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KNOP - Q1 2018 Knot Offshore Partners LP Earnings Call

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CORPORATE PARTICIPANTS

John Costain *KNOT Offshore Partners LP - CEO and CFO*

CONFERENCE CALL PARTICIPANTS

Hillary Cacanando *Wells Fargo Securities, LLC, Research Division - Associate Analyst*

PRESENTATION

Operator

Good day, and welcome to the KNOT Offshore Partners First Quarter 2018 Earnings Conference Call. (Operator Instructions) Please note, today's event is being recorded.

With that, I'd like to turn the conference over to John Costain. Please go ahead.

John Costain *- KNOT Offshore Partners LP - CEO and CFO*

Thank you. If any of you have not read the earnings release or slide presentation, they are both available on the Investors section of our website.

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

A quick reminder that any forward-looking statements made during today's call are subject to risks and uncertainties and these are discussed at length in our annual and quarterly SEC filings.

As you know, actual events and results can differ materially from those forward-looking statements. The partnership does not undertake a duty to update any forward-looking statements.

So introduction. KNOT Offshore Partners, KNOP, focuses on the shuttle tanker segment. The individual tankers field specific (inaudible) components in the offshore oil production value chain.

Shuttle tankers operate in a niche space and under nonvolume-based contracts transporting oil from the offshore production units to shore side.

Often being built to the charter's requirements the tankers are generally used on specific oil fields, enabling the partnership to yield both the sustainable and stable revenue longer term.

Oil production continues to move further offshore so shuttle tankers operate in a space which will see substantial growth in the coming years.

Some of the largest discovered oil reserves in the Southern Hemisphere are in the pre-salt, 130 kilometers off the coast of Brasil.

The average annual production operates in the pre-salt layer, which includes portions of Petrobras and its partners. In 2007, where the largest in the company's history reaching a mark of 1.29 million barrels per day. Although our MLP is young, our sponsor is a very experienced operator having being involved in the designer construction of this type of vessel growing its fleet organically for more than 30 years. In the last 18 months, the MLP has acquired Raquel Knutsen in Q4 '16, Tordis in Q1 '17, Vigdis in Q2, Lena in Q3, Brasil in Q4 and Q1 '18 Anna Knutsen. We have achieved these acquisitions through a combination of common and preferred shares together with refinancings in revolving credit facilities.

This has enabled us to grow our distributable cash flow cover to our current level and improve the long-term outlook for the MLP. Our sponsor, Knutsen NYK is, according to Clarkson Platou Research, part of the largest shipping group in the world, and NYK is a major company in the Mitsubishi family. In the space of just under 5 years, the fleet has grown 300% to 16 vessels with an average age of about 4.75 years.

Now turning to the presentation.

Looking at Slide 3. The financial highlights.

For the first quarter of 2018, the partnership generated its best set of results. All of the following are our highest figures on both an aggregate and a per unit basis.

Total revenue of $68 million, operating income of $31.9 million, net income of $30.7 million and adjusted EBITDA of $53.4 million.

The partnership generated distributable cash flow of $27.9 million, and after declaring a cash distribution of $0.52 per unit this gives a coverage of $1.55 for the quarter.

During the quarter, the fleet operated a 99.6% utilization for scheduled operations. Since our initial public offering in 2013, it declared and paid common unit distributions of $9.78. So our initial investors have received a total return of 47%. Our current distribution is stable around 10%.

On the 30th of January, 2018, the partnership closed $100 million senior secured credit facility with a consortium of banks in which Bank of Tokyo-Mitsubishi UFJ acted as agent. This was secured on a total [commencement] a margin of 2.1% over LIBOR.

On the 1st of March, 2018, the partnership acquired the shuttle tanker Anna Knutsen from Knutsen NYK for a purchase price of $120 million. After acquisition, there were approximately -- there was approximately $74.4 million of debt secured on the vessel.

Slide 4, the income statement.

The total revenues were $68 million for the 3 months ended 31 March, 2018, it compares to $61.6 million through the 3 months ended December 31, Q4.

The increase in revenues was mainly due to increased earnings from the Brasil Knutsen as she was included in the results from operations from the 15th of December, 2017. And 1 month of earnings on the Anna Knutsen included from the 1st of March plus full quarter of earnings from the Carmen Knutsen, which was up -- incurred up higher in the fourth quarter due to both schedule drydocking and subsequent propeller repairs. The increase was partly offset by reduced revenues from the Raquel Knutsen as a result of 4.5 days of fire.

Reduced revenues from Brasil Knutsen, as she started showing drydocking at the end of the quarter and 2 addition calendar days in the fourth -- Q4 compared to Q1.

Vessel operating expenses for the first quarter 2018 were $13.2 million, a decrease of $1.9 million from $15.7 million in Q4 of 2017.

The decrease was mainly due to the bunker consumption in connection with the scheduled drydocking and propeller repairs of the Carmen Knutsen that was charged in the fourth quarter.

This was partially offset by higher operating expenses due to the Brasil Knutsen and Anna Knutsen including results from operations from December 15 and 1st of March, 2018, respectively.

General administration expenses were $1.3 million for the first quarter, won't change from the fourth quarter.

Depreciation of $21.6 million for Q1, an increase of $1.5 million. The increase was mainly due to the Brasil Knutsen. Anna Knutsen being included in operations from the 15th of December and the 1st of March.

As a result, operating income from Q1 was $31.9 million compared to $25 million in Q4. Interest expense for Q1 was $10.6 million compared to $9.2 million in Q4. The increase is mainly due to additional debt incurred in connection with the acquisitions.

Realized, nonrealized derivative gains were $10 million in Q1 compared to $3 million in Q4.

The unrealized noncash element of the mark-to-market gain was $9.2 million for Q1 compared to $3.8 million for Q4. Of the unrealized gain for the first quarter 2018, $8.9 million related to mark-to-market gains on interest rates swaps due to the swap rate here in the quarter. The comparison for Q4 was a mark-to-market gain of $4.6 million and an unrealized loss of $0.8 million related to the foreign exchange contracts due to the strength of the U.S. dollar against the market.

As a result, net income for the Q1 was $30.7 million compared to $18.6 million for Q4.

Slide 5. Adjusted EBITDA.

In Q1, the partnership generated EBITDA of $53.4 million compared to $45.1 million to Q4. Adjusted EBITDA refers to earnings before interest, taxation, depreciation and amortization and other financial items, it provides a proxy for cash flow.

Adjusted EBITDA of course is a non-U. S. GAAP measure used by our investors to measure partnership performance. With a wasting asset like a vessel, younger fleets tend to produce lower EBITDA for every dollar invested.

The annuity effect reduces the annual loss in the early years, which is factored into the replacement CapEx calculation for the distributable cash flow.

At the end of Q1, the KNOT fleet had 16 vessels with an average age of 4.7 years compared to the rest of the industry average for shuttle tankers excluding KNOP of around 12 years.

The formation of -- since the formation of KNOP, we have very high levels of vessel utilization on an average around 99.6% of scheduled operations.

Financial risk translates into a continually high and increasing predictable revenue, adjusted EBITDA and discounted cash flow as more vessels are added to the fleet.

Slide 6. Distributable cash flow.

Another non-U. S. GAAP measure to measure estimate distributable -- distribution sustainability.

Distributable Cash Flow or DCF represents a net income adjusted for depreciation on realized gains and losses from derivatives and foreign exchange.

Distributions on a Series A convertible preference units for other noncash items and estimate of maintenance and maintenance capital for drydocking and replacement capital expenditures, which are required to maintain long-term operating capacity up and therefore, the revenue generated by the partnership capital assets.

DCF was $27.9 million in Q1. The comparison to $21.5 million in Q4. We maintained our distribution level for Q1 at $0.52 per unit equivalent to an annual distribution of $2.80. The distribution coverage ratio is our highest ever recorded at 1.55% for Q1.

Impact in the calculation for the full year 2018, 1/3 of the time charter from the complete drydockings between May and November 2018.

More specifically, the partnership's earnings for the second quarter of 2018 will be affected by the planned 5 year special survey drydocking of Brasil Knutsen which was off-hire for 56 days, including mobilization back and forth with Brasil. The drydocking of Brasil Knutsen was completed on-time and was in budgeted cost.

Offsetting this off-hire will be the Anna Knutsen expected to operate for the entire second quarter.

The Hilda is due her first 5 year special survey drydocking in the third quarter of 2018, and the Torill and Ingrid Knutsen are due for their 4, 5 special survey drydocking in the fourth quarter of 2018.

These vessels operate in the North sea and will undergo drydocking in Europe and are expected to incur off-hire times of approximately 18 to 20 days per vessel as well as off-hire on these vessels with positional bunker costs are expensed impacting the 2018 results.

Nevertheless, whilst we have not guided financial results for 2018, we expect a coverage ratio of overflow of 1.3% on average for the year. The average coverage ratio was 1.26% before year-end 2017.

In Q1, the partnership had interest rates swap agreement totaling $645 million on which the partnership received interest based on LIBOR and paid an average interest rate of 1.73%. These have an average maturity of approximately 4.5 years. Whilst the partnership financial results are impacted by changes in the market value of these swaps, our cash flow is stabilized mitigating the interest rate impact on the DCF. We also see rising interest rates in the U.S. in 2018 and '19 together with increasing replacement CapEx provisions charged on our vessels as they get older. However, over coverage has increased from earlier years and our full year estimates for 2018 and '19 look solid. KNOT has an elevated yield compared to most MLPs and is focused on building coverage and deleveraging, as today it's not making accretive investments.

Given the quality and market position of the sponsor together with the shuttle tanker outlook, this yield has elevated in a very attractive value proposition.

There is therefore little benefit to the MLP in the short term to increase the distribution. When the yield is close to 10%, we continue to see double-digit distributions and a signal our investors will prefer increased coverage through investments and secondly deleveraging rather than increasing dividends.

The growth in -- growing coverage ratio gives the partnership more flexibility regarding both our capital base and distributions going forward.

Slide 7, the balance sheet.

At the end of Q1, the partnership had $57.1 million in available liquidity, which consisted of cash and cash equivalents of $44.1 million and $13 million of capacity under it's revolving credit facilities.

The revolving credit facilities mature in June and August 2019. Given the increasing fleet size we hope to extend these facilities.

We have a predictable cash flow, a healthy liquidity position and with the total refinancing no significant volume repayments until 2019.

The partnership's total interest-bearing debt is standing as of the 31 March, 2018 was $1.133 billion net of debt issuance costs.

The average margin was approximately 2.1% over LIBOR for Q1.

While March 1, 2018, the partnership acquired (inaudible) Anna Knutsen from Knutsen NYK for a purchase price of $120 million less $405 million of debt net of capitalization fees.

There were other purchase prices adjustments totaling $5.3 million. On its closing, the partnership repaid $32 million of the debt misleading an aggregate of approximately $74 million.

The debt was repayable -- the debt is repayable in quarter installments with a final OEM payment of $57.1 million due in March 2020.

It has a margin of 2%.

The purchase price of Anna -- of the Anna acquisition was settled in cash.

As well as the acquisition, the other significant transactions effecting the balance sheet occurred in January 2018, when the partnership subsidiary that owns the vessel Torill Knutsen closed $100 million senior secured term facility with the consortium of banks, in which the Bank of Tokyo-Mitsubishi UFJ acted as agent.

The new facility is repayable in 24 consecutive and quarterly installments with a balloon payment of $60 million due on majority.

It has a margin of 2.1%, maturing in January 2024.

The facility refinanced its $73.1 million loan facility associated with the vessel, capital interest and margin of 2.5%, almost due to be repaid in full in November 2018, a much larger loan with a significantly lower margin.

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

The reasons Torill Knutsen has been on charter to a subsidiary of Royal Dutch Shell since October 2015. After the initial 2-year period, Shell lifted the first of 6 annual extension options. The next option is declarable in July and the vessel has a competitive option rate fully reflecting the current market. So Shell, we believe are right into continue using this vessel for the long term.

Bodil Knutsen, our largest shuttle tanker operating in the North Sea, is ice class and on chart to Statoil AS until May 2019. Following the end of the charter, there are 5 annual extension options.

Torill and Hilda Knutsen operates on the Goliat. The first field to be developed in the Barents Sea and it currently represents the world's most northerly offshore development.

It is estimated that the Barents Sea contains nearly half of the discovered oil reserves in the Norwegian Shale.

Starting production in 2016, the estimated lifetime in the field is 15 years. It has an estimated recoverable reserves equivalent of about 178 million barrels of oil.

Hilda and Torill are 2 or 3 specially designed shuttle tankers built to operate in this arctic environment. Never have shuttle tankers had to make such strict requirements. Our vessels are heavily ventralized allowing the flue and hence the vessels to operate safely in temperatures down to minus 30 degrees celsius.

As the initial 5-year term on both vessels, there are 5 annual extension options, we expect any trading and shipping [SPA] any to lift the first of these annual extension options to Hilda in July and Torill in October.

Our bankers are certainly relaxed. We have recently completed refinancing on both vessels on significantly better terms than our previous deals.

Today, many charters like this annual option time of agreement, both for the commercial flexibility and because of the imposition of more unrisked financial disclosure requirements, there is a much lower impact in the accounts of the charterer.

For the MLP, this mix of short and long charters in the portfolio is useful because as well as tailoring solutions for the charterers wishes. We believe asset prices could firm and the market will tighten in the coming years and given the size of our fleet and therefore, it's commercial footprint, some measure of contract flexible is desirable.

4 of our vessels are on long-term (inaudible) chartered till 2023 with Petrobras transporting. These vessels are amongst the youngest in the Petrobras fleet delivering between 2011 and 2012 and are heavily utilized. Dan Sabia and Dan Cisne are unique sized and Fortaleza and Recife Knutsen have shallow (inaudible) with a lot sophisticated capacity.

Derivative 2013, the Carmen is on charter direct to vessels signing back until 2023.

The Ingrid was delivered in December 2013 and is operating in the North Sea on a time charter for Standard Marine Tønsberg, a Norwegian subsidiary of ExxonMobil. This will expire in the first quarter of 2024.

The charter has options to extend the charter to 5 1-year periods.

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

The Tordis, Vigdis and Lena Knutsen are on 5-year time charters to Brazil Shipping I, a subsidiary of Shell. These will expire in 2022, and the charter has options to extend with 2 additional 5-year options, totaling 15 years.

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

The KNOT fleet has an average remaining fixed contract duration of just under 4 years and an additional 4.7 years on average in charterers option.

Whilst we currently have no further dropdown candidates, which means no near-term equity requirement, given the market outlook, we will expect to be able to build the MLP significant in the coming years.

Slide 9, refinancing our fleet.

We have a significant refinancing due in 2019, where the current debt secured on Fortaleza receive Windsor, Bodil and Carmen requiring a renewal. And a smaller commercial trans due on the Ingrid towards the end of 2018.

We are starting the process and we'll look to finalize a new facility around September 2018. This will be secured against all available vessels. Compared to what currently exists, the average margin on a new facility remains in line.

With the package as currently presented, we anticipate that we will be able to increase the overall size of the tax credit line by around $20 million. A drawdown structured debt element will match the borrowing at the end of June giving a small advantage.

In summary, Slide 10, KNOT Offshore Partners should be considered as a mobile pipeline business with fully contracted revenue streams and therefore, a great fit in the MLP market.

Since being awarded its first few contracts in 1984, Knutsen has grown organically for over 30 years as the business has been able to build into a sizable fleet of these tankers, currently 29 units.

The quarter -- this quarter reports the partnership's highest ever quarterly performance both in absolute and per unit terms for revenue, profit, EBITDA and distributable cash flow. Yet another quarter with strong financial performance and substantial increase in all financial measures. Not surprising when set against the acquisition program.

1 vessel Raquel was added into the fleet in March in Q4 2016. 4 vessels were added to the fleet during 2017, Tordis 1st quarter, Vigdis 2nd quarter, Lena 3rd quarter and Brasil 4th quarter. A fifth vessel, in the 16th month day, the Anna was added on the 1st of March 2018.

KNOP has very good access to financing in the last year to finance the growth acquisitions. We have raised both $211 million worth of new equity and $200 million worth of long-term debt with $25 million in credit facilities fall on attractive terms.

KNOP is well-placed to complete in future candidates. We have a solid and profitable contract base generated by our modern fleet, which by the end of December have an average age of around 4.75 years.

Since the formation of KNOP, we have a very high levels of vessel utilization, on average around 99.6%.

Financially, this translates into high and increasingly predictable revenue, adjusted EBITDA and a discounted cash flow as more vessels are added to the fleet.

No one has more expertise in operating the sophisticated shale tankers of KNOT Offshore Partners and we operate these vessels with real expertise.

Today supply is timing and the market is expanding and the -- with tenders back the sponsor expects to build a further drop-down inventory. We have a large and financially strong and supportive sponsor who knows his market as well as anyone.

We remain a very attractive value proposition with a quarter distribution of $0.52 equating to around 10% as an annual distribution.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question today comes from Hillary Cacanando with Wells Fargo.

Hillary Cacanando - *Wells Fargo Securities, LLC, Research Division - Associate Analyst*

So -- I'm sorry I missed part of the presentation. Did you talk about the recontracting opportunity for Windsor, Hilda and Torill by any chance? Or -- I'm sorry if you...

John Costain - *KNOT Offshore Partners LP - CEO and CFO*

Well, I dug options from -- yes, I mentioned that Hillary, I just briefly said that we have a structure on all of these ships, which is 1 option, 1 option, 1 for 5 or 6 years periods. Windsor has already had 1 of those option periods exercised. July -- in July, Hilda and Windsor, their charter has to declare whether they are going to exercise those options and we're not receiving indication that they're not and given the late stage now, I think it's highly likely we can assume that they will lift those options or alternative the vessels will get redelivered which is unlikely in the current market environment. As I said in the presentation, that we feel it's good to have a mix between long and short contracts because the market is tightening and the asset prices are starting to come back. So it's good to have a mix and it's also good for the charter to have a bit of flexibility as well. So it works -- it cuts both ways really. Well, yes, today we have quite a lot of ships with these structures. I mean given also the financial constraints the charterer having short contracts, it works on a financial disclosure basis for as much as lower impact on their accounts and we see more of these type of agreements coming to play.

Hillary Cacanando - *Wells Fargo Securities, LLC, Research Division - Associate Analyst*

And so you said you think these options will be exercised?

John Costain - *KNOT Offshore Partners LP - CEO and CFO*

Yes, definitely. There's no reason why they wouldn't be. I mean there isn't really any -- I mean, we haven't really ordered a new ship, any, for instance, on the Hilda. So it's -- to have it redelivered the ship and move the oil from the platform or carry on with the charter. I mean normally it would take probably 3 years to build a vessel like that. So it's certainly a month away from exercise, so I think it's (inaudible) available they will do anything over an exercise at this point as they haven't come back and told us anything other than (inaudible).

Hillary Cacanando - *Wells Fargo Securities, LLC, Research Division - Associate Analyst*

Okay. And then I know there is no more asset in the dropdown pipeline. Is it -- are there other -- is it because there is no -- the assets at the parent level have, like, not enough -- the contract length is not long enough? Or is it just...

John Costain - *KNOT Offshore Partners LP - CEO and CFO*

We tend to put on -- yes, we tend to put on new ships over longer contracts or better quality, all better quality in contracts really. The sponsor has quite a lot of the older tankers. I think looking at the MLP today, it's not going to stand still in the long run. I mean it is a nicely from a shipping company effected the oil mobile pipeline company with 16 very well-positioned tankers, which are specialized and very great revenue on contracts. I mean I just look at it as an investment, it's very attractive for the sponsor to use as a vehicles for carrying on growing. But we're obviously having internal discussions as to the best way forward but we're not going to do it. It's go out into the market and just press and win contracts, that's anonymous but are not realistic. And when we looked at the last contract, the Petrobras won in Brazil. We were quoted from the yard that we went to, they wanted a 10% increase in the price and the rates that have been banded about are quite significantly lower than what the normal market rate has been in recent years. So it's quite surprised. I guess anyone doing the Petrobras, they had to make a very attractive offer to get a deal. That's why we lead it. I don't know what else. So -- but I think you can guarantee that we are in talks with the charters and there is an (inaudible) to order the ships and I think we're comfortable with the present situation.

Operator

The next question comes from [Robert Saavedra] with [RE Saavdera & Associates Marine Surveyors].

Unidentified Analyst

My first question has to do with your Series A convertible preferred units. There were no change in the number from last quarter to this quarter. Are you still in the market to want to purchase some of those to reduce the number?

John Costain - *KNOT Offshore Partners LP - CEO and CFO*

No. Not today. We -- I mean my own view on it, it is not is necessary that the sponsors book. We don't want to lower too many preference into the MLP we don't have to because obviously it creates a problem for the common units. We -- our competitor 20% common -- sorry, 20% press, which I think is a little bit higher. I mean, I think I like the amount we've got today, I don't particularly want to put more and we're not in the market to that sort of capital. But obviously, we never say never because at some -- the preference market might be open when the common unit market is closed. As of today, we finished our business and I think the answer is probably no. On those preference units, the strike price has drifted up to $24.50 because we've been reporting good results on the company, so that's very positive and they are working very well for the MLP because they're definitely very accretive. So -- but we have been balanced our gains because (inaudible) a yields trip on top of the common unit holder.

Unidentified Analyst

Right. My general concern is because of worldwide interest rates are starting to climb a little bit. My second question has to do with what your average debt per vessel is? And whether you see yourselves reducing that average debt per vessel?

John Costain - *KNOT Offshore Partners LP - CEO and CFO*

Well, inevitably, our debt is structured debt first mortgage priority debt, which is relatively cheap compared to equity. We have a very good quality sponsor and we have very good quality end-user contracts that support that sort of level of debt. And we obviously will take the opportunity if we're not doing accretive acquisitions to reduce the debt level. So we will reduce the debt. I mean basically at one point...

Unidentified Analyst

But you are doing that average debt per vessel. I realized taking on new vessels increases the total debt but the average across all the vessels is what I'm concerned about that it's going down in a healthy manner. Let me ask you another question. It goes down by program I realize that. But you're not taking any extra cash to alleviate a debt level on a faster basis there.

John Costain - *KNOT Offshore Partners LP - CEO and CFO*

No. I mean we were paying, these are very, very good contracts with end-user oil (inaudible) or so we can leverage quite well against that. Because obviously, there is no intermediary here, we -- the vessel is actually acting as a pipeline. So the cash flow is very secure. So you get -- you can leverage accordingly. And if you got a long contract, though, you have it's quite straightforward to do that. We -- it always operate with a decent amount of leverage and basically, when we win these contracts they are competitive and therefore, you have to have leverage to make a -- we're paying 10% yield today and I'll...

Unidentified Analyst

I know. That's one of the main reasons we're stockholders in it because of the nice yield and the soundness of your balance sheet and the way you're running the business, we're very pleased. Do you have any feeling for the average resale value of the vessels that you had? If you had to say okay, here is the whole fleet, here is what the average price of the whole fleet would be per vessel?

John Costain - *KNOT Offshore Partners LP - CEO and CFO*

On a break of charter free basis you mean. So basically, you're discounting the whole contracts have been placed and put them into like as a shuttle tanker probably...

Unidentified Analyst

Yes, I'm just trying to look at the assets by the assets themselves not as a business because obviously, the business is doing very well. Paying the nice dividends, et cetera, but I'm just looking at it from the standpoint of -- you've got value in every ship and of course, each ship is different value if it was going to be resold. So taking an average across all the ships where would you place a reasonable market value as an average number? And then also what would the average scrap value of those vessels be?

John Costain - *KNOT Offshore Partners LP - CEO and CFO*

The average price point is about $16, $17 a unit. I would say and then the premium is basically the charters and the positional sponsor in the market. But there is a resale hard value and it's pretty decent in relation to the unit. I mean obviously, it gets even more interesting as the dollar is -- as the dollar weakens more, because it has weakened in the last 2 years. And I think that's probably why you see it in the Marine space. You're looking at the Marine investment now which is probably a bit unfair, but there you go. In the Marine space, generally in the last few weeks, you've seen quite a lift in the prices of lot of these companies. Basis the fact that there are prices starting to creep up. I mean bear in mind in the U.S. in the last 2 years if you look at the benchmark of the U.S. dollar against say the SDR, Special Drawing Rights currency of the IMF. It's lost about 10% of its value and also you'll see the dollar of interest rates are going up rather to rest of the world, so the dollar is actually losing ground. It is the go-to currency of the world still but actually in positional terms, it's losing a bit of value and that makes shipping investments interesting, that's why they've lifted. But we're a bit more stable on that. We're somewhere between that in the pipeline because obviously where it impacts is obviously -- where your question is interesting is obviously the week contracting activity when we build a new ship and we go on to a field and that obviously impacts how the level at which the pricing is determined for the whole contract. So the charterer will generally look for a point in the market where the asset flex is starting to climb and we are there today and we see a pickup in activity because of it, they're not stupid they realized when they look at the market, they see if the price is bottoming out, it's both advantageous for them but it's also advantageous for the owner because obviously if you're at the bottom of the market and it's starting to climb and you order a ship and you get a 5-year contract the residual risk at the end of the contract for the owner is lower because the starting price was lower and for the charterer it gets a double benefit because the owner will go into the lower -- a lower figure, weighted average cost of capital on that basis but the residual risk is lower and also the starting price the asset price is lower, so that's what the game is with the market a little bit. So I can't say that we're not linked to the ship prices but we're a bit distant from it because we're not always stationed in the market. We do a contract and generally it's on the life of the field. But you can never say never, and it depends who moves into the market and what actually happens with it. So your question is very valid, but yes, today it's lower versus the unit price, which is -- but I think over time -- I think what's also interesting, as interest rates go up, relatively speaking a 4, 5 year old vessel is cheaper than a new build because it's actually been paid down a bit. So actually makes it mildly more competitive. But you are getting the annuity effect and if interest rates do go up significantly, it's not necessarily a bad thing for a company with a lot of slightly old tonnage. So you could -- these things happen but just maxed when you start to think about it. With all the U.S. capital market structure, there's always a circle around revenue. I think, you can always just buy everything and look at it from another point of view but your questions are interesting, yes.

Unidentified Analyst

Okay. And the other thing is in the VLCC market, you see the average value, roughly speaking of VLCCs around $16 million from scrap value point of view. If you were to look at your ships. Now your ships obviously are more specialized, would the scrap value on our ships be considerably different than that? Or would that same deal price and the equivalent?

John Costain - *KNOT Offshore Partners LP - CEO and CFO*

These are half the size -- they're half the size. But that 25,000 tonnes, 27,000 tonnes worth of steal where VLCC is 45,000 tonnes, 50,000 tonnes. The scrap price is about $400 a tonne. So it's a little bit more than that.

Unidentified Analyst

My last question is...

John Costain - *KNOT Offshore Partners LP - CEO and CFO*

(inaudible)

Unidentified Analyst

I realize we're not in the market to scrap any of our vessels. I understand that. Of course, I do. But I'm just trying to get a hard number in my mind, what the steel is worth there and all versus our vessels, et cetera. Now the last question I have is what percent of our debt is fixed?

John Costain - *KNOT Offshore Partners LP - CEO and CFO*

Well, we have to run some instruments basically. So $645 million out of the $1.1 billion is fixed. So that sort of reflects the contracts that you could see as well because obviously got about 4, 4 or 5 ships with 1-year contracts. So you probably match the long-term contracts up with the fixed portion.

Operator

At this time, this will conclude today's question-and-answer session. Like to turn the conference back over to John Costain for any closing remarks.

John Costain - *KNOT Offshore Partners LP - CEO and CFO*

Now thank you very much. And I appreciate everybody taking the time and interest in coming on the call. And hopefully, we will continue with the good quarters going forward. Thank you.

Operator

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