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KS Bancorp, Inc. (KSBI – OTC BB)

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John A. (Buddy) Howard, CFA
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Price:	\$18.00	EPS*	2015A:	\$1.08	P/E	2015A:	16.7 x
52 Wk. Range:	\$11.75 - \$19.91	(FY: DEC)	2016A:	\$1.61		2016A:	12.0 x
Div/Div Yld:	\$0.08 / 0.4%		2017E:	\$1.75		2017E:	10.3 x
Shrs/Mkt Cap:	1.3 mm / \$24 mm	Book Value:		\$18.63	Price/Book Value:		0.97 x

* EPS are diluted.

Background

KS Bancorp, Inc. is a Smithfield, North Carolina-based, single bank holding company with approximately \$360 million in assets as of December 31, 2016. 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, KS Wealth Management Services offers a broad array of services to help clients manage, protect and build upon their financial resources. Selected wealth management services include investments, college savings programs, lifetime charitable giving, business succession planning, insurance and risk management. In addition, 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. Currently, the Company's stock is traded on the over-the-counter bulletin board under the symbol "KSBI."

Fourth Quarter Results Were Excellent; EPS Increased 47%

KS Bancorp reported much better than expected results in the fourth quarter of 2016, finishing the year with an earnings level that fell just short of an all-time high reached in 2006. Balance sheet growth was also commendable, with loans, deposits and assets increasing in at least the mid-double digits. And asset quality held up well, with nonperforming assets remaining essentially unchanged from the level at September 30, 2016 but well below year-ago levels.

Net income for the fourth quarter of 2016 was \$610,000, or \$0.47 per diluted share, up from \$417,000, or \$0.32 per diluted share, in the year-ago quarter. We had been projecting the Company would earn \$0.35 per diluted share, so the results were a full \$0.12 better than we had expected. The strength of the operating results was fairly broad based, with strong increases in net interest income and noninterest income, along with a drop in the provision. Specifically, net interest income increased 6% to \$2,861,000 for the fourth quarter of 2016 from \$2,706,000 in the year-ago quarter, with most of that growth coming from higher average earning assets. The growth in noninterest income was even stronger, at 20%, thanks to improvement in mortgage banking income and solid fees from the trust operation. Expenses, on the other hand, were quite contained. Noninterest expense was only up 4%, and excluding gains on the sale of foreclosed real estate, actually dropped slightly to \$2,668,000 in 2016's fourth quarter, versus \$2,690,000 in the year-ago quarter. Finally, we would note that there was no provision for loan losses in 2016's fourth quarter, versus a provision of \$114,000 in the year-ago quarter.

SYMBOL: KSBI

TOTAL ASSETS: \$360 MM

HQ: SMITHFIELD, NC

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

4TH QUARTER HIGHLIGHTS:

EPS: \$0.47 vs. \$0.32

NET INTEREST INCOME
INCREASED 6%

NONINTEREST INCOME WAS UP
20%, WHILE NONINTEREST
EXPENSE INCREASED A MODEST
4%

Earnings for the Full Year Were Likewise Strong

For the twelve months ended December 31, 2016, net income was \$2,109,000, or \$1.61 per diluted share, up from \$1,416,000, or \$1.08 per diluted share, in the previous year. Net interest income was up 7%, while noninterest income increased 34% and noninterest expense was up 4%. There was only a modest provision for loan losses of \$5,000 in 2016, versus \$114,000 in 2015. Return on average equity for the past year was approximately 8.9%, while return on average assets was roughly 0.61%. As was mentioned earlier, balance sheet growth was also commendable. From December 31, 2015 to December 31, 2016, gross loans increased 7%, while deposits were up 11% and assets grew 7%. The capital position remains solid as well, as shareholders' equity was \$24.4 million, or 6.8% of total assets, at December 31, 2016. The Company's strong ROAE obviously is helping to support its ongoing growth.

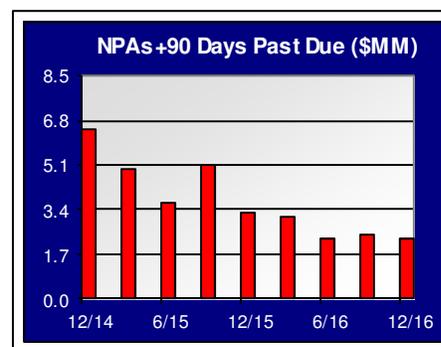
KS Bancorp Continues to Outperform Peers; Relative Valuation is Attractive

KS Bancorp is one of the better performing savings institutions in the region. As can be seen from table below, the Company has a higher return on average equity and higher return on average assets than the typical savings institution. (For purposes of peers, we included publicly traded savings institutions that were based in the Southeast or Mid-Atlantic area with assets under \$2 billion.) Moreover, it has much better asset quality and a higher level of reserve coverage. Despite the superior fundamentals, the stock trades at a discount to its peer medians on the basis of both price to earnings and price to book value. (The dividend yield is slightly lower than the peer median, but not far below it.) From a long-term return standpoint, we believe investors can often achieve superior returns by investing in high quality institutions at market (or below market) multiples. One catalyst that we often see helping to move a multiple up is the underlying level of loan and overall balance sheet growth. As we have stated in previous reports, KS Bancorp's underlying balance sheet growth has been improving over the past several quarters.

PEER GROUP COMPARISON: KSBI VS. SOUTHEAST/MID-ATLANTIC PUBLIC SAVINGS INSTITUTIONS							
	ROAA MRQ	ROAE MRQ	NPAs/ Assets	Reserves/ Loans	Dividend Yield	Price/ EPS	Price/ Book Value
KSBI	0.69%	9.9%	0.65%	1.40%	0.4%	12.0x	0.97x
Peer Median	0.62%	4.7%	0.79%	0.94%	1.2%	19.7x	1.11x

Asset Quality Trends Remain Favorable

KS Bancorp continues to make progress reducing its level of problem assets. Nonperforming assets were \$2.3 million, or 0.65% of assets, at December 31, 2016, versus \$2.4 million, or 0.69% of total assets, at September 30, 2016 and \$3.3 million, or 0.97% of total assets, as of December 31, 2015. The majority of NPAs consisted of nonaccrual loans (\$2.1 million), followed by other real estate owned (\$0.2 million). The reserve position is strong as well, as the allowance for loan losses was \$3.8 million, or 1.40% of total loans at December 31, 2016, versus \$3.5 million, or 1.41% of total loans, at the year-ago date.



Projections Increased

Based on the strength of the fourth quarter results, we are increasing our earnings projections for 2017. Specifically, we are projecting earnings of \$2.3 million, or \$1.75 per diluted share. These projections could vary widely based on changing economic conditions.

ADDITIONAL INFORMATION UPON REQUEST

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YEAR-TO-DATE HIGHLIGHTS:

EPS: \$1.61 vs. \$1.08

BALANCE SHEET GROWTH
WAS COMMENDABLE AS WELL

KS BANCORP IS A HIGH-
PERFORMING SAVINGS
INSTITUTION

DESPITE ITS SUPERIOR
PERFORMANCE, ITS STOCK IS
TRADING AT VERY
REASONABLE MULTIPLES

THIS HAS POSITIVE
IMPLICATIONS FROM A LONG-
TERM RETURN STANDPOINT

ASSET QUALITY HAS BEEN
HOLDING UP WELL

NPAs-TO-ASSETS: 0.65% vs.
0.97% AT YEAR-AGO DATE

RESERVES-TO-LOANS: 1.40%

EPS:
2015A: \$1.08
2016A: \$1.61
2017E: \$1.75