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KS Bancorp, Inc. (KSBI – OTC BB)

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John A. (Buddy) Howard, CFA
January 26, 2018

Price:	\$30.50	EPS*	2016A:	\$1.61	P/E	2016A:	18.9 x
52 Wk. Range:	\$18.50 - \$33.00	(FY: DEC)	2017A:	\$2.17 *		2017A:	14.1 x
Div/Div Yld:	\$0.12 / 0.4%		2018E:	\$2.60		2018E:	11.7 x
Shrs/Mkt Cap:	1.3 mm / \$40 mm	Book Value:		\$19.91	Price/Book Value:		1.53 x

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

Background

KS Bancorp, Inc. is a Smithfield, North Carolina-based, single bank holding company with approximately \$374 million in assets as of December 31, 2017. 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, 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 Earnings Were Outstanding

KS Bancorp reported an excellent fourth quarter, capping off a year in which core earnings (before the deferred tax charge discussed below) reached an all-time high. The deferred tax charge related to the new tax law that reduces corporate income tax rates to 21%, and similar such charges will be reported by many other institutions that have deferred taxes. The net effect of the tax law change was a \$784,000 reduction in KS Bancorp's deferred tax asset, which was recorded through an increase in income tax expense. While the one-time increase in income tax expense basically led to a break-even quarter, core earnings were quite strong and exceeded our projections.

In terms of actual results, net income in the fourth quarter of 2017 (*after* the tax adjustment) was \$6,000, or \$0.00 per diluted share, as compared to net income of \$610,000, or \$0.47 per diluted share, in the year-ago quarter. Earnings excluding the tax adjustment would have been \$790,000, or \$0.60 per share. We had been projecting the Company would earn \$0.51 per share. (Based on the strength of the results, we are revising our 2018 earnings projections upwards, as is discussed later in the report.) As has been the case for several quarters, most of the improvement in operating earnings was due to strong growth in net interest income, combined with excellent cost containment. Net interest income increased 12% to \$3,215,000 for the fourth quarter of 2017 from \$2,861,000 in the year-ago quarter, reflecting strong growth in average earning assets. Noninterest income was down slightly (4%) to \$711,000 in 2017's fourth quarter from \$739,000 in the year-ago quarter, due mainly to a decrease in fees from presold mortgages, though service charges on deposits had a solid increase of 7% over this

SYMBOL: KSBI

TOTAL ASSETS: \$374 MM

HQ: SMITHFIELD, NC

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

THERE WAS A DEFERRED TAX ASSET CHARGE OF \$1.0 MILLION IN THE QUARTER

EPS: \$0.60 (EXCLUDING TAX RELATED CHARGE) VS. \$0.47

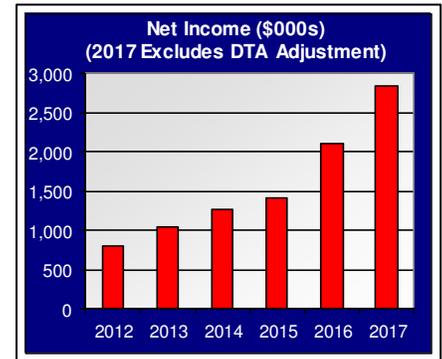
NET INTEREST INCOME INCREASED 12%

NONINTEREST INCOME AND NONINTEREST EXPENSE WERE FAIRLY FLAT

period. As was stated earlier, expenses were well contained, as noninterest expense was up a modest 5% and dropped slightly on a linked quarter basis. Finally, there was a \$40,000 credit for the provision for loan losses in 2017's fourth quarter, versus no provision in the year-ago quarter.

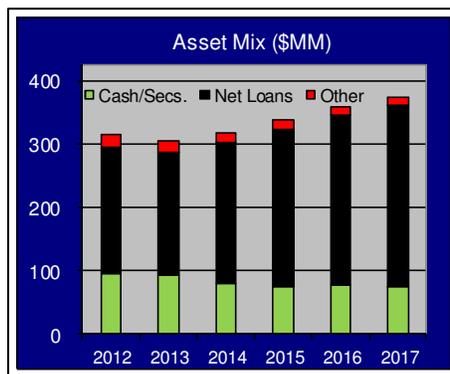
Net Income Growth Has Been Accelerating

For the full year of 2017, KS Bancorp reported net income (excluding the deferred tax asset adjustment) of \$2,843,000, or \$2.17 per diluted share, as compared to \$2,109,000, or \$1.61 per diluted share, in 2016. As can be seen in the adjacent chart, this represents a significant improvement from 2016 and reflects a particularly strong surge in earnings over the past two years. The strong momentum has come largely from the Company's significant growth in average earning assets, mainly in the loan portfolio, as is discussed in more detail below. Importantly, essentially all of this growth in earnings has come from recurring earnings sources, meaning that there have been minimal if any nonrecurring gains contributing to the increase.



Mix of Assets Has Become More Profitable; Reflects Excellent Loan Growth

As was stated above, KS Bancorp has been shifting its asset composition to a more profitable mix (i.e., more loans, less in cash and securities). This can be seen in the growing black bar (loans) in the adjacent chart. Net loans represented 77% of total assets at the end of 2017 (cash and securities were 20%), up (down in the case of cash and securities) from 63% of assets (31% for cash and securities) in 2012. The ability to increase the size of the loan portfolio has not only benefitted average earning assets but has also benefitted margins, since loans are among the Bank's highest yielding assets. In terms of recent growth, net loans were \$286 million at December 31, 2017, up 7% from the year-ago level, while assets and deposits increased 4% over this period. Stockholders' equity totaled \$26.1 million, or 7.0% of total assets, at December 31, 2017, and all of the Bank's regulatory capital ratios exceed the minimums to be considered "well capitalized."



ASSET MIX CONTINUES TO SHIFT TOWARDS LOANS

LOANS ARE NOW 77% OF TOTAL ASSETS, UP FROM 63% AT THE END OF 2012

THE ABILITY TO GROW LOANS HAS NOT ONLY FUELED EARNING ASSET GROWTH BUT HAS ALSO BENEFITTED MARGINS

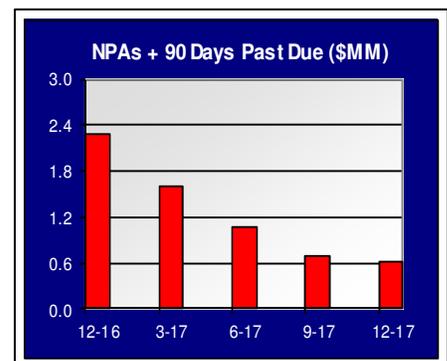
ASSET QUALITY CONTINUES TO IMPROVE

NPAS-TO-ASSETS: 0.21% VS. 0.86% AT YEAR-AGO DATE

RESERVES-TO-LOANS: 1.40%

Nonperforming Assets Decreased

The Company's asset quality continued to improve at the end of the year. Nonperforming assets totaled \$618,000, or 0.21% of total assets, at December 31, 2017, down from \$697,000, or 0.19% of assets, at September 30, 2017, and \$2,329,000, or 0.86% of total assets, as of December 31, 2016. Nonperforming assets were entirely comprised of nonaccrual loans, as there was no OREO. The allowance for loan losses was \$4.1 million, or 1.40% of total loans at December 31, 2017, which was up from \$3.8 million, or 1.40% of total loans, as of the year-ago date.



Projections Increased

Based on the strength of the fourth quarter, we are increasing our 2018 earnings projection to \$3.4 million, or \$2.60 per diluted share. These projections could vary widely based on changing economic conditions.

ADDITIONAL INFORMATION UPON REQUEST

EPS:
2016A: \$1.61
2017A: \$2.17*
2018E: \$2.60

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

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