ended March 31, 2014. This is mainly due to our payment during the three months ended March 31, 2014 of a guarantee commission of the outstanding amount under the Guarantee Institute for Export Credits guarantee related to the \$120 million *Bodil Knutsen* credit facility, which was repaid in full in June 2014.

Table of Contents

Realized and unrealized gain (loss) on derivative instruments: Realized and unrealized loss on derivative instruments for the three months ended March 31, 2015 was \$5.6 million, compared to a gain of \$46,000 for the same period in 2014, as set forth in the table below:

	Three Months Ended March 31,		
<i>(US \$ in thousands)</i>	2015	2014	\$ change
Realized gain (loss)			
Interest rate swap contracts	\$ (1,026)	\$ (554)	\$ (472)
Foreign exchange forward contracts		252	(252)
Unrealized gain (loss)			
Interest rate swap contracts	(3,075)	348	(3,422)
Foreign exchange forward contracts	(1,522)		(1,523)
Total realized and unrealized (loss) gain	\$ (5,623)	\$ 46	\$ (5,669)

As of March 31, 2015, 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 \$382.3 million. In addition to an increased notional amount, the increased net realized and unrealized loss on interest rate swap contracts was due to a decrease in long-term swaps rate during the three months ended March 31, 2015. As of March 31, 2015, we had entered into foreign exchange forward contracts, selling a total notional amount of \$20.0 million against NOK at an average exchange rate of NOK 6.395 per 1.0 U.S. Dollar, which are economic hedges for certain vessel operating expenses and general expenses in NOK. For the three months ended March 31, 2015, the NOK had weakened further against the U.S. Dollar resulting in an unrealized loss on the foreign exchange forward contracts.

Net gain (loss) on foreign currency transactions: Net gain on foreign currency transactions for the three months ended March 31, 2015 was \$72,000 compared with a net loss of \$24,000 for the same period in 2014.

Income tax benefit: Income tax expense for the three months ended March 31, 2015 was estimated to be \$3,000, and is related to UK income tax. All Norwegian subsidiaries and their operations are subject to the tonnage tax regime and at March 31, 2015 their tax base was negative. Income tax expense for the three months ended March 31, 2014 was estimated to be \$19,000 and related to net finance income in Norwegian kroner in Norwegian subsidiaries.

Net income: As a result of the foregoing, we earned net income of \$7.2 million for the three months ended March 31, 2015 compared to net income of \$6.4 million for the same period in 2014.

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 will distribute our available cash, we expect that we will 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 NOK, British Pounds and Euros. We may make use of derivative instruments for interest rate and currency risk management purposes, and we expect 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 \$15.3 million for drydocking and classification surveys for the five time charter vessels in our fleet in 2016, 2017 and 2018. 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 dry-docking yard that will depend on actual deviation from the vessel's ordinary trading area to dry-docking yard.

As of March 31, 2015, our current liabilities exceeded current assets by \$23.3 million. Included within current liabilities are mark-to-market valuations of derivative instruments representing \$9.0 million of these liabilities, and included within current assets are mark-to-market valuations of swap derivative instrument representing \$0.4 million of these assets. We currently have no intention of terminating these swap derivative instruments and foreign currency contracts and hence realizing these liabilities.

Table of Contents

As March 31, 2015, our current cash and cash equivalents were \$32.7 million. In June 2014, we established a \$20 million revolving credit facility as part of our \$240 million senior secured loan facility. The revolving credit facility is available until June 2019. As of March 31, 2015, the revolving credit facility was fully drawn. On June 23, 2015, the revolving credit facility was repaid in full.

On February 13, 2015, we paid a quarterly cash distribution of \$0.49 per unit with respect to the quarter ended December 31, 2014. This cash distribution amounted to \$11.5 million.

On May 14, 2015, we paid a quarterly cash distribution of \$0.51 per unit with respect to the quarter ended March 31, 2015. This cash distribution amounted to \$12.1 million.

We believe that our current resources are sufficient to meet our working capital requirements for our current business for at least the next twelve months.

Cash Flows

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

(US \$ in thousands)	Three Months Ended March 31,	
	2015	2014
Net cash provided by operating activities	\$ 22,131	\$ 12,215
Net cash provided by investing activities	52	80
Net cash used in financing activities	(20,047)	(15,748)
Effect of exchange rate changes on cash	(136)	(45)
Net increase in cash and cash equivalents	2,000	(3,498)
Cash and cash equivalents at beginning of period	30,746	28,836
Cash and cash equivalents at end of period	32,746	25,338

Net cash provided by operating activities

Net cash provided by operating activities increased by \$9.9 million to \$22.1 million for the three months ended March 31, 2015 compared to \$12.2 million for the same period in 2014. This was mainly due to higher earnings through the contributions from (i) the *Hilda Knutsen* and the *Torill Knutsen* being included in our results of operation as of July 1, 2014 and (ii) the *Dan Cisne* being included in our result of operations as of December 15, 2014.

Net cash provided by investing activities

Net cash provided by investing activities decreased by \$28,000 to \$52,000 for the three months ended March 31, 2015, compared to \$80,000 for the same period in 2014.

Net cash used in financing activities

Net cash used in financing activities during the three months ended March 31, 2015 of \$20.0 million mainly related to the repayment of long-term debt of \$8.6 million and payment of cash distributions during the period of \$11.5 million.

Net cash used in financing activities during the three months ended March 31, 2014 of \$15.7 million mainly related to the repayment of long-term debt of \$7.4 million, the payment of cash distributions during the period of \$7.6 million and a change in restricted cash of \$1.0 million.

Table of Contents**Borrowing Activities****Long-Term Debt**

As of March 31, 2015 and December 31, 2014, the Partnership had the following debt amounts outstanding:

<i>(U.S. Dollars in thousands)</i>	Vessel	March 31, 2015	December 31, 2014
\$220 million loan facility	<i>Windsor Knutsen, Bodil Knutsen,</i>		
	<i>Carmen Knutsen</i>	\$ 208,214	\$ 212,142
\$20 million revolving credit facility	<i>Windsor Knutsen, Bodil Knutsen,</i>		
	<i>Carmen Knutsen</i>	20,000	20,000
\$140 million loan facility	<i>Fortaleza Knutsen & Recife Knutsen</i>	133,438	135,625
\$160 million loan facility	<i>Fortaleza Knutsen & Recife Knutsen</i>		
\$120 million loan facility	<i>Bodil Knutsen</i>		
\$85 million loan facility	<i>Windsor Knutsen</i>		
\$93 million loan facility	<i>Carmen Knutsen</i>		
\$117 million loan facility	<i>Hilda Knutsen</i>	85,492	86,724
\$117 million loan facility	<i>Torill Knutsen</i>	86,728	87,960
\$58.8 million loan facility	<i>Dan Cisne</i>	58,770	58,770
\$12.0 million Seller's Credit		12,000	12,000
Total long-term debt		604,642	613,221
Less current installments		38,718	38,718
Less \$12.0 million Seller's Credit		12,000	12,000
Long-term debt, excluding current installments and Seller's Credit		\$ 553,924	\$ 562,503

The total outstanding debt as of March 31, 2015 is repayable as follows:

<i>(US \$ in thousands)</i>	Period repayment	Balloon repayment
Remainder of 2015	\$ 30,139	\$
2016	39,018	
2017	39,318	
2018	38,387	136,500
2019	18,132	269,678
2020 and thereafter	27,000	6,470

Total	\$ 191,994	\$ 412,648
-------	------------	------------

As of March 31, 2015, the interest rates on our loan agreements were LIBOR plus a fixed margin ranging from 2.125% to 4.5%.

Table of Contents

\$240 Million Secured Loan Facility

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) to repay existing debt under previous loan facilities and a \$10.5 million seller's credit from KNOT. The Senior Secured Loan Facility consists 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 terminates in June 2019, and 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 March 31, 2015, the Revolving Credit Facility was fully drawn and the outstanding balance was \$20.0 million. The outstanding balance on the Revolving Credit Facility was repaid on June 23, 2015 using a portion of the net proceeds from the June 2015 Offering.

The Term Loan Facility is repayable in quarterly instalments 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%.

The *Windsor Knutsen*, the *Bodil Knutsen* and the *Carmen Knutsen*, assignments of earnings, charterparty contracts and insurance proceeds are pledged as collateral for the Senior Secured Loan Facility. The 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 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 Senior Secured Loan Facility for the first two years, 120% for the third and fourth years, and 125% thereafter;

Positive working capital for the borrowers and the Partnership;

Minimum liquidity of the Partnership of \$16 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 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 March 31, 2015, the borrowers and the Partnership were in compliance with all covenants under this facility.

\$117 Million Hilda Loan Facility

Edgar Filing: KNOT Offshore Partners LP - Form 6-K

The \$117 million secured loan facility (the *Hilda Facility*) is repayable in quarterly installments over five years with a final balloon payment due at maturity in July 2018. The *Hilda Facility* bears interest at LIBOR plus a fixed margin of 2.5%. The facility is guaranteed by the Partnership and KNOT Shuttle Tankers AS and is secured by a vessel mortgage on the *Hilda Knutsen*. The *Hilda Knutsen*, assignments of earnings, charterparty contracts and insurance proceeds are pledged as collateral for the *Hilda Facility*. The Partnership and KNOT Shuttle Tankers AS are the sole guarantors. 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 \$16 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 March 31, 2015, the borrowers and the Partnership were in compliance with all covenants under this facility.

Table of Contents

\$117 Million Torill Loan Facility

The \$117 million secured loan facility (the *Torill Facility*) is repayable in quarterly installments over five years with a final balloon payment due at maturity in October 2018. The *Torill Facility* bears interest at LIBOR plus a fixed margin of 2.5%. The facility is guaranteed by the Partnership and KNOT Shuttle Tankers AS and is secured by a vessel mortgage on the *Torill Knutsen*. The *Torill Knutsen*, assignments of earnings, charterparty contracts and insurance proceeds are pledged as collateral for the *Torill Facility*. The Partnership and KNOT Shuttle Tankers AS are the sole guarantors. 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 \$16 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 March 31, 2015, the borrowers and the Partnership were in compliance with all covenants under this facility.

\$140 Million Secured Loan Facility

In June 2014, the Partnership's subsidiary Knutsen Shuttle Tankers XII KS entered into a senior syndicate secured loan facility in the amount of \$140 million (the *New Fortaleza and Recife Facility*). The *New Fortaleza and Recife Facility* was drawn in November 2014 and replaced a \$160 million secured loan facility previously secured by the *Fortaleza Knutsen* and the *Recife Knutsen*. The *New Fortaleza and Recife Facility* is repayable in quarterly installments over five years with a final balloon payment due at maturity at 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 *New 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 *New 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 New 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 \$16 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 New 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 December 31, 2014, the guarantors were in compliance with all covenants under this facility. Due to negative mark-to-market value of foreign exchange forward contracts of \$2.7 million as of December 31, 2014, the borrower was not in compliance with the positive working capital covenant, as the working capital included the negative mark-to-market value of foreign exchange forward contracts. As of March 31, 2015, the borrower and the Partnership were in compliance with all covenants under this facility.

\$58.8 Million Secured Loan Facility

In April 2014, KNOT's 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 purchase of the vessels from J. Lauritzen. In connection with the Partnership's acquisition of KNOT Shuttle Tankers 20 AS, the company that owns the *Dan Cisne*, in December 2014, the \$172.5 million senior secured loan facility was split into a tranche which is related to the *Dan Cisne* of \$58.8 million (the *Dan Cisne Facility*). The *Dan Cisne Facility* is guaranteed by the Partnership and secured by a vessel mortgage on the *Dan Cisne*. The *Dan Cisne Facility* is repayable in semiannual instalments with a final balloon payment due at maturity at September 2023. The *Dan Cisne Facility* bears interest at LIBOR plus a margin of 2.4%. The *Dan Cisne Facility* contains the following financial covenants:

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

Minimum liquidity of the Partnership of \$16 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%.

Table of Contents

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 March 31, 2015, the borrower and the Partnership were in compliance with all covenants under this facility.

\$12 Million Seller's Credit

As part of financing for the purchase of the *Dan Cisne*, KNOT provided a \$12.0 million seller's credit (the Seller's Credit), which was guaranteed by the Partnership, had a maturity date of December 2019 and bore interest at LIBOR plus a fixed margin of 4.5%. Accrued interest on the Seller's Credit accumulated at the end of each six-month period and was capitalized. On June 15, 2015, the Partnership repaid the Seller's Credit with a portion of the net proceeds from the June 2015 Offering.

Derivative Instruments and Hedging Activities

As of March 31, 2015, the Partnership has entered into various interest rate swap agreements effective until March, April, May, July and August, 2018 and September, 2023 for a total notional amount of \$382.3 million to hedge against the interest rate risks of its variable-rate borrowings. Under the terms of the interest rate swap agreements, the Partnership will receive from the counterparty interest on the notional amount based on three or six month LIBOR and will pay to the counterparty a fixed rate. For the interest rate swap agreements above, the Partnership will pay to the counterparty a weighted average interest rate of 1.47%.

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 March 31, 2015, 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 127.9 million.

We do not apply hedge accounting for derivative instruments. We do not speculate using derivative instruments.

Contractual Obligations

The following table summarizes our long-term contractual obligations as of March 31, 2015:

(US \$ in thousands)	Total	Payments Due by Period			
		Less than 1 Year	1-3 Years	4-5 Years	More than 5 Years
Long-term debt obligations (including interest)(1)	\$ 681,143	\$ 58,711	\$ 115,068	\$ 470,701	\$ 36,663
Total	\$ 681,143	\$ 58,711	\$ 115,068	\$ 470,701	\$ 36,663

(1) The long-term debt obligations have been calculated assuming interest rates based on the 6-month LIBOR as of March 31, 2015, plus the applicable margin for all periods presented.

Off-Balance Sheet Arrangements

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

Critical Accounting Estimates

The preparation of the unaudited condensed consolidated and combined carve-out 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 and combined carve-out financial statement included in our 20-F dated March 25, 2014 filed with the SEC.

Quantitative and Qualitative Disclosures About Market Risk

We are exposed to various market risks, including interest rate, foreign currency exchange 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 exchange risks. Our policy is to economically hedge our exposure to risks, where possible, within boundaries deemed appropriate by management.

Table of Contents

Interest Rate Risks

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 which 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 swaps to manage our exposure to interest rate risks. Interest rate swaps 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 swaps are used is determined by reference to our net debt exposure and our views regarding future interest rates. Our interest rate swaps do not qualify for hedge accounting and movements in their fair values are reflected in the statement of operations under gain/(loss) on derivative financial instruments. Interest rate swap agreements that have a positive fair value are recorded as Derivative assets, while swaps with a negative fair value are recorded as Derivative liabilities.

As of March 31, 2015, our net exposure to floating interest rate fluctuations on its outstanding debt was approximately \$189.6 million, based on total net interest bearing debt of approximately \$604.6 million less the notional amount of our floating to fixed interest rate swaps of \$382.3 million, and less cash and cash equivalents of \$32.7 million.

A 1% change in short-term interest rates would result in an increase or decrease to our interest expense of approximately \$1.9 million on an annual basis as of March 31, 2015.

Foreign Currency Fluctuation Risks

We and our subsidiaries utilize 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 Foreign exchange gain/(loss); 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 March 31, 2015 we had entered into foreign exchange forward contracts, selling a total notional amount of \$20.0 million against NOK at an average exchange rate of NOK 6.395 per 1.0 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 the customers consist primarily of major oil and gas companies, independent oil and gas producers and government-owned oil companies. As of March 31, 2015 and December 31, 2014, five customers 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 2014 20-F.

Table of Contents

FORWARD-LOOKING STATEMENTS

This Report on Form 6-K contains certain forward-looking statements concerning future events and KNOT Offshore Partners LP's (KNOT Offshore Partners') operations, performance and financial condition. 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, likely result, plan, 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 KNOT Offshore Partners' control. Actual results may differ materially from those expressed or implied by such forward-looking statements. Important factors that could cause actual results to differ materially include, but are not limited to:

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

KNOT Offshore Partners' ability to make or increase cash distributions on its units and the amount of any such distributions;

KNOT Offshore Partners' ability to integrate and realize the expected benefits from acquisitions;

KNOT Offshore Partners' anticipated growth strategies;

the effect 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;

Edgar Filing: KNOT Offshore Partners LP - Form 6-K

changes in KNOT Offshore Partners' operating expenses, including drydocking and insurance costs and bunker prices;

KNOT Offshore Partners' future financial condition or results of operations and future revenues and expenses;

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

KNOT Offshore Partners' ability to make additional borrowings and to access debt and equity markets;

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

KNOT Offshore Partners' ability to maintain long-term relationships with major users of shuttle tonnage;

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

KNOT Offshore Partners' ability to purchase vessels from KNOT in the future;

KNOT Offshore Partners' continued ability to enter into long-term time charters;

KNOT Offshore Partners' ability to maximize the use of its vessels, including the re-deployment or disposition of vessels no longer under long-term time charter;

the financial condition of KNOT Offshore Partners' 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;

KNOT Offshore Partners' 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 KNOT Offshore Partners' ability to comply with, governmental regulations, maritime self-regulatory organization standards, as well as standard regulations imposed by its charterers applicable to KNOT Offshore Partners' business;

Table of Contents

availability of skilled labor, vessel crews and management;

KNOT Offshore Partners' general and administrative expenses and its fees and expenses payable under the fleet management agreements and the management and administrative services agreement;

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

estimated future maintenance and replacement capital expenditures;

KNOT Offshore Partners' 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 KNOT Offshore Partners' securities in the public market;

KNOT Offshore Partners' 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 KNOT Offshore Partners files with the SEC.

All forward-looking statements included in this Report on Form 6-K are made only as of the date of this report. New factors emerge from time to time, and it is not possible for KNOT Offshore Partners to predict all of these factors. Further, KNOT Offshore Partners cannot assess the impact of each such factor on its 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. KNOT Offshore Partners does not intend to release publicly any updates or revisions to any forward-looking statements contained herein to reflect any change in KNOT Offshore Partners' expectations with respect thereto or any change in events, conditions or circumstances on which any such statement is based.

Table of Contents

EXHIBITS

The following exhibits are filed as part of this report:

Exhibit No.	Description
4.1	Letter Agreement, dated June 15, 2015, among Knutsen NYK Offshore Tankers AS, KNOT Offshore Partners LP, KNOT Shuttle Tankers 20 AS and Sumitomo Mitsui Banking Corporation Europe Limited, relating to the Accession Letter, dated December 15, 2014, among Knutsen NYK Offshore Tankers AS, KNOT Offshore Partners LP, KNOT Shuttle Tankers 20 AS and Sumitomo Mitsui Banking Corporation Europe Limited
4.2	Ship Management Agreement for the <i>Dan Sabia</i> , between KNOT Shuttle Tankers 21 AS and KNOT Management Denmark A/S, as amended

Table of Contents

SIGNATURES

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: June 29, 2015

By: /s/ JOHN COSTAIN

Name: John Costain

Title: *Chief Executive Officer and Chief Financial Officer*