

OFFICES of LEXINGTON STATE BANK

DAVIDSON COUNTY...

MAIN OFFICE

38 West First Avenue

ARCADIA*

3500 Old Salisbury Road

LEXINGTON LOAN CENTER

300 East Center Street

MIDWAY*

11492 Old U.S. Highway 52

NATIONAL HIGHWAY*

724 National Highway, Thomasville

NORTH LEXINGTON

1109 Winston Road

PIEDMONT RETIREMENT CENTER

100 Hedrick Drive, Thomasville

RANDOLPH STREET*

941 Randolph Street, Thomasville

FORSYTH COUNTY...

CLEMMONS*

2386 Lewisville-Clemmons Road

KERNERSVILLE*

131 East Mountain Street

REYNOLDA*

2804 Fairlawn Drive, Winston-Salem

RURAL HALL*

8055 Broad Street

GUILFORD COUNTY...

HIGH POINT*

200 Westchester Drive

RANDOLPH COUNTY...

ARCHDALE*

11651-D North Main Street

STOKES COUNTY...

DANBURY*

Highway 8 & 89, Old Walnut Cove Road

WAKE COUNTY...

RALEIGH

805 Spring Forest Road, Suite 800

* LSB Teller 24 here and at Lexington's Forest Hill Centre, C&E Convenience Center, Parkway Plaza Shopping Center, Davidson County Community College, Davidson County Governmental Center, Southmont, Lexington Memorial Hospital, Davidson County Courthouse, RCR Racing Museum, and Olivers Crossing.

LSB Bancshares, Inc.

SECOND QUARTER REPORT,
2004

First-rate banking. On a first-name basis.

To Our Shareholders:

In the second quarter, the soft economy continued to pose challenges for many businesses and individuals. As a result of the difficult economic environment, compression of our net interest margin and reduced mortgage financing activity, net income in the second quarter was \$2,236,000 or \$.26 per diluted share compared to \$2,697,000 or \$.31 per diluted share in the second quarter of 2003, a decrease of 16.1% in earnings per share. For the six months ended June 30, 2004, net income was \$4,389,000 or \$.51 per diluted share compared to \$5,251,000 or \$.61 per diluted share for the first six months of 2003. Compression of the net interest margin contributed to a decline in net interest income of approximately \$860,000 or 4.3% for the first six months compared to the same period a year ago; noninterest income, net of a one-time gain on the sale of property that had been classified as other real estate owned, was relatively flat while noninterest expense was up 2.8% compared to last year. On an annualized basis, return on average assets at the end of the second quarter was 1.01% and return on average shareholders' equity was 9.80%. Reserve for loan losses at the end of the second quarter was \$8,112,000 or 1.18% of loans while shareholders' equity totaled \$89,269,000.

A quarterly dividend of \$.16 per share was paid July 15, 2004, to shareholders of record July 1, 2004. We enclose with this report for our shareholders our Investor Relations Report prepared by Equity Research Services, Inc., that is being mailed to those individuals and firms that have expressed interest in receiving current information regarding your company and its performance.

Our Annual Shareholders' Meeting was held Wednesday, April 21, 2004, at Bancshares' headquarters followed by a luncheon at the J. Smith Young YMCA. At the Annual Shareholders' Meeting, the four directors nominated by the Board were reelected.

Shareholders approved the LSB Bancshares, Inc., Comprehensive Equity Compensation Plan for Directors and Employees and ratified the appointment of Turlington and Company L.L.P. to conduct the independent audit for the year 2004. As reported at the Annual Shareholders' Meeting, there was speculation that the stock of many banks, including LSB, would not be included in the Russell 3000 index based on market capitalization. On July 1, the Russell 3000 index was reconstituted; the stock of LSB Bancshares, Inc., was not included and the market has adjusted.

We announced in the second quarter the realignment of our branch network in Lexington in response to our customers' changing banking patterns. Following the opening this summer of our Uptown Express office, we will close our South Main office and consolidate our North Lexington and Loan Center offices with our West Side and expanded Talbert offices respectively. We anticipate the consolidations and closing will occur on September 3 which will increase our efficiency while responding to the changing needs of our customers.

We recently announced our expanded brand positioning "As Easy As LSB" in the evolution of the brand attributes that have become synonymous with your bank in providing excellent customer service in a straightforward, simplified manner.

We ask that you recommend the services of LSB TheBank to your friends and acquaintances; thank you for your continued confidence and support.



Robert F. Lowe
Chairman, President and
Chief Executive Officer



LSB Bancshares, Inc.

P.O. Box 867
Lexington, North Carolina 27293-0867

336/248-6500 www.lsbnc.com MEMBER FDIC

Consolidated Balance Sheets

(In Thousands)

	<u>June 30</u>	
	<u>2004</u>	2003
Assets		
Cash and Due from Banks	\$ 46,522	\$ 49,895
Interest-Bearing Bank Balances	1,723	4,430
Federal Funds Sold	18,768	15,050
Investment Securities:		
Held to Maturity, at Amortized Cost.....	30,740	40,426
Available for Sale, at Market Value	93,422	92,582
Loans.....	687,736	674,391
Less, Reserve for Loan Losses	(8,112)	(7,724)
Net Loans	679,624	666,667
Premises and Equipment.....	16,884	14,250
Other Assets	12,392	11,361
Total Assets	<u>\$ 900,075</u>	<u>\$ 894,661</u>
Liabilities		
Deposits:		
Demand	\$ 89,699	\$ 101,798
Savings, N.O.W. and Money Market Accounts....	414,263	401,573
Certificates of Deposit of less than \$100,000.....	119,549	136,711
Certificates of Deposit of \$100,000 or more	91,519	101,742
Total Deposits	715,030	741,824
Securities Sold Under Agreements to Repurchase ...	1,134	1,068
Borrowings from the Federal Home Loan Bank	90,000	58,000
Other Liabilities	4,642	5,337
Total Liabilities	<u>810,806</u>	<u>806,229</u>
Shareholders' Equity		
Preferred Stock, Par Value \$.01 Per Share:		
Authorized 10,000,000 shares; None Issued	0	0
Common Stock, Par Value \$5 Per Share:		
Authorized 50,000,000 Shares; Issued 8,579,468		
Shares in 2004 and 8,522,590 Shares in 2003.....	42,897	42,613
Paid-In Capital	10,397	9,974
Directors' Deferred Plan	(1,174)	(1,085)
Retained Earnings	37,349	35,109
Accumulated Other Comprehensive Income.....	(200)	1,821
Total Shareholders' Equity	<u>89,269</u>	<u>88,432</u>
Total Liabilities and Shareholders' Equity.....	<u>\$ 900,075</u>	<u>\$ 894,661</u>
Memorandum: Standby Letters of Credit	\$ 5,366	\$ 3,628

Consolidated Statements of Income

(In Thousands Except Share Data)

	<u>Three Months Ended</u>		<u>Six Months Ended</u>	
	<u>June 30</u>		<u>June 30</u>	
	<u>2004</u>	2003	<u>2004</u>	2003
Interest Income				
Interest and Fees on Loans.....	\$ 10,848	\$ 11,522	\$ 21,442	\$ 22,833
Interest on Investment Securities:				
Taxable	771	1,021	1,591	2,063
Tax Exempt.....	372	398	754	803
Interest-Bearing Bank Balances	37	44	86	98
Federal Funds Sold.....	39	64	85	161
Total Interest Income	<u>12,067</u>	<u>13,049</u>	<u>23,958</u>	<u>25,958</u>
Interest Expense				
Deposits	1,597	2,167	3,242	4,466
Securities Sold Under Agreements to				
Repurchase	2	3	5	8
Borrowings from the Federal Home Loan Bank ..	821	769	1,630	1,544
Total Interest Expense	<u>2,420</u>	<u>2,939</u>	<u>4,877</u>	<u>6,018</u>
Net Interest Income	<u>9,647</u>	10,110	<u>19,081</u>	19,940
Provision for Loan Losses.....	<u>781</u>	487	<u>1,292</u>	1,074
Net Interest Income After Provision				
for Loan Losses	<u>8,866</u>	9,623	<u>17,789</u>	18,866
Noninterest Income				
Service Charges on Deposit Accounts	1,835	1,716	3,506	3,323
Gains on Sales of Mortgages	147	379	257	737
Other Operating Income	1,907	1,620	3,482	3,004
Total Noninterest Income	<u>3,889</u>	<u>3,715</u>	<u>7,245</u>	<u>7,064</u>
Noninterest Expense				
Personnel Expense.....	4,962	5,299	10,109	10,315
Occupancy Expense	420	394	880	778
Equipment Depreciation and Maintenance	554	499	1,093	974
Other Operating Expense	3,532	3,117	6,490	5,999
Total Noninterest Expense.....	<u>9,468</u>	<u>9,309</u>	<u>18,572</u>	<u>18,066</u>
Income Before Income Taxes.....	3,287	4,029	6,462	7,864
Income Taxes.....	1,051	1,332	2,073	2,613
Net Income	<u>\$ 2,236</u>	<u>\$ 2,697</u>	<u>\$ 4,389</u>	<u>\$ 5,251</u>
Earnings Per Share				
Basic	\$.26	\$.32	\$.51	\$.62
Diluted	\$.26	\$.31	\$.51	\$.61
Weighted Average Shares Outstanding				
Basic	8,587,482	8,510,088	8,570,431	8,492,709
Diluted	8,623,383	8,571,002	8,624,437	8,556,098

LSB BANCSHARES, INC.

ROBERT F. LOWE <i>Chairman, President & Chief Executive Officer</i>	MONTY J. OLIVER <i>Secretary & Treasurer</i>
H. FRANKLIN SHERRON, Jr. <i>Vice President</i>	ROBIN A. HUNEYCUTT <i>Assistant Secretary</i>
DIRECTORS of LSB BANCSHARES, INC. and LEXINGTON STATE BANK	
ROBERT F. LOWE, <i>Chairman</i>	DAVID A. SMITH
MICHAEL S. ALBERT	ROBERT B. SMITH, Jr.
LEONARD H. BECK	BURR W. SULLIVAN
MARVIN D. GENTRY	JOHN W. THOMAS III
SAMUEL R. HARRIS	ROBERTS E. TIMBERLAKE
WALTER A. HILL, Sr.	LLOYD G. WALTER, Jr.
SUE H. HUNTER	JULIUS S. YOUNG, Jr.

LEXINGTON STATE BANK

ROBERT F. LOWE <i>Chairman & Chief Executive Officer</i>	MONTY J. OLIVER <i>Executive Vice President, Chief Financial Officer & Cashier</i>
H. FRANKLIN SHERRON, Jr. <i>President & Chief Operating Officer</i>	

SUBSIDIARIES of LEXINGTON STATE BANK

LSB INVESTMENT SERVICES, INC.	
DAVIDSON COUNTY	FORSYTH COUNTY
Lexington <i>29 West Center Street</i>	Winston-Salem <i>161 South Stratford Road</i>
Wallburg <i>10335 North N.C. Highway 109</i>	STOKES COUNTY
Welcome <i>6123 Old U.S. Highway 52</i>	King <i>647 South Main Street</i>

PEOPLES FINANCE COMPANY

*203 East Center Street, Lexington
607 South Main Street, King
11246 North Main Street, Suite 306, Archdale*

LEGAL COUNSEL Brinkley, Walsler, PLLC	INDEPENDENT ACCOUNTANT Turlington & Company, L.L.P.
TRANSFER AGENT & REGISTRAR EquiServe Trust Company, N.A. 800/633-4236	STOCK LISTING LSB Bancshares, Inc., common stock is traded on the NASDAQ National Market System (LXBK)