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KS Bancorp, Inc. (KSBI – OTC BB)

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Price:	\$25.50	EPS*	2017A:	\$2.17*	P/E	2017A:	11.8 x
52 Wk. Range:	\$24.01 - \$33.08	(FY: DEC)	2018A:	\$3.00		2018A:	8.5 x
Div/Div Yld:	\$0.28 / 1.10%		2019E:	\$3.12		2019E:	8.2 x
Shrs/Mkt Cap:	1.1 mm / \$28 mm	Book Value:		\$21.01	Price/Book Value:		1.21 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 \$397 million in assets as of March 31, 2019. 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."

First Quarter EPS Was Up 28%; Earnings Benefitted From Good Expense Containment

KS Bancorp reported another excellent quarter for the three months ended March 31, 2019, with solid increases in revenues and good expense containment. Although earnings were slightly below what we projected, the underlying fundamentals were quite positive, with increases in key balance sheet areas relative to the year-ago figures and asset quality remaining high. Moreover, the steady management of expenses has resulted in improved profitability metrics for the Company. Although ROAA was essentially unchanged from the year-ago quarter, ROAE, the *efficiency* ratio and noninterest expense as a percentage of average assets all improved significantly. (In fact, we would note that KS Bancorp's ROAE was the highest of its peers.)

Performance Ratios (Annualized %)		
	Q1 18	Q1 19
ROAE	11.76	14.45
ROAA	0.82	0.82
Efficiency Ratio	74.2	72.9
Nonint. Exp./Avg. Assets	2.97	2.81

In terms of specific results, net income for the first quarter of 2019 was \$820,000, or \$0.74 per diluted share, which was up 7% (28% based on earnings per share, due to the reduced number of outstanding shares) from \$764,000, or \$0.58 per diluted share, in the year-ago quarter. Net interest income increased 2% to \$3,136,000 in 2019's first quarter, as compared to \$3,067,000 in the year-ago quarter, with the increase driven by growth in average earning assets, as margins continued to trend somewhat lower. Noninterest income was up 3% to \$701,000 in the first quarter of 2019, versus \$678,000 in the year-ago quarter, with growth in fees from presold mortgages and other income (mostly trust income) offsetting a slight decrease in service charges on deposits. Noninterest expense increased less than 1%

SYMBOL: KSBI

TOTAL ASSETS: \$397 MM

HQ: SMITHFIELD, NC

CONTACT:
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EARL W. WORLEY, JR., COO
REGINA J. SMITH, CFO
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1ST QUARTER HIGHLIGHTS:

FIRST QUARTER RESULTS
WERE QUITE COMMENDABLE

KEY METRICS SUCH AS ROAE
WERE IMPRESSIVE

EPS: \$0.74 VS. \$0.58

NET INTEREST INCOME WAS UP
2%, WHILE NONINTEREST
INCOME INCREASED 3%

NONINTEREST EXPENSE INCREASED LESS THAN 1%, AND DECLINED ON A LINKED QUARTER BASIS

to \$2,798,000 in 2019's first quarter from \$2,777,000 in the year-ago quarter, and actually *decreased* on a linked quarter basis. As mentioned previously, this containment of expenses resulted in improvement in several measures of efficiency. Noninterest expense as a percentage of average assets (annualized) decreased 16 basis points, and the efficiency ratio improved as well. The cost containment was mainly due to declines in both compensation and benefits and occupancy and equipment. Finally, there was no provision for loan losses in either the first quarter of 2019 or 2018.

Balance Sheet Growth is Likely to Remain in the Upper Single Digits

FROM 3/31/18 TO 3/31/19:

DEPOSITS INCREASED 8%, ASSETS GREW 6% AND NET LOANS WERE UP 4%

EQUITY/ASSETS: 5.86%

KS Bancorp continues to expand the balance sheet at a somewhat tempered rate, which actually allows it to be somewhat disciplined in its pricing of both deposits and loans. Over the past year (from March 31, 2018 to March 31, 2019), deposits were up 8%, while assets increased 6% and net loans grew 4%. As was stated earlier, capital remains somewhat tight, with shareholders' equity at \$23.3 million, or 5.86% of total assets, at March 31, 2019, compared to \$25.7 million, or 6.83% of total assets, at the year-ago date.

KSBI's Relative Valuation Appears Attractive Based on Performance

KSBI HAD THE HIGHEST ROAE OF ITS PEER GROUP

ASSET QUALITY WAS SUPERIOR COMPARED TO THE NC PEER GROUP AS WELL

THE DIVIDEND YIELD IS HIGHER THAN THE PEER GROUP

KS Bancorp continues to perform quite well relative to similar North Carolina financial institutions, which we have defined as publicly traded banks and savings institutions with assets between \$250 million and \$750 million. The Company's annualized ROAA of 0.82% was in line with the peer group median of 0.82%, while its annualized return on average tangible common equity ("ROATCE") of 14.45% was much higher than the peer median 11.73%, and in fact was the highest of the peer group. The Company also has superior asset quality compared to its NC peers, with a lower NPAs-to-assets ratio and better reserve coverage. Despite KS Bancorp's superior performance, KSBI shares currently trade at a significant discount to its North Carolina peers based on price to latest twelve months earnings and price to tangible book value. Lastly, the shares have a cash dividend yield of 1.10%, which was higher than the median for the group (the median did not pay a dividend). Bottom line, we view the shares as having excellent long-term upside potential, particularly if management can maintain the current momentum in earnings.

THE SHARES TRADE AT A LARGE DISCOUNT TO THE MULTIPLES BASED ON EARNINGS AND TANGIBLE BOOK VALUE

PEER GROUP COMPARISON: KSBI VS. NC PUBLIC BANKS							
	ROAA MRQtr	ROATCE MRQtr	NPAs/ Assets	Reserves/ Loans	Dividend Yield	Price/ EPS	Price/Tang. Book Value
<i>KSBI</i>	0.82%	14.45%	0.33%	1.33%	1.10%	8.1x	1.21x
<i>Peer Median</i>	0.82%	11.73%	0.42%	0.97%	0.00%	12.3x	1.32x

Asset Quality Remains Quite Good

NPAS-TO-ASSETS: 0.33%

RESERVES-TO-LOANS: 1.33%

While nonperforming assets increased relative to the year-ago date, asset quality remains quite good and, in fact, is better than most NC publicly traded banks. Specifically, nonperforming assets totaled \$1,327,000, or 0.33% of total assets, at March 31, 2019, compared to \$1,178,000, or 0.29% of total assets, at December 31, 2018, and \$669,000, or 0.18% of assets, at March 31, 2018. (All of the NPAs were nonaccrual loans.) The Company had an allowance for loan losses of \$4.0 million, or 1.33% of total loans at the end of the first quarter of 2019, compared to \$4.1 million, or 1.41% of total loans, at the year-ago date.

Projections

**EPS:
2017A: \$2.17*
2018A: \$3.00
2019E: \$3.12**

For the year 2019, we are estimating that KS Bancorp will earn \$3.5 million, or \$3.12 per diluted share, versus our previous projection of \$3.6 million, or \$3.25 per diluted share. These projections could vary widely based on changing economic conditions.

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

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