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April 11, 2007
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Shore Bancshares, Inc.



SHORE BANCSHARES, INC.
Banking. Insurance. Investments.

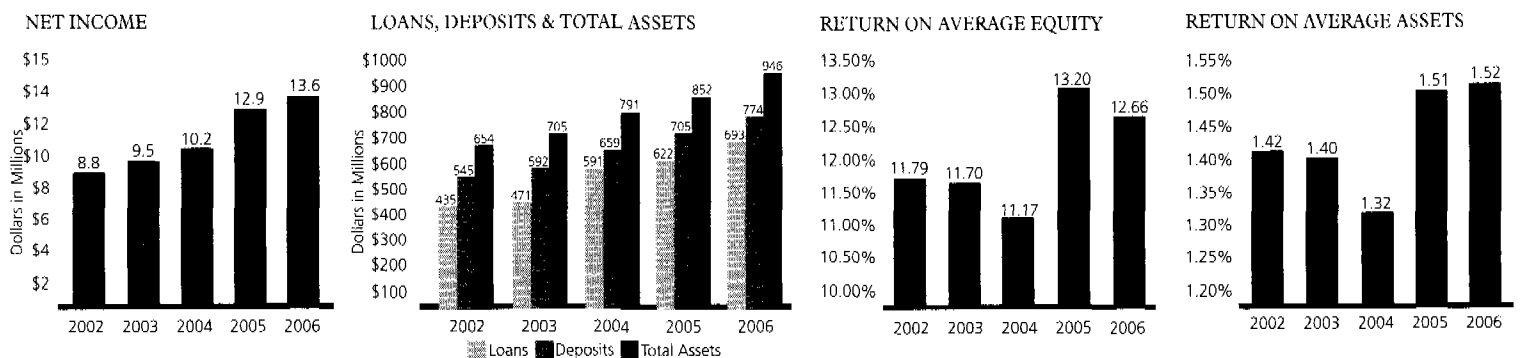
SELECTED FINANCIAL DATA

(Dollars in thousands, except per shares data)	Years Ended December 31,				
	2006	2005	2004	2003	2002
RESULTS OF OPERATIONS:					
Interest income	\$57,971	\$47,384	\$38,291	\$34,339	\$36,306
Interest expense	<u>19,075</u>	<u>11,899</u>	<u>9,010</u>	<u>9,743</u>	<u>12,438</u>
Net interest income	38,896	35,485	29,281	24,596	23,868
Provision for credit losses	<u>1,493</u>	<u>810</u>	<u>931</u>	<u>335</u>	<u>356</u>
Net interest income after provision for credit losses	37,403	34,675	28,350	24,261	23,512
Noninterest income	12,839	11,498	10,224	9,845	5,968
Noninterest expenses	<u>28,534</u>	<u>25,431</u>	<u>22,535</u>	<u>19,344</u>	<u>15,960</u>
Income before taxes	21,708	20,742	16,039	14,762	13,520
Income taxes	<u>8,154</u>	<u>7,854</u>	<u>5,841</u>	<u>5,266</u>	<u>4,730</u>
NET INCOME	\$13,554	\$12,888	\$ 10,198	\$ 9,496	\$ 8,790
PER SHARE DATA: (1)					
Net income – basic	\$1.62	\$1.55	\$1.24	\$1.18	\$1.09
Net income - diluted	1.61	1.55	1.23	1.16	1.08
Dividends paid	.59	.54	.48	.44	.40
Book value (at year end)	13.28	12.17	11.24	10.31	9.68
Tangible book value (at year end) (2)	11.67	10.51	9.53	9.37	8.72
FINANCIAL CONDITION (at year end):					
Assets	\$945,649	\$851,638	\$790,598	\$705,379	\$654,066
Deposits	774,182	704,958	658,672	592,409	545,192
Total loans, net of unearned income and allowance for credit losses	693,419	622,227	590,766	470,895	435,422
Stockholders' equity	111,327	101,448	92,976	83,527	78,028
PERFORMANCE RATIOS (for the year):					
Return on average assets	1.52%	1.51%	1.32%	1.40%	1.42%
Return on average stockholders' equity	12.66%	13.20%	11.17%	11.70%	11.79%
Net interest margin	4.70%	4.69%	4.10%	3.91%	4.12%
Efficiency ratio(3)	55.15%	54.13%	57.04%	56.17%	53.49%
Dividend payout ratio	36.65%	34.33%	38.71%	37.29%	36.59%
Average stockholders' equity to average total assets	11.98%	11.86%	11.79%	11.96%	12.00%

(1) Per share data is adjusted to give retroactive effect of a 3 for 2 stock split in the form of a stock dividend that was payable to stockholders of record as of May 12, 2006.

(2) Total stockholders' equity, net of goodwill and other intangible assets, divided by the number of shares of common stock outstanding at year-end.

(3) Noninterest expenses as a percentage of total revenue (net interest income plus total noninterest income). Lower ratios indicate improved productivity.



LETTER TO SHAREHOLDERS

To Our Shareholders:

During 2006, Shore Bancshares continued to solidify its position as the leading independent community banking organization headquartered on the Delmarva Peninsula.

In a very challenging operating environment, we reported full-year net income of \$13.6 million or \$1.61 per diluted share, up 5.2% over the very strong year that we enjoyed in 2005. We recently increased the cash dividend to an annualized rate of \$.64 per share, which results in a payout of 39.5% of 2006 earnings and a yield of slightly more than 2.5% based on a stock price of \$25. We also split the stock 3-for-2 during the second quarter.

Our banking performance for the full year was solid, with good loan growth throughout the year and a healthy 11.7% increase in fee income. The net interest margin during 2006 was consistent with the prior year at 4.70%, despite a tough and very persistent interest rate scenario combined with intense competition for deposits throughout our markets. We added substantially to the provision for credit losses, primarily in an act of prudence to account for healthy loan growth across the portfolios. Overall credit quality remains excellent, however, and continues to be a hallmark of this organization.

The Company's return on average assets for the year was 1.52% and our return on average stockholders' equity was 12.66%. Total stockholders' equity was over \$111 million at year-end, advancing by about 9% and enhancing our strong capital position.

At December 31, 2006, total assets were \$946 million, total deposits were \$774 million and loans totaled \$700 million. At a time when the entire industry is working its way through a very difficult cycle, we are pleased that the strength and profitability of Shore Bancshares and its underlying markets have consistently enabled us to produce a healthy return to our shareholders ... and also enabled us to generate good organic balance sheet growth.

Spurry succeeds Granville as Board Chairman; Duncan and Beatty appointed to senior management roles; Cannon retires

A key to our future success is the development of a succession plan for Board leadership and the senior management team.

In May, Christopher F. Spurry was elected to serve as Chairman of the Board of Shore Bancshares, succeeding Richard C. Granville, who remains a Director. Mr. Spurry has been a director of the Company since April 2004 and a director of Talbot Bank of Easton, Maryland since 1995.

The Boards of Directors of Shore Bancshares, Inc. and its subsidiary Talbot Bank announced in July that William W. (Buck) Duncan joined Talbot Bank as its new President and Chief Executive Officer and was appointed to serve as a Director of Shore Bancshares. In a related move, Vice President Lloyd L. "Scott" Beatty, Jr. was promoted to Chief Operating Officer of the holding company. He also has served as a holding company Director since 2000 and a Talbot Bank Director since 1992.

Mr. Beatty most recently was President of Choptank Partners and Managing Director/COO of Darby Overseas Investments, LTD. Previously, Mr. Beatty had a long and distinguished career in public accounting with the firm Beatty, Satchell and Company in a variety of capacities, including Managing Partner. He has served on the boards of a variety of local and national organizations including Shore Health Systems,

Eastern Shore Land Conservancy, Talbot Hospice and the United Fund of Talbot County. Mr. Beatty will continue as a Director of The Talbot Bank and Shore Bancshares, Inc. He graduated from the Salisbury University and earned his CPA license in 1976.

From 2004 and until joining Talbot Bank, Mr. Duncan served as Chairman of Mercantile Eastern Shore Bank. From 1982 through 2004 he was President and Chief Executive Officer of St. Michaels Bank, St. Michaels, MD, a Mercantile Bancshares Corporation affiliate. From 1973 through 1982 he was a vice president and senior loan officer of First National Bank of Maryland in Salisbury. From 2001 through 2004 Mr. Duncan was a director of the Federal Reserve Bank of Richmond. He was a former director of Talbot Hospice Foundation, Inc., a former director and vice chairman of Shore Health Systems, Inc. and a director and past president of the Rotary Club of Easton.

He has also served on numerous area boards, including the United Fund of Talbot County, the Maryland Bankers Association, Memorial Hospital at Easton, Inc. as a director and Chairman, the Academy Art Museum, the Chesapeake Bay Maritime Museum, the Talbot YMCA, and the Talbot County Chamber of Commerce. He holds a BA in Economics from Davis & Elkins College and MS degree in Management from the University of Arkansas.

One of the critical issues defined in the planning process was the need to separate the dual CEO roles of Talbot Bank and Shore Bancshares. The purpose for making the separation was to provide Mr. Vermilye more time to work closely with Mr. Beatty to expand and enhance the Shore Bancshares franchise. We are very pleased to have a career banker of Mr. Duncan's stature join the Shore Bancshares family of companies to lead Talbot Bank.

In December, Daniel T. Cannon retired from the Board of Directors and as Executive Vice President of the Company and as President and CEO of our subsidiary The Centreville National Bank of Maryland. He began his career with the company in 1978. A search is currently underway for a new President and CEO to replace Mr. Cannon in Centreville.

Expansion efforts to continue on Delmarva Peninsula

In 2007, we intend to continue our focus on expansion. Efforts to improve our organic growth will be at the forefront of our expansion strategy. In this respect, our goal is to improve our market share within our existing footprint by optimizing customer service and efficiency, expanding the scope of our products and continuing to make substantive investments in the existing infrastructure. We are now a family of five successful companies, four of which are over 100 years old. Our growth has produced 27 locations, 17 of which are bank branches and 10 are non-bank offices associated with our fee-based subsidiary businesses. Our geographic footprint in Maryland and Delaware is concentrated on what we believe to be the best strategic, natural submarkets – pockets of opportunity – where the small business and population growth rates, per capita income and household spending levels are above state and national averages.

From time to time, management explores the possibility of strategic transactions with well-run, successful community banks, located within defined areas of

the Delmarva Peninsula. In addition to our focus on organic growth, we intend to continue to leverage our current position as the largest publicly traded financial holding company headquartered on Delmarva and explore strategic opportunities as and when they arise.

We believe that our organization has a unique and healthy internal culture. By becoming the "employer of choice" within the local markets we serve, and then sustaining that position, we hope to become the "bank



of choice" within those same markets. Local businesses, professionals and area households recognize the quality of our employees and the attitude they bring to each customer's banking experience. A welcoming smile, a warm friendly environment and in-depth knowledge of our basic products and services awaits each customer at every location.

Management strategy has longer-term emphasis

We are managing this organization for longer-term value and, as suggested by the Board's decision to increase the common stock dividend as well as our recent substantial investments in new management talent and depth, we are confident in our ability to execute on our strategic growth plan as we move into 2007 and beyond. We believe that our Delmarva markets are healthy and growing, we are clearly focused on the fundamentals of good community banking, and we believe we are well positioned to take advantage of consolidation-related disruption in our industry.

The Company's Board of Directors, management team and employees understand the challenges, risks and opportunities that lie ahead for our industry and our Bank. We also believe that Shore Bancshares, Inc. is a most attractive opportunity for investors in the community bank sector as well as the Delmarva and mid-Atlantic marketplace. As always we remain enthused, committed and optimistic about our future.

Sincerely,

W. Moorhead Vermilye, President & CEO

Christopher F. Spurry, Chairman of the Board



BOARDS OF DIRECTORS

SHORE BANCSHARES, INC.

HERBERT L. ANDREW, III
Farmer

BLENDA W. ARMISTEAD
Investor

LLOYD L. BEATTY, JR.
Vice President & COO, Shore Bancshares, Inc.

PAUL M. BOWMAN
Attorney, Law Office of Paul M. Bowman

DANIEL T. CANNON
Executive Vice President, Shore Bancshares, Inc.
President & CEO, The Centreville National Bank of MD

WILLIAM W. "BUCK" DUNCAN
President and CEO, The Talbot Bank of Easton, MD

THOMAS H. EVANS
President and CEO, The Felton Bank

MARK M. FREESTATE
Vice President, The Avon-Dixon Agency, LLC

RICHARD C. GRANVILLE
Investor

W. EDWIN KEE, JR.
Professor, University of Delaware and
President of Kee's Creek Farm

NEL R. LeCOMPTE
Certified Public Accountant, Office of Neil R. LeCompte

JERRY F. PIERSON
President, Jerry F. Pierson, Inc.

CHRISTOPHER F. SPURRY, CHAIRMAN
President, Spurry and Associates, Inc.

W. MOORHEAD VERMILYE
President & CEO, Shore Bancshares, Inc.

Officers	
W. Moorhead Vermilye	President & CEO
Daniel T. Cannon	Executive Vice President
Susan E. Leaverton	Treasurer
Carol I. Brownawell	Secretary
Lloyd L. Beatty, Jr.	Vice President & COO
Timothy J. Berrigan	Vice President, Information Technology
Laurie H. Yorkilous	Director of Marketing
Pamela C. Hunt	Vice President, Human Resources

TRANSFER AGENT

Registrar & Transfer Company
10 Commerce Drive
Cranford, New Jersey 07016
Investor Relations: 1-800-368-5948
E-mail for investor inquiries: info@rtco.com

THE TALBOT BANK OF EASTON, MARYLAND

HERBERT L. ANDREW, III
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LLOYD L. BEATTY, JR.
DONALD D. CASSON, CHAIRMAN
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GARY L. FAIRBANK
DUANE F. MARSHALL
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DAVID L. PYLES
STEPHEN M. STEARER
CHRISTOPHER F. SPURRY
DAVID P. VALLIANT
W. MOORHEAD VERMILYE
WILLIAM W. "BUCK" DUNCAN

Officers	
William W. "Buck" Duncan	President & CEO
Jerome M. McConnell	Executive Vice President & SLO
Susan E. Leaverton	Vice President & CFO
Laura P. Heikes	Vice President & COO

THE CENTREVILLE NATIONAL BANK OF MARYLAND

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DANIEL T. CANNON
ANN B. COLLIER
MARK M. FREESTATE, CHAIRMAN
THOMAS K. HELFENBEIN
JAMES A. JUDGE
CLYDE V. KELLY, III
NEIL R. LECOMPTE
JERRY F. PIERSON
WM. MAURICE SANGER
WM. F. SYLVESTER, JR.
JEFFREY E. THOMPSON
MARY ELLEN VALLIANT

Officers	
Daniel T. Cannon	President & CEO
Carol I. Brownawell	Executive Vice President & CFO
Thomas E. Beery	Senior Vice President & SLO
Rita B. Mielke	Vice President & COO

WYE TRUST SERVICES

A Division of The Centreville National Bank of Maryland

Officers	
Elizabeth Spurry Keller	Senior Vice President, Business Development
James M. Vermilye	Senior Vice President/ Trust Officer
Henry Brandt	Vice President/Trust Officer

WYE MORTGAGE GROUP

A Division of The Centreville National Bank of Maryland

Officers	
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Laurie Schnaitman	Vice President

THE AVON-DIXON AGENCY, LLC

LLOYD L. BEATTY, JR.
LEONARD "JAY" DAYTON, JR.
MARK M. FREESTATE
WILLIAM L. LANE, JR., CHAIRMAN
DAVID C. LEE
SALLY E. MCCLELLAN
EDWARD "NED" McDONALD
TERRY M. MEAD
DIANA H. JOHNSON
JACK BROOKS
JOHN DEWILDER
JOHN WILSON

Officers	
Terry M. Mead	CEO

ELLIOTT WILSON INSURANCE, LLC

EDWARD "NED" McDONALD
TERRY M. MEAD
ERIKA S. WILSON

Officers	
Terry M. Mead	CEO

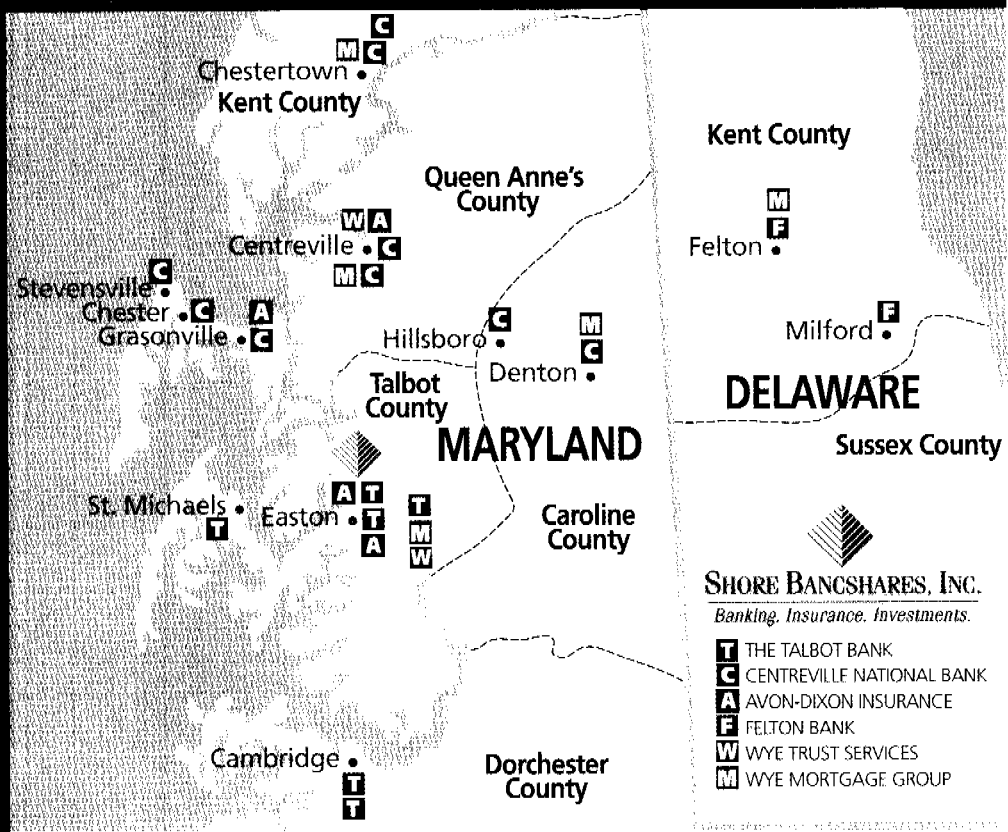
THE FELTON BANK

FREDERICK A. DUFFY
THOMAS H. EVANS
W. EDWIN KEE, JR., CHAIRMAN
HARVEY R. KENTON, JR.
THOMAS E. MEVIN
DAVID W. MOORE, VICE CHAIRMAN
JAMES W. TORBERT
W. MOORHEAD VERMILYE

Officers	
Thomas H. Evans	President
Susan E. Leaverton	Vice President & CFO
Robin M. Deputy	Vice President & COO
Dianne L. Webb	Vice President

Seated, left to right: Lloyd L. Beatty, Jr., W. Moorhead Vermilye, Christopher F. Spurry
Standing, left to right: Thomas H. Evans, Neil R. LeCompte, W. Edwin Kee, Jr.,
Herbert L. Andrew, III, Paul M. Bowman, Mark M. Freestate,
Blenda W. Armistead, Jerry F. Pierson, William W. "Buck" Duncan
Not pictured: Daniel T. Cannon, Richard C. Granville

LOCATIONS



SHORE BANCSHARES, INC.
Banking. Insurance. Investments.

- T** THE TALBOT BANK
- C** CENTREVILLE NATIONAL BANK
- A** AVON-DIXON INSURANCE
- F** FELTON BANK
- W** WYE TRUST SERVICES
- M** WYE MORTGAGE GROUP

THE CENTREVILLE NATIONAL BANK OF MARYLAND

Centreville Office
 109 N. Commerce Street
 Centreville, MD 21617
 410/758-1600
 877/758-1600

Route 213 Office
 2609 Centreville Road
 Centreville, MD
 410/758-2414

Chester Office
 300 Castle Marina Road
 Chester, MD 21619
 410/604-6270

Chestertown Office
 305 East High Street
 Chestertown, MD 21620
 410/778-1299

Denton Office
 850 South 5th Avenue
 Denton, MD 21629
 410/820-4007

Grasonville Branch
 202 Pullman Crossing
 Grasonville, MD 21638
 410/827-4636

Hillsboro Office
 21913 Shore Highway
 Hillsboro, MD 21641
 410/820-2121

Stevensville Office
 408 Thompson Creek Road
 Stevensville, MD 21666
 410/643-2233

Washington Square Office
 899 Washington Avenue
 Chestertown, MD 21620
 410/810-0591

WYE TRUST SERVICES
 A Division of The Centreville National Bank of Maryland

Main Office
 17 E. Dover Street
 Easton, MD 21601
 410/763-8543

Centreville Office
 109 N. Commerce Street
 Centreville, MD 21617
 410/758-1600

WYE MORTGAGE GROUP
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(Administrative Offices)
 Centreville Office
 109 N. Commerce Street
 P.O. Box 400
 Centreville, MD 21617
 443/262-9326

Easton Office
 17 E. Dover Street
 Easton, MD 21601
 410/770-8786

THE TALBOT BANK OF EASTON, MARYLAND

Main Office
 18 East Dover Street
 Easton, MD 21601
 410/822-1400
 800/673-8258

Tred Avon Square Branch
 212 Marlboro Ave
 Easton, MD 21601
 410/819-3022

St. Michaels Branch
 1013 S. Talbot Street
 St. Michaels, MD 21663
 410/745-9166

Elliott Road Branch
 8275 Elliott Road
 Easton, MD 21601
 410/822-2642

Dorchester Square Branch
 2745 Dorchester Square
 Cambridge, MD 21613
 410/476-3762
 410/221-7690

Sunburst Branch
 424 Dorchester Ave
 Cambridge, MD 21613
 410/476-4407
 410/228-8402

THE AVON-DIXON AGENCY, LLC

Headquarters
 28969 Information Lane
 Easton, MD 21604
 410/822-0506
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 106 N. Harrison Street
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 Grasonville, MD 21638
 410/827-3161
 800/734-4176

The Avon-Dixon Agency
 t/a W.M. Freestate & Son
 105 Lawyers Row
 Centreville, MD 21617
 410/758-0757
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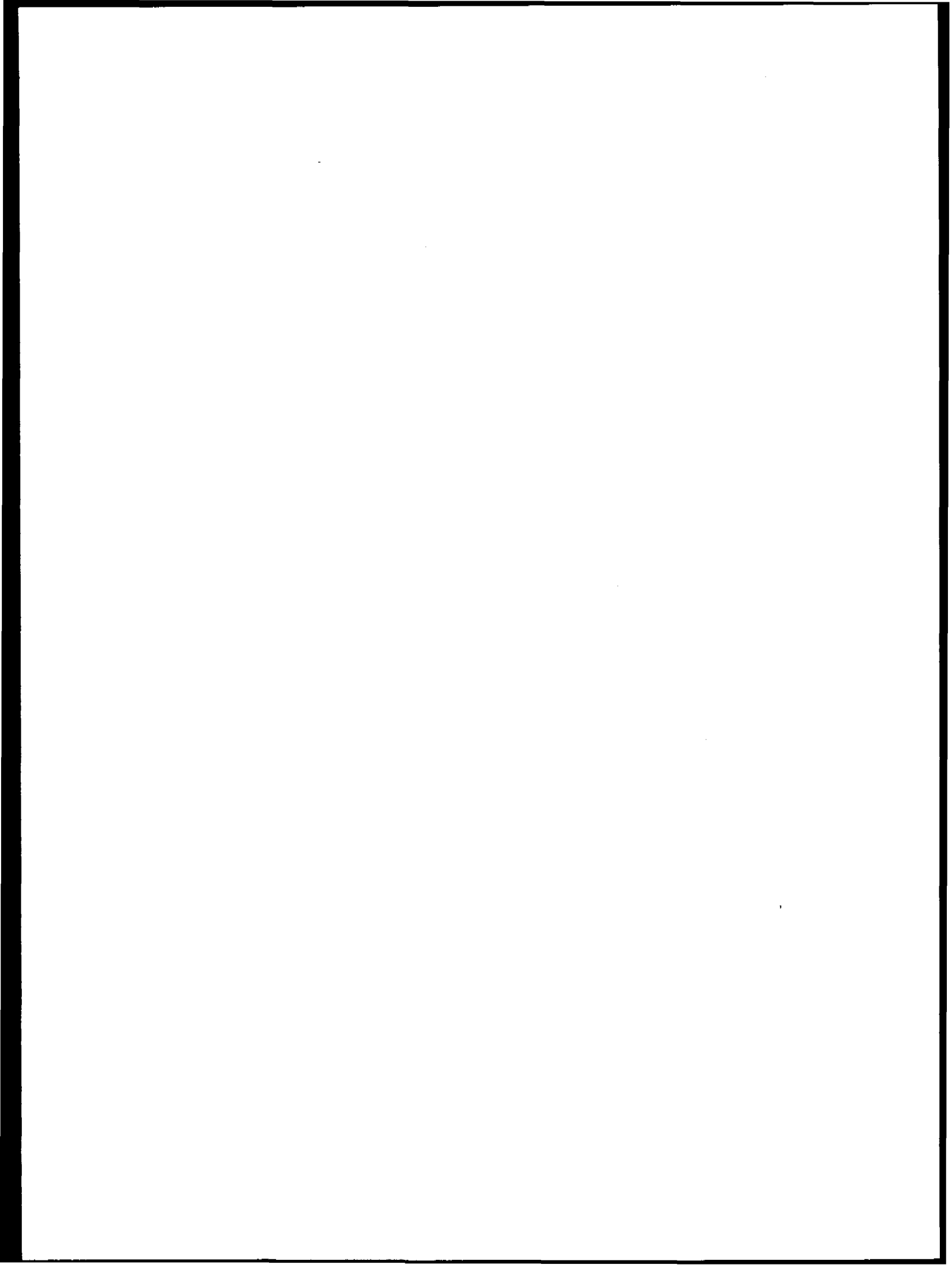
ELLIOTT WILSON INSURANCE, LLC

Professional Trucking Services
 106 N. Harrison Street
 Easton, MD 21601
 410/820-7797
 800/235-9885

THE FELTON BANK

Felton Branch
 120 W. Main Street
 P.O. Box 266
 Felton, DE 19943
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Milford Branch
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 Milford, DE 19963
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CORPORATE OFFICES

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THE TALBOT BANK OF EASTON

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THE CENTREVILLE NATIONAL BANK OF MARYLAND

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