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KS Bancorp, Inc. (KSBI – OTC BB)

John A. (Buddy) Howard, CFA
July 22, 2019

Price:	$26.07	**EPS***	**2017A:**	$2.17*	**P/E**	**2017A:**	12.0 x
52 Wk. Range:	$24.01 - $30.00	(FY: DEC)	**2018A:**	$3.00		**2018A:**	8.7 x
Div/Div Yld:	$0.28 / 1.07%		**2019E:**	$3.20		**2019E:**	8.2 x
Shrs/Mkt Cap:	1.1 mm / $29 mm	**Book Value:**		$22.56	**Price/Book Value:**		1.16 x

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

SYMBOL: KSBI

TOTAL ASSETS: $397 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 $397 million in assets as of June 30, 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."

2ND QUARTER HIGHLIGHTS:

EARNINGS WERE ABOVE EXPECTATIONS

EPS: $0.82 VS. $0.71

NET INTEREST INCOME GREW 3% FROM THE YEAR-AGO QUARTER

WHILE NONINTEREST INCOME DECREASED 2% FROM THE YEAR-AGO LEVEL, IT WAS UP 23% ON A LINKED QUARTER BASIS

Second Quarter EPS Were $0.04 Ahead of Projections; Equity Increased 26% in the Past Year

KS Bancorp reported a solid second quarter of 2019, with earnings that exceeded projections by $0.04 per share. Balance sheet growth was generally modest, as we had expected, although stockholders' equity actually increased 26% over the past year, reflecting a combination of a high ROAE and an improvement in the Accumulated Other Comprehensive Loss (i.e., unrealized losses on securities) section of the equity account. As is discussed in more detail on the opposite page, the Company's capital ratios continue to strengthen. Finally, asset quality remained sound. Although nonperforming assets were up from the year-ago level, they declined relative to March 31, 2019, and asset quality metrics were superior to the Company's peers.

Net income in the second quarter of 2019 was $907,000, or $0.82 per diluted share, up from $887,000, or $0.71 per diluted share, in the year-ago quarter. (The higher growth in the per share earnings was due to the accretion from last year's stock repurchase.) The principal driver of the higher earnings was net interest income, which increased modestly (3%) to $3,236,000 for the second quarter of 2019 from $3,140,000 in the year-ago quarter. The growth in net interest income was primarily due to average earning assets growth, as margins remain below year-ago levels. Noninterest income decreased 2% to $860,000 in 2019's second quarter from $882,000 in the year-ago quarter, though it increased 23% on a linked quarter basis, mainly due to growth in deposit service charges and trust income. Noninterest expense was essentially unchanged (it was up less than 1%) to $2,912,000 for the second quarter of 2019 compared to $2,893,000 in the year-ago quarter. Finally, there was a provision for loan losses of $25,000 in 2019's second quarter, versus no provision in the year-ago quarter.

SIX MONTH HIGHLIGHTS:

EPS INCREASED 19% ON A YEAR-TO-DATE BASIS

EPS: $1.56 VS. $1.31

NET INTEREST INCOME INCREASED 3%

PERFORMANCE RATIOS WERE QUITE IMPRESSIVE, PARTICULARLY ROAE

FROM 6/30/18 TO 6/30/19, NET LOANS AND DEPOSITS INCREASED 3%

SHAREHOLDERS' EQUITY INCREASED 26% OVER THE PAST YEAR, AND THE CAPITAL RATIOS HAVE BEEN IMPROVING

NPAS REMAIN IN A LONG-TERM DOWNTREND

NPAS-TO-ASSETS: 0.32%

RESERVES-TO-LOANS: 1.31%

EPS:
2017A: $2.17*
2018A: $3.00
2019E: $3.20

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

Year-to-Date-Performance Was Strong As Well; EPS Up 19%

Year-to-date results were solid as well, with net income at $1,727,000, or $1.56 per diluted share, versus $1,651,000, or $1.31 per diluted share, in the year-ago period. Net interest income increased 3%, while noninterest income and noninterest expense were essentially unchanged. Finally, there was a provision for loan losses of $25,000 in the first half of 2019, versus none in the first six months of 2018. Profitability ratios remain excellent, particularly returns on equity. As can be seen in the adjacent table, annualized ROAE for the first six months of 2019 was well over 14%, which was up from the year-ago level. The efficiency ratio also improved. Annualized ROAA was essentially unchanged, while the margin decreased modestly. These ratios are much better than those for the Bank's peer group and are part of the reason we believe the shares are trading at an attractive level, particularly given the low multiple of earnings. Even though the shares appear inexpensively valued, the stock has been performing relatively well over the past few years. Specifically, the shares have a three-year total return of 96% compared to 34% for the peer group median, and a five-year total return of 175% versus 71% for the peer median.

Performance Ratios (Annualized %)

	YTD 18	YTD 19
ROAE	13.56	14.75
ROAA	0.88	0.87
Efficiency Ratio	73.0	72.0
Net Interest Margin	3.38	3.29

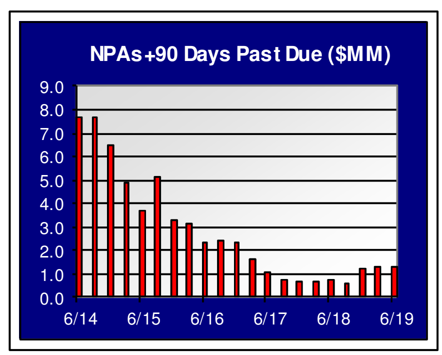
Capital Ratios Have Been Building

As we mentioned earlier in the report, balance sheet growth from June 30, 2018 to June 30, 2019 was relatively modest, with net loans and deposits increasing 3% and total assets increasing 4%. One area of the balance sheet however that has increased rapidly has been stockholders' equity. Specifically, stockholders' equity increased 26% to $25.0 million, or 6.30% of total assets, at June 30, 2019, from $19.8 million, or 5.18% of total assets, at the year-ago date. This improvement, which can be seen in the table above, matches an overall improvement in regulatory ratios that has been occurring at the Bank.

Capital Position Is Increasing	Q2 18	Q3 18	Q4 18	Q1 19	Q2 19
KSBI Common Equity ($mms)	19.8	20.3	22.1	23.3	25.0
KSBI Equity/Assets	5.18%	5.22%	5.53%	5.86%	6.30%
Bank Regulatory Ratios:					
Tier 1 Capital Ratio	12.16%	12.35%	12.68%	12.88%	12.89%
Total Capital Ratio	13.41%	13.60%	13.93%	14.13%	14.15%
Tier 1 Leverage Ratio	9.42%	9.51%	9.52%	9.63%	9.89%

NPAs Declined From March 31, 2019

Although nonperforming assets increased compared to the year-ago date, they still remain in a long-term downtrend. In terms of recent figures, nonperforming assets were $1,279,000, or 0.32% of total assets, as of June 30, 2019, versus $1,327,000, or 0.33% of total assets, at March 31, 2019, and $735,000, or 0.19% of total assets, at June 30, 2018. (All of the NPAs were nonaccrual loans.) At June 30, 2019, the Company had an allowance for loan losses of $4.0 million, or 1.31%, versus $4.1 million, or 1.37% of total loans, at the year-ago date.



Projections

For the year 2019, we are projecting that KS Bancorp will have net income of $3.5 million, or $3.20 per diluted share, which is up from our previous estimate of $3.12 per diluted share. These projections could vary widely based on changing economic conditions.

ADDITIONAL INFORMATION UPON REQUEST