

KNOT Offshore Partners

First Quarter 2021 Earnings Results Conference Call

Thursday, May 13, 2021, 11:00 AM Eastern

CORPORATE PARTICIPANTS

Gary Chapman - *Chief Executive Officer*

KNOP First Quarter 2021 Earnings Results Conference Call Transcript

PRESENTATION

Operator

Good day and welcome to the KNOT First Quarter 2021 Earnings Results Conference Call. All participants will be in a listen-only mode. Should you need assistance during today's call, press star, zero, to be connected to a conference specialist. After today's presentation, there will be an opportunity to ask questions. To ask a question, press star then one on a touchtone phone. To withdraw your question, press star, then two.

I would now like to turn the conference over to Gary Chapman, Company CEO. Please go ahead.

Gary Chapman

Thank you and welcome, everybody to our first quarter earnings call for 2021. You can, as always, find our earnings release and this presentation on our website at knotoffshorepartners.com. Our call today includes certain non-U.S. GAAP measures of distributable cash flow and adjusted EBITDA. And although our earnings include a reconciliation of those non-GAAP measures to the most directly comparable GAAP measures, please remember that any forward-looking statements made during today's call are subject to risks and uncertainties.

This presentation and our other publicly available information contains forward-looking statements. Actual events and results can materially differ from those statements and the partnership does not have or undertake a duty to update any forward-looking statements. I refer you to slide two in our annual and quarterly SEC filings for further details.

Slide three. First quarter and subsequent highlights. The partnership is able to report another strong and stable sets of quarterly results. Total revenue in the first quarter was \$71.5 million, operating income \$27.6 million, and net income \$28.1 million. Adjusted EBITDA was \$51.3 million, distributable cash flow was \$21.7 and our coverage ratio was 1.20.

Available liquidity at the end of the first quarter was \$115 million, which included cash and cash equivalents of \$60 million. Scheduled fleet utilization was 91.6% in the quarter, noting that if we were to include the Windsor Knutsen that received insurance proceeds equivalent to hire during the quarter, then that utilization figure increases to 97.5%. We announced our 23rd consecutive quarterly distribution of \$0.52 per common unit, which is in fact paid today.

Our crew and our operations have remained materially unaffected by the COVID-19 pandemic to-date, and we continue to establish and maintain strict procedures and protocols around our operations to do all we can to keep our colleagues safe, despite the many challenges that have arisen and are continuing. At the end of the quarter, the Partnership had \$670 million of remaining firm contracted forward revenue excluding options. In respect of the Windsor Knutsen, you may recall we explained previously that the vessel was found to have a crack in her main engine block back in December 2020 and she was placed off hire.

The Partnership's insurance is covering the cost of repairs and providing income at approximately the level earned during the vessel's prior long-term charter, excepting the 14-day deductible period under the policy until such time as the vessel is repaired and fully operational which is expected to be in or around June 2021. The incident and the repair are not expected to result in any future loss of hire and the repairs are progressing well, on time and on budget. We closed the sale and leaseback agreement for the Raquel Knutsen in January 2020 and further details on this transaction can be found in our fourth quarter 2020 earnings release.

Slide four. In March, the Tove Knutsen developed a technical fault due to a leakage from its controllable pitch propeller. The vessel was repaired and returned to operation on April 15, 2021, and net insurance recoveries, the Partnership currently estimates that the aggregate cost of this incident will be approximately \$0.3 million.

During the first quarter, the Bodil Knutsen successfully completed its scheduled second renewal survey drydocking, and the Partnership took advantage of the drydocking to also install a ballast

KNOP First Quarter 2021 Earnings Results Conference Call Transcript

water treatment system on the vessel, which further builds the vessel and our fleet's green credentials.

Based on the timing and sequencing of events, the Bodil Knutsen was effectively redelivered to the Partnership from Equinor on February 22nd, 2021 at the start of the vessel's drydock. We are now actively marketing the vessel for new time charter employment. In the interim period and to provide support to the Partnership, our sponsor, Knutsen NYK Offshore Tankers AS, KNOT, has agreed to time charter the Bodil Knutsen from the Partnership on a flexible rolling three-month basis, possibly for the remainder of 2021, commencing on a date to be agreed in May 2021. The charter rate payable will be lower than the rate the Partnership would normally wish to achieve in the market, reflecting the short-term situation in the North Sea at this time, yet providing the Partnership with valuable support and certainty of income. As a related party transaction, this charter proposal has been reviewed and approved by the Partnership's independent Conflicts Committee.

In May 2021, the Partnership reached an agreement with the VOC Industry Co-operation Norwegian Sector, or "VOCIC Norway", whereby VOCIC Norway agreed to fund loss of hire at a reduced rate during, and costs related to the installation of a VOC, Volatile Organic Compound, recovery plant on the Bodil Knutsen. The work is expected to be carried out in the third or fourth quarter of 2021 and take around one month.

This will be the second material improvement made to the vessel in 2021, after the addition of the ballast water treatment system. The VOC system will significantly improve the operational attractiveness of the vessel in the North Sea and Norwegian sectors going forward, as well as virtually eliminate the non-methane VOC released into the atmosphere arising from the vessel's cargo.

Finally, the Tordis Knutsen is due to undergo her first planned five-year special survey drydocking in the fourth quarter of 2021, and which is expected to be carried out in Europe. The vessel is expected to be off hire for approximately 50 to 55 days, including mobilization to and from Europe and this is expected to have a scheduled impact on our fourth quarter earnings.

To slide five, where we set out some of the unique aspects of our business. In brief, we are a market leader with more than 30 years of experience. We are classified as a corporation for U.S. federal income tax purposes and issue 1099s. Our vessels are specialized assets with limited replacement risk. Most of our vessels have operational flexibility and are capable of servicing many different fields. There are high barriers-to-entry due to the specialist nature of our vessels and crew. We have a diverse set of financially strong contractual counterparties. Our contracts are fixed rate and typically one to seven years, and once in operation they don't depend on oil prices, and our customers bear the risk of vessel utilization and operational fuel costs.

Our management strategy remains to operate the business with a focus on long term stability as far as possible and as we have seen in 2021 so far, our combination of strong coverage and diversification is serving us well as we maintain good coverage even as more vessels transition between contracts than has been the case historically.

And finally, our debt repayment profile means we expect to pay down around \$90 million this year.

Slides six through nine, are our main financial results and I will highlight just a few relevant points. For the first quarter of 2021, we were able to maintain revenues broadly in line with previous quarters at \$71.5 million, notwithstanding the Bodil Knutsen drydock and some of the one-off technical issues already outlined.

Vessel operating expenses for the quarter were slightly higher, partly due to bunker costs related to the Bodil Knutsen drydock and also due to higher crew costs arriving from COVID related issues, though we do expect some of this crew cost overshoot will fall back over the course of the year.

Adjusted EBITDA on slide seven, came out at \$51.3 million, another very consistent quarter. Distributable cash flow on slide eight was 1.2 times in the quarter, reflecting slightly lower fleet utilization, mainly related to the Bodil Knutsen drydock, an expected increase in our estimated

KNOP First Quarter 2021 Earnings Results Conference Call Transcript

maintenance and replacement Capex adjustment and the impact of an increased realized loss arising from our interest rate swap contracts due to lower LIBOR and a non-recurring item related to the Raquel Knutsen sale and leaseback refinance.

We have spoken previously about targeting stability and we consider this to be an example whereby our strong coverage has given us room to maneuver when we have experienced a degree of turbulence. Maintaining our coverage at 1.2 times despite that turbulence shows the extent to which our current contracts and diversification of revenue streams has provided us with depth of cover and we currently expect our contract portfolio to continue to provide cover throughout this current year.

On slide nine, I will just note here, the increase in our current liabilities, which principally represents the refinancing's we have due in the coming year, with the first significant tranche due in November 2021. We're already in detailed negotiations with our lending group in relation to this and all indications so far are very positive. We plan to report more on this in the next quarter.

Slide 10 gives an update on our contracted revenue and charter portfolio. At the end of the quarter, we had \$670 million of contracted forward revenue remaining to the Partnership and average remaining charter period of 2.5 years and our customers have options to extend these charters by further 2.8 years on average. For the Windsor Knutsen, we're showing here a small gap around the end of the second quarter 2021, where there could be a small open period between the end of the repairs and the anticipated commencement of the new charter. Ultimately, this may not occur, but until we get closer to the time and agree a precise delivery date with the charterer then there is this possibility.

For the Bodil Knutsen, we are showing the time charter to KNOT in the middle of the year, which is on a rolling three-month basis to allow flexibility for when a third-party time charter is found. Thereafter, you will see that our remaining fleet is contracted for the remainder of the year though as mentioned, Tordis Knutsen is scheduled for its first planned five-year special survey drydocking in the fourth quarter. As disclosed in our fourth quarter 2020 results, the Partnership secured new fixed contracts for the vessels Tordis, Vigdis and Lena Knutsen that will commence between May and December of 2023.

On slide 11, our sponsor KNOT continues to have six vessels that could be acquired by the Partnership with an average fixed contract period of 5.3 years, and with an average of a further 7.3 years extension options. Although, we have seen a welcome increase in our unit price, still today we have no firm plans for acquiring another vessel however, at this time, we are actively considering our options for later in the year.

New vessels that provide further diversification and cash flow coverage would further insulate the partnership from any headwinds. Our sponsor KNOT continues to provide flexibility in respect of the timing of any acquisitions and we will continue to take a prudent approach, taking into consideration the long-term interests of the business. And as always, the acquisition by KNOP of any dropdown vessels in the future would be subject to the approval of our independent Conflicts Committee, as well as the Board of Directors of each of KNOP and our sponsor KNOT.

Slide 12, is to demonstrate how our stable fixed rate business has performed over the last several years, particularly in the face of volatile oil prices. I won't dwell on this. You can certainly see for yourself.

Slide 13, we included this slide in our fourth quarter presentation just recently, but I wanted to keep it in here to reiterate that with our customers Capex schedules shifting to the right, we see the headwinds we're now facing very much as a timing issue and we continue to expect the market overall to normalize and grow substantially. We see both Brazil and the North Sea markets as not only maintaining but growing in the coming years.

On slide 14, we're looking at the same timeline, but with a focus on shuttle tankers. Although we've plotted the supply/demand on here, and it looks very precise, actually the picture changes a little all the time, but there are two messages we'd like to present. The first is that the market is still relatively

KNOP First Quarter 2021 Earnings Results Conference Call Transcript

balanced even over the next year or more, as the vast majority of shuttle tankers are on long term contracts, and therefore it never takes much for the market to tighten up. And secondly, we then expect to see growth and the many and very sizable FPSO activities announced by Petrobras in Brazil is one source that evidences this assumption. And with oil prices, perhaps rebounding faster than was predicted and showing less volatility, that growth may yet come earlier than we are anticipating and showing on this slide today.

Slide 15, ESG. The first thing to say is that we're committed to playing our part in driving each of the E, S and G headings. And one way that we demonstrate that is to report both new initiatives and our progress on the many others that we are already undertaking, and we published our first ESG report in respect of 2019 and we are working on our 2020 report just now. You can find the 2019 reports on our website.

I've already mentioned the ballast water treatment system installed on the Bodil Knutsen and the VOC plant that will be installed later this year, and as well as, our sponsors has ordered two next-generation LNG-fueled shuttle tankers. These are just a couple of the most obvious items, but there are many others. We also take health, safety and quality very seriously and we regularly monitor a large number of operational KPIs to maintain and understand how our fleet is operating and constantly improve where we can. One outcome is that throughout 2020 and to-date in 2021, our fleet experienced no serious incidents or casualties. And finally, but not least, as our ESG activities could be a presentation in themselves, we have robust anti-corruption practices and policies and a supplier code of conduct in place among several other governance documents.

Slide 16. So our near-term priorities for this coming quarter and beyond are: continue to operate our vessels safely and efficiently and ensure the health and safety of our crew and employees, and we make no apology for repeating this statement every quarter. Continue to progress ongoing discussions with our lenders for refinancing's due in August and November 2021 and we anticipate we will give an update on that as part of our second quarter. All indications so far are positive, and progress has been made in line with our timeline and expectations.

We are of course working to secure new long-term employment for the Bodil Knutsen following the KNOT charter, and we expect to finalize our 2020 ESG report shortly. We continue to explore options and possibilities for a further internally financed dropdown later in 2021, possibly in the fourth quarter. And we are, as always, continuing our ongoing close dialogue with our customers concerning operations, chartering and rechartering options and opportunities.

Slide 17. So, in summary, we believe we have delivered another strong quarter with high utilization, strong cash flow and good coverage, which has enabled us to maintain our distribution. We had \$670 million of forward contracted revenue at the end of the quarter and we are not exposed to short term oil price fluctuation.

Recent effects of COVID on our customers capex schedules have created near term headwinds for shuttle tanker demand. But other than the specific vessels listed, our fleet is fully contracted for the remainder of 2021 and we believe we can deliver solid coverage throughout the remainder of the year. And then, in the mid to long term, as we have shown in the presentation, oil production in Brazil and the North Sea area from shuttle tanker serviced fields is expected to grow significantly and as a result, we believe the shuttle tanker markets fundamentals and growth prospects overall continue to remain strong.

Thank you very much for listening. And that concludes the presentation. And I'll be happy to take questions.

Operator

We will now begin the question-and-answer session. To ask a question, press star then one on a touchtone phone. If you are using a speaker phone, please pick up your handset before pressing the keys. If at any time your question has been addressed and you would like to withdraw your question, press star then two. At this time, we will pause momentarily to assemble our roster. And the first question comes from Liam Burke with B. Riley. Please go ahead.

KNOP First Quarter 2021 Earnings Results Conference Call Transcript

Liam Burke

Thank you. Hi, Gary. How are you today?

Gary Chapman

Hello. Liam, I'm well. Thank you. I hope you're doing well.

Liam Burke

Oh, good. I'm glad to hear that. You mentioned the Bodil Knutsen would be chartered by your sponsor on a rolling 90-day period. And then you touched on the fact that there's, I believe, challenges related to the North Sea? Or can I get some clarification on how the North Sea ties into this?

Gary Chapman

Yeah, sure. The Bodil is an ice class vessel, and it suited to North Sea operations as opposed to Brazil. And I think at the moment, with the vessel coming off charter, we're looking for various options for the vessel to seek new employment. And at the moment, this as an example, of the headwinds that we've explained previously. With various projects shifting to the right, there's a little softness in the market at the moment. And that has meant that we've been discussing with the Sponsor about how we can deal with that in the immediate term, until we find alternative employment. And I think the solution we found, I think, gives KNOP what it needs, which is the certainty of income. And I think that's really what we've been focused on.

Liam Burke

Okay. That's fair. And then you mentioned as many, I mean, I guess, in the prepared comments, four new builds on a dropdown schedule. 2021, you're looking at one? How many realistically could you look at over a period of time? Or could you actually drop down over a period of time?

Gary Chapman

Yeah. There are actually six sitting at the Sponsor at the moment. And we're looking at plans to purchase a vessel if we can in Q4, as I mentioned. I think at this stage today, the traditional equity issuance is perhaps still not there for us. We are likely to put in place an ATM facility, such that if an opportunity arises for us to go down an equity issuance that way, then at least we have that opportunity. But obviously, an ATM or any equity issuance is only useful if we have an accretive use for those funds, as you mentioned.

So, at the moment, we are looking at an internally financed dropdown, similar perhaps to how we did the one in December 2020. But we are constantly assessing all of our options. I think, realistically, this year we're targeting one. We might be able to do two. But I think one is a more realistic target and then we go from there. I think further out than that it becomes harder for us to anticipate at this point, but I'm sure we'll get more clarity as we go through the year.

Liam Burke

Great. Thank you, Gary.

Gary Chapman

Thank you, Liam.

Operator

As a reminder, if you have a question, press star then one to be joined into the queue. The next question comes from Richard Diamond with Castlewood. Please go ahead.

Richard Diamond

Yes. Good morning, Gary, and appreciate the steady hand. According to Tradewinds news this morning, steel prices on new vessels are up 11% and the price has risen from \$90 million to \$100 million in the last two months. Assuming the price of shuttle tankers are also going up, can you discuss the implication of higher newbuild prices on rates and any other implications for KNOP?

Gary Chapman

KNOP First Quarter 2021 Earnings Results Conference Call Transcript

Yeah. Thank you, Richard. Good question. I think in terms of higher newbuilds prices for us and new projects, there are no speculative orders for shuttle tankers. So, to the extent that newbuild prices go up, that would get plugged into our financial modeling in terms of when we're putting tenders forward for new business. So that ultimately it is passed on to our charterer. I think what's very interesting is that when newbuild prices go up, it allows our existing fleet to become more competitive at times of rechartering. So that when you have the higher newbuild price, clearly an existing vessel is able to command a higher charter rate at rechartering as well. So in actual fact for us with vessels coming off charter in the next sort of 12, 18 months, we actually will welcome higher newbuild prices. I think it's helpful for us as an existing vessel owner.

Richard Diamond

All right. Given the shortage of births now, until 2024, because of all the container ship and other types of vessel ordering, will that cause charterers who want new vessels to look more aggressively to make sure that you can get the slots?

Gary Chapman

I'm sure it will. It may very well bring forward some of our customers decision making, if they look around at the slots and yards that are available and realize that if they don't get in soon, then maybe they won't. But I think that's an issue for KNOT, our sponsor, primarily, but obviously, ultimately that has a knock on for us. I think our focus is on the rechartering rates. And hopefully, as I'd mentioned, the increase in newbuild prices will have a positive effect on rechartering rates. And that's really the main benefit for us, the sponsor already has six vessels with contracts that are either delivered or being constructed today that we'll be able to purchase. So, I think for our Sponsor, I think, yes, it can help with new business and therefore ultimately growth for us as the MLP, but at the moment we've got six vessels that we can already look forward to.

Richard Diamond

Thank you very much, Gary.

Gary Chapman

Thank you, Richard.

Operator

As we have no further questions, this concludes our question-and-answer session. I would now like to turn the conference back over to Gary Chapman for any closing remarks.

Gary Chapman

Thank you very much everybody for your time and have a good day.

Operator

The conference is now concluded. Thank you for attending today's presentation. You may now disconnect.