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KS Bancorp, Inc. (KSBI – OTC BB)

John A. (Buddy) Howard, CFA
April 24, 2018

Price:	$32.85	**EPS***	**2016A:**	$1.61	**P/E**	**2016A:**	20.4 x
52 Wk. Range:	$19.50 - $34.00	(FY: DEC)	**2017A:**	$2.17 *		**2017A:**	15.1 x
Div/Div Yld:	$0.12 / 0.4%		**2018E:**	$2.60		**2018E:**	12.6 x
Shrs/Mkt Cap:	1.3 mm / $43 mm	**Book Value:**		$19.59	**Price/Book Value:**		1.68 x

* EPS are diluted. 2017 EPS exclude deferred tax asset expense of $0.78 per share.

SYMBOL: KSBI

TOTAL ASSETS: $376 MM

HQ: SMITHFIELD, NC

CONTACT:
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EARL W. WORLEY, JR., COO
REGINA J. SMITH, CFO
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Background

KS Bancorp, Inc. is a Smithfield, North Carolina-based, single bank holding company with approximately $376 million in assets as of March 31, 2018. KS Bank, Inc., a state-chartered savings bank, is KS Bancorp's sole subsidiary. The Bank conducts its operations through nine full service branch offices that are located in Kenly, Goldsboro, Wilson, Garner, Selma, Clayton, Wendell, Four Oaks and Smithfield, North Carolina, as well as a mortgage origination office in Greenville, NC. The Company emphasizes being a community-oriented financial institution and offers a broad range of personal and business banking products and services, mortgage products and wealth management. KS Personal Services offers a complete suite of deposit and loan products that are tailored to specific needs, while KS Business Services includes not only deposit and loan products but also payroll services (through Flex Pay), merchant card services, cash management and remote deposit. KS Mortgage Services offers competitive mortgage products through a responsive team of mortgage specialists. Finally, the Company has a Trust Services Division, through which it offers a complete line of trust services, such as money management, IRAs, trust administration and estate administration. The Company also helps clients manage, protect and build upon their financial resources through college savings programs, lifetime charitable giving, investments, business succession planning, insurance and risk management. The Company's stock is traded on the over-the-counter bulletin board under the symbol "KSBI."

1ST QUARTER HIGHLIGHTS:

FIRST QUARTER EARNINGS WERE UP 27%

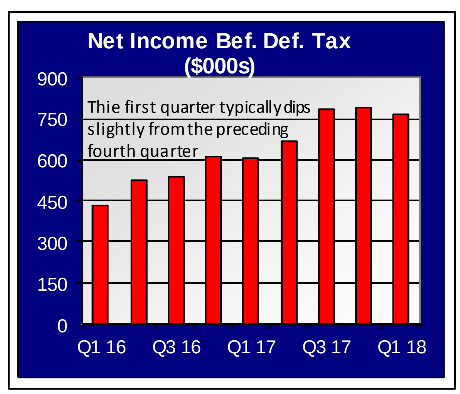
EPS: $0.58 VS. $0.46

NET INTEREST INCOME INCREASED 5%, REFLECTING MODEST GROWTH IN MARGINS AND AVERAGE EARNING ASSETS

NONINTEREST INCOME WAS UP 1%, THOUGH TRUST INCOME WAS UP 11%

First Quarter Earnings Increased Sharply; Profitability Ratios Remain High

KS Bancorp reported another solid quarter in the three months ended March 31, 2018. Earnings were strong, increasing significantly from the year-ago level, and benefitted not only from higher net interest income and noninterest income but also a lower effective tax rate. Balance sheet growth, relative to the year-ago level, remained positive, and was generally in the low single digits. Finally, asset quality was excellent, with the level of nonperforming to assets close to a ten-year low.



As was stated above, earnings in 2018's first quarter were quite strong. Although net income dipped slightly from the preceding fourth quarter (which is fairly normal for KS Bancorp), it increased an impressive 27% from the year-ago figure, reaching $764,000, or $0.58 per diluted share, versus $603,000, or $0.46 per diluted share, in the year-ago quarter. Net interest income increased 5% to $3,067,000 for the first quarter of 2018 from $2,923,000 in the year-ago quarter, reflecting modest increases in both the net interest margin and average earning assets. Thanks to the excellent asset quality, there was no provision for loan losses in either quarter. Noninterest income was up 1% to $678,000 in 2018's first quarter from $668,000 in the year-ago quarter, with an11% increase in Trust income essentially offsetting a decline in fees from presold mortgages.

NONINTEREST EXPENSE WAS ONLY UP 3%

KEY PROFITABILITY METRICS WERE QUITE STRONG, WITH ANNUALIZED ROAE REACHING 11.76%

BALANCE SHEET GROWTH WAS FAIRLY CONTROLLED, WITH LOANS UP 6% OVER THE PAST YEAR

Expense control was also excellent, as noninterest expense was only up 3%. The other aspect of the quarterly performance that we found noteworthy was the improvement of several of KS Bancorp's key performance metrics. As can be seen from the adjacent table, annualized return on average equity was 11.76% in 2018's first quarter, which placed it among the top 10% of publicly traded savings banks in the nation. Its annualized return on average assets was also commendable at 0.82%, while its NPAs/assets was 0.18% and its net interest margin was 3.36%. All of those figures are better than the medians for the typical savings bank. Recent balance sheet growth has been in the low single digits. From March 31, 2017 to March 31, 2018, gross loans increased 6%, while assets and deposits were up 2%. Stockholders' equity totaled $25.7 million, or 6.8% of total assets, at March 31, 2018. All of the Bank's regulatory capital ratios exceed the minimums to be considered "well capitalized."

Performance Ratios at a Glance (%)

	Q1 16	Q1 17
ROAA (Annualized)	0.66	0.82
ROAE (Annualized)	9.78	11.76
Net Int. Margin	3.31	3.36
NPAs/Assets	0.43	0.18

KS BANCORP HAS ACHIEVED A MUCH HIGHER LEVEL OF PROFITABILITY OVER THE PAST SEVERAL YEARS

WHILE A GOOD BIT OF THAT IMPROVEMENT CAME FROM HIGHER NET INTEREST INCOME, MOST OF IT CAME FROM BETTER EFFICIENCY, AS EXPENSES INCREASED LESS RAPIDLY THAN ASSETS

THE RATIO OF NONINTEREST EXPENSE TO AVERAGE ASSETS DECLINED FROM 3.38% IN 2013 TO JUST UNDER 3% IN THE MOST RECENT 12 MONTHS

Improvement in Profitability Metrics Has Largely Been From Improving Efficiency

If we look back over the past several years of KS Bancorp's performance, we note that there has been a notable improvement in several of its key profitability metrics, one of them being return on average assets. As we consider the source of that improvement, we see that it was mainly the result of: 1) expanding net interest income and 2) containing expenses in the face of a growing asset base. This can be seen in the table below, which shows the key areas of the income statement as a percentage of average assets. Whereas net interest income was 3.11% of average assets in 2013, it had increased to 3.34% of average assets in the trailing 12 months ended March 31, 2018, a benefit of 23 basis points. The greater contribution, however, occurred from efficiency improvements, as seen by noninterest expense dropping to 2.99% of average assets in the trailing 12 months ended March 31, 2018 versus 3.38% in 2013, an improvement of 39 basis points. Bottom line, this decrease of 39 basis points reflects the Bank's progress in growing assets without growing expenses, which is essentially operating leverage. Although not shown, the Bank's improvement in ROE has been even more impressive, partly due to the fact that the capital has also been leveraged (i.e., "more" is being done per dollar of capital).

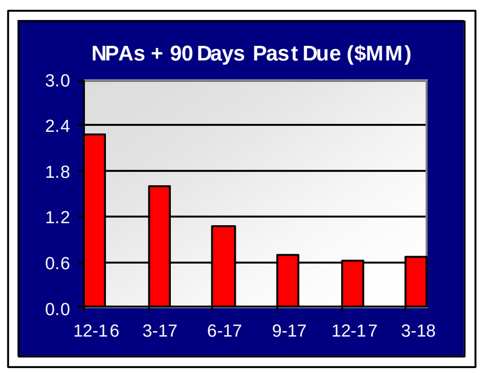
Key Figures as a Percentage of Average Assets							2013-Q1 18
	2013	2014	2015	2016	2017	TTM Q1 18	Change
Net Interest Income	3.11%	3.26%	3.21%	3.21%	3.33%	3.34%	0.23%
Provision	-0.05%	0.00%	-0.03%	0.00%	0.06%	0.06%	0.11%
Noninterest Income	0.75%	0.64%	0.64%	0.80%	0.76%	0.75%	0.01%
Noninterest Expense	-3.38%	-3.33%	-3.16%	-3.07%	-2.99%	-2.99%	0.39%
Pretax Income	0.42%	0.57%	0.65%	0.94%	1.15%	1.17%	0.74%

NPAS-TO-ASSETS: 0.18% VS. 0.43% AT YEAR-AGO DATE

RESERVES-TO-LOANS: 1.41%

Asset Quality is Excellent

Asset quality remains quite good. Nonperforming assets totaled $669,000, or 0.18% of total assets, at March 31, 2018, versus $618,000, or 0.17% of total assets, at December 31, 2017 and $1,593,000, or 0.43% of total assets, as of March 31, 2017. The current level of NPAs is near a ten-year low. The allowance for loan losses was $4.1 million, or 1.41% of total loans at March 31, 2018, versus $3.7 million, or 1.37% of total loans, as of the year-ago date.



EPS:
2016A: $1.61
2017A: $2.17*
2018E: $2.60

***EXCLUDES $0.78 PER SHARE RELATED TO DEFERRED TAX ASSET EXPENSE**

Projections Maintained

We are maintaining our 2018 earnings projection at $3.4 million, or $2.60 per diluted share. These projections could vary widely based on changing economic conditions.

ADDITIONAL INFORMATION UPON REQUEST