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KS Bancorp, Inc. (KSBI – OTC BB)

John A. (Buddy) Howard, CFA
October 25, 2018

Price:	$27.50	**EPS***	**2016A:**	$1.61	**P/E**	**2016A:**	17.1 x
52 Wk. Range:	$24.01 - $34.00	(FY: DEC)	**2017A:**	$2.17 *		**2017A:**	12.7 x
Div/Div Yld:	$0.17 / 0.62%		**2018E:**	$2.96		**2018E:**	9.3 x
Shrs/Mkt Cap:	1.1 mm / $30 mm	**Book Value:**		$18.35	**Price/Book Value:**		1.50 x

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

SYMBOL: KSBI

TOTAL ASSETS: $390 MM

HQ: SMITHFIELD, NC

CONTACT:
HAROLD T. KEEN, PRES.
EARL W. WORLEY, JR., COO
REGINA J. SMITH, CFO
(919) 938-3101

Background

KS Bancorp, Inc. is a Smithfield, North Carolina-based, single bank holding company with approximately $390 million in assets as of September 30, 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 trust services. 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."

3RD QUARTER HIGHLIGHTS:

EARNINGS WERE MUCH STRONGER THAN EXPECTED

THIRD QUARTER EARNINGS INCREASED 48%

EPS: $0.89 VS. $0.60

ROAE: 19.65%
ROAA: 1.02%

NET INTEREST INCOME INCREASED 3%

Third Quarter Results Were Excellent; EPS Increased 48% and ROAE Reached Nearly 20%

KS Bancorp reported another excellent quarter in the three months ended September 30, 2018. Earnings were much stronger than we had expected, partly due to better than anticipated increases in net interest income, but also due to solid increases in noninterest income. At the same time, the Company has done an excellent job on expense containment, as noninterest expenses actually declined despite a total revenue increase of about 7%. The higher earnings led to impressive increases in key profitability metrics, such as ROAE and ROAA, as can be seen in the adjacent table. Specifically, annualized return on average equity was 19.65% in the third quarter of 2018, up from 11.90% in the year-ago quarter, while annualized return on average assets was 1.02% versus 0.85% for the same respective periods. (The median ROAE for comparably sized banks in the region is about 10%.) We would also note that asset quality remained pristine in the quarter and that overall balance sheet growth was commendable.

Performance Ratios at a Glance (%)

	Q3 17	Q3 18
ROAA (Annualized)	0.85	1.02
ROAE (Annualized)	11.90	19.65
Net Int. Margin	3.45	3.45
NPAs/Assets	0.19	0.14

In terms of actual results, net income in 2018's third quarter increased 26% to $985,000, or $0.89 per diluted share, up from $782,000, or $0.60 per diluted share, in the year-ago quarter. Making that increase all the more impressive was the fact that there was no provision for loan losses in the current quarter, versus a *credit* for loan losses of $187,000 in the year-ago quarter. Net interest income in 2018's third quarter was up 3% to $3,189,000 from $3,095,000 in the year-ago quarter, with nearly all

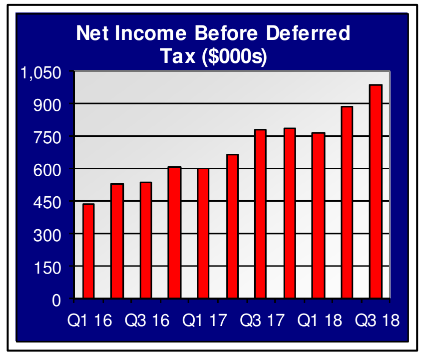
NONINTEREST INCOME SURGED 23%

NONINTEREST INCOME BENEFITTED FROM $134,000 IN SBA RELATED GAINS

NONINTEREST EXPENSE ACTUALLY DECLINED

QUARTERLY EARNINGS HAVE BEEN GROWING CONSISTENTLY OVER THE PAST SEVERAL YEARS

of that increase coming from higher average earning assets, as the net interest margin held fairly steady. As was the case last quarter, noninterest income was particularly impressive, growing 23% to $865,000 in 2018's third quarter from $702,000 in the year-ago quarter. Most of that increase came from income from the sale of an SBA loan ($134,000 in 2018's third quarter, versus none in the year-ago quarter) and higher trust income ($192,000 in 2018's third quarter, versus $171,000 in the year-ago quarter). Even excluding the SBA income, though, noninterest income was still up about 4%. Finally, noninterest expense was down slightly to $2,799,000 in 2018's third quarter from $2,810,000 in the year-ago quarter. As can be seen in the adjacent chart, quarterly earnings have been consistently increasing for several years.



NINE MONTHS HIGHLIGHTS:

EPS: $2.18 VS. $1.57

NONINTEREST INCOME WAS UP 17%, WHILE NONINTEREST EXPENSE WAS UP 3%

Earnings for the First Nine Months Were Similarly Impressive

Net income for the first nine months of 2018 was $2,636,000, or $2.18 per diluted share, versus $2,053,000, or $1.57 per diluted share, in the year-ago period. Net interest income increased 4% to $9,396,000 in the first nine months of 2018 from $9,032,000 in the year-ago period, while noninterest income was up 17% to $2,425,000 from $2,078,000 over the same respective period. As was the case with the quarterly results, there was no provision for loan losses in 2018's year-to-date period, versus a credit of $187,000 in the year-ago period. Noninterest expense was up 3% to $8,469,000 in 2018's first nine months, versus $8,232,000 in the year-ago period.

GROSS LOANS INCREASED 5% OVER THE PAST YEAR, WHILE DEPOSITS WERE UP 8%

WHILE CAPITAL RATIOS ARE FAIRLY TIGHT, WE EXPECT THEM TO INCREASE OVER TIME

Balance Sheet Growth Has Been Good; High ROAE Should Allow Capital Ratios to Improve

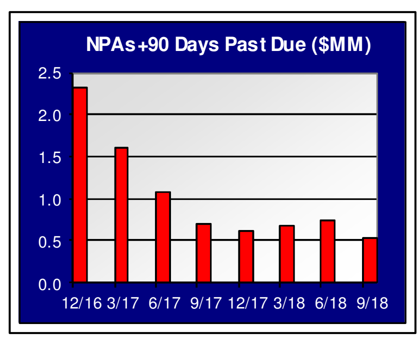
With capital ratios somewhat tight (the equity-to-assets ratio was 5.2% at September 30, 2018), we do not expect rapid balance sheet growth in the immediate future. However, our view is that modest balance sheet growth should be beneficial to earnings, as it will put less pressure on the Bank to increase the provision for loan losses and also allow it to be fairly disciplined in credit selection and pricing. Notwithstanding that expectation, the Company continues to achieve positive loan growth, as gross loans grew 5% in the past year, while deposits were up 8% and assets increased 5%. One thing that should help sustain capital ratios is KS Bancorp's high ROAE, which was close to 20% in the most recent quarter. Although we don't expect it to remain this high, we do believe it will be at least in the mid-teens in the near term. And as long as ROAE comfortably exceeds the rate of growth in assets and risk-weighted assets, capital ratios should remain steady or increase.

NPAS-TO-ASSETS: 0.14% VS. 0.19% AT YEAR-AGO DATE

RESERVES-TO-LOANS: 1.35%

Asset Quality Continues to Improve

Asset quality remains excellent. Nonperforming assets totaled $534,000, or 0.14% of assets, at September 30, 2018, versus $735,000, or 0.19% of assets, at June 30, 2018 and $697,000 or 0.19% of assets, at September 30, 2017. NPAs consisted solely of nonaccrual loans. The allowance for loan losses was $4.1 million, or 1.35% of total loans at September 30, 2018, versus $3.9 million, or 1.35% of total loans, as of September 30, 2017.



EPS:
2016A: $1.61
2017A: $2.17*
2018E: $2.96

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

Projections Increased

Based on the recent results, we are increasing our 2018 earnings estimate to $3.5 million, or $2.96 per diluted share. We will introduce our 2019 projections in the next report. These projections could vary widely based on changing economic conditions.

ADDITIONAL INFORMATION UPON REQUEST