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**KS Bancorp, Inc. (KSBI – OTC BB)**

**John A. (Buddy) Howard, CFA**  
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<b>Price:</b>	\$25.25	<b>EPS*</b>	<b>2017A:</b>	\$2.17*	<b>P/E</b>	<b>2017A:</b>	11.6 x
<b>52 Wk. Range:</b>	\$24.01 - \$34.00	(FY: DEC)	<b>2018A:</b>	\$3.00		<b>2018A:</b>	8.4 x
<b>Div/Div Yld:</b>	\$0.17 / 0.67%		<b>2019E:</b>	\$3.25		<b>2019E:</b>	7.8 x
<b>Shrs/Mkt Cap:</b>	1.1 mm / \$28 mm	<b>Book Value:</b>		\$19.97	<b>Price/Book Value:</b>		1.26 x

\* EPS are diluted. 2017 EPS exclude deferred tax asset expense of \$0.60 per share.

**Background**

KS Bancorp, Inc. is a Smithfield, North Carolina-based, single bank holding company with approximately \$400 million in assets as of December 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 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.”

**Fourth Quarter Results Were Excellent; Record High Earnings For The Year**

For the fourth quarter of 2018, KS Bancorp reported excellent results, with earnings that exceeded our estimates by \$0.04 per share. Profitability ratios remained strong, and while nonperforming assets increased compared to the year-ago date, overall asset quality was better than the majority of the Company’s peers. From a balance sheet standpoint, asset and loan growth were generally in the low single digits, with much stronger growth in deposits. The results for the full year were likewise quite impressive, as the Company’s yearly earnings reached an all-time high and management achieved its goal of earning \$3.00 per share.

The earnings comparisons were affected by a significant year-ago tax adjustment. Specifically, earnings in the fourth quarter of 2017 reflected a \$784,000 deferred tax asset charge that related to the adoption of the Tax Cut and Jobs Act of 2017. So while reported net income for the fourth quarter of 2018 was \$906,000, or \$0.82 per diluted share, versus \$6,000, or \$0.00 per diluted share, in the year-ago quarter, the more comparable year-ago figure (excluding the deferred tax asset charge) was \$790,000, or \$0.60 per diluted share. Based on this normalized year-ago figure, earnings in 2018’s fourth quarter were up about 15%, which we considered excellent. As can be seen in the adjacent chart,



**SYMBOL: KSBI**

**TOTAL ASSETS: \$400 MM**

**HQ: SMITHFIELD, NC**

**CONTACT:**  
**HAROLD T. KEEN, PRES.**  
**EARL W. WORLEY, JR., COO**  
**REGINA J. SMITH, CFO**  
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**4<sup>TH</sup> QUARTER HIGHLIGHTS:**

**EXCLUDING THE DEFERRED TAX ASSET CHARGE IN THE YEAR-AGO QUARTER, EARNINGS INCREASED 15%**

**EPS: \$0.82 vs. \$0.00 (\$0.60 EXCLUDING THE TAX ADJUSTMENT)**

**GROWTH IN AVERAGE EARNING ASSETS OFFSET MODEST MARGIN WEAKNESS**

**LONGER-TERM EARNINGS TREND IS FAVORABLE**

NONINTEREST INCOME WAS UP  
5%

TRUST INCOME INCREASED 19%

NONINTEREST EXPENSE GREW A  
MODEST 2%

#### 12 MONTHS HIGHLIGHTS:

EPS: \$3.00 vs. \$1.57  
(\$2.17 EXCLUDING THE TAX  
ADJUSTMENT)

NONINTEREST INCOME WAS UP  
14%, EXCLUDING SECURITY  
LOSSES

FROM 12/31/17 TO 12/31/18:

NET LOANS GREW 3%  
ASSETS WERE UP 7%  
DEPOSITS INCREASED 11%

EQUITY/ASSETS: 5.53%

THE STOCK APPEARS TO BE  
UNDERVALUED BASED ON THE  
COMPANY'S PERFORMANCE

NPAS-TO-ASSETS: 0.29%

RESERVES-TO-LOANS: 1.34%

EPS:  
2017A: \$2.17\*  
2018A: \$3.00  
2019E: \$3.25

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

earnings have generally been trending up for the past few years. Net interest income in 2018's fourth quarter was flat at \$3.2 million, with growth in average earning assets essentially offsetting modestly lower margins. Noninterest income had a commendable increase of 5% to \$747,000 in the fourth quarter of 2018 from \$711,000 in the year-ago quarter, with a large part of that growth coming from higher trust income, which grew 16% over this period. Earnings also benefited from solid cost containment, as noninterest expense was up a modest 2% to \$2.8 million in 2018's fourth quarter.

	Key Ratios vs. Peers (%)	
	KSBI	NC Peer Median
ROAA (Annualized)	0.92	0.89
ROAE (Annualized)	17.07	9.99
Efficiency Ratio	71.3	72.6
Overhead Ratio	64.6	66.3

Finally, there was no provision for loan losses in the fourth quarter of 2018, versus a *credit* for loan losses of \$40,000 in the year-ago quarter. As can be seen from the above table, KS Bancorp continues to report strong profitability metrics, with ROAA, ROAE, and efficiency and overhead ratios being superior to the medians for similarly sized NC financial institutions.

### Core Earnings for 2018 Were up 25%, Which Was an All -Time High; EPS Reached \$3.00

Earnings for the year 2018 were likewise excellent. Net income for the twelve months ended December 31, 2018 were \$3.5 million, or \$3.00 per diluted share, as compared to \$2.1 million, or \$1.57 per diluted share (post deferred tax adjustment) in 2017. Excluding the deferred tax adjustment, earnings in 2017 were \$2.8 million, or \$2.17 per diluted share. Net interest income was up 3% to \$12.6 million from \$12.2 million, while noninterest income increased 14% to \$3.2 million from \$2.8 million. Cost containment was also excellent, much as it was in the quarter, with noninterest expense up 3% to \$11.3 million for the year 2018 from \$11.0 million in 2017. The strong earnings growth was also achieved despite the fact that there was a *credit* for loan losses of \$227,000 in 2017.

### Balance Sheet Growth Was Led by Deposits

Balance sheet growth was generally in the low single digits over the past year, which is appropriate given the relatively tight capital position. Specifically, from December 31, 2017 to December 31, 2018, net loans increased 3%, total assets were up 7%, and deposits grew 11%. Capital wise, shareholders' equity totaled \$22.1 million, or 5.53% of total assets, at December 31, 2018. While capital remains tight, the high return on equity is allowing capital ratios to increase, as the equity-to-assets ratio was 5.18% at June 30, 2018 and 5.22% at September 30, 2018.

### A Comment About Valuation

We believe a strong case can be made that KS Bancorp's shares are undervalued based on the Bank's earnings trends, stable growth and the high ROAE. While the shares are, in fact, trading at a premium to book value, that is more than compensated, in our view, by the unusually high ROAE. On the basis of earnings, the stock is only trading at roughly eight times trailing earnings (all recurring). We will provide a more detailed discussion of the recent performance/valuation comparisons in our next report.

### Asset Quality Remains Sound

Nonperforming assets increased relative to the year-ago date, but overall asset quality remains better than most of the Company's NC peers. Nonperforming assets were \$1,178,000, or 0.29% of total assets, at December 31, 2018, as compared to \$534,000, or 0.14% of assets, at September 30, 2018, and \$618,000 or 0.21% of assets, at December 31, 2017. (All of NPAs were nonaccrual loans.) The median NPAs/assets ratio for the comparably sized NC financial institutions was 0.45%. The allowance for loan losses totaled \$4.0 million, or 1.34% of total loans at December 31, 2018, versus \$4.1 million, or 1.40% of total loans, at the year-ago date.

### 2019 Projections Released

For the year 2019, we are projecting KS Bancorp will earn \$3.6 million, or \$3.25 per diluted share. These projections could vary widely based on changing economic conditions.

#### ADDITIONAL INFORMATION UPON REQUEST

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