102 7751

Presence

Stability

Strength

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Shore Bancshares, Inc.

Banking. Insurance. Investments.

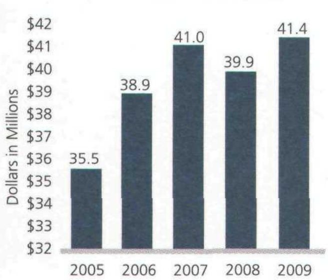
2009 Annual Report

SELECTED FINANCIAL DATA

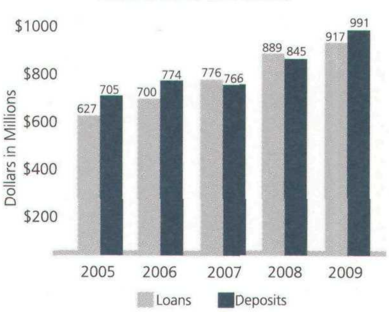
(Dollars in thousands, except per share data)	2009	2008	2007	2006	2005
	Years Ended December 31,				
RESULTS OF OPERATIONS:					
Interest income	**$58,789**	$61,474	$65,141	$57,971	$47,384
Interest expense	**17,411**	21,555	24,105	19,074	11,899
Net interest income	**41,378**	39,919	41,036	38,897	35,485
Provision for credit losses	**8,986**	3,337	1,724	1,493	810
Net interest income after provision for credit losses	**32,392**	36,582	39,312	37,404	34,675
Noninterest income	**19,541**	20,350	14,679	12,839	11,498
Noninterest expense	**40,248**	38,370	32,539	28,535	25,431
Income before income taxes	**11,685**	18,562	21,452	21,708	20,742
Income tax expense	**4,412**	7,092	8,002	8,154	7,854
Net income	**7,273**	11,470	13,450	13,554	12,888
Preferred stock dividends and discount accretion	**1,876**	—	—	—	—
Net income available to common shareholders	***$5,397***	*$11,470*	*$13,450*	*$13,554*	*$12,888*
PER COMMON SHARE DATA:					
Net income – basic	**$0.64**	$1.37	$1.61	$1.62	$1.55
Net income – diluted	**0.64**	1.37	1.60	1.61	1.54
Dividends paid	**0.64**	0.64	0.64	0.59	0.54
Book value (at year end)	**15.18**	15.16	14.35	13.28	12.17
Tangible book value (at year end)[1]	**12.64**	12.55	11.68	11.67	10.51
FINANCIAL CONDITION (at year end):					
Loans	**$ 916,557**	$ 888,528	$ 776,350	$699,719	$627,463
Assets	**1,156,516**	1,044,641	956,911	945,649	851,638
Deposits	**990,937**	845,371	765,895	774,182	704,958
Long-term debt	**1,429**	7,947	12,485	25,000	4,000
Stockholders' equity	**127,810**	127,385	120,235	111,327	101,448
PERFORMANCE RATIOS (for the year):					
Return on average total assets	**0.48%**	1.13%	1.42%	1.52%	1.51%
Return on average stockholders' equity	**4.00**	9.22	11.79	12.66	13.20
Net interest margin	**3.90**	4.23	4.64	4.70	4.69
Efficiency ratio[2]	**66.07**	63.66	58.40	55.15	54.13
Dividend payout ratio	**100.00**	46.72	39.75	36.42	34.84
Average stockholders' equity to average total assets	**11.96**	12.30	12.04	11.98	11.86

[1]Total stockholders' equity, net of goodwill and other intangible assets, divided by the number of shares of common stock outstanding at year end.
[2]Noninterest expense as a percentage of total revenue (net interest income plus total noninterest income). Lower ratios indicate improved productivity.

NET INTEREST INCOME

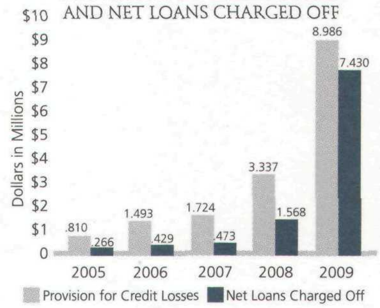


LOANS AND DEPOSITS



DILUTED EARNINGS PER SHARE AND DIVIDENDS PAID PER SHARE

PROVISION FOR CREDIT LOSSES AND NET LOANS CHARGED OFF



LETTER TO STOCKHOLDERS

To Our Stockholders,

We are pleased to report that our Company produced favorable financial results for 2009 when compared to the banking industry and our Mid-Atlantic peer group. Many of our peers and other competitors reported unprecedented losses in 2009, while we continued to produce sustained profitability and decent growth, despite the most difficult ongoing operating environment our Board of Directors and Management team has seen.

Financial Results

Net income available to common stockholders for 2009 was $5.397 million compared to $11.470 million in 2008. Diluted earnings per common share were $0.64 for 2009 compared to $1.37 for 2008. The Company's participation in the TARP program in 2009 resulted in lower net income available to common stockholders of $1.876 million or $0.22 per share. Our return on average assets was 0.48% and return on average stockholder's equity was 4.0% compared to 1.13% and 9.22%, respectively, for 2008.

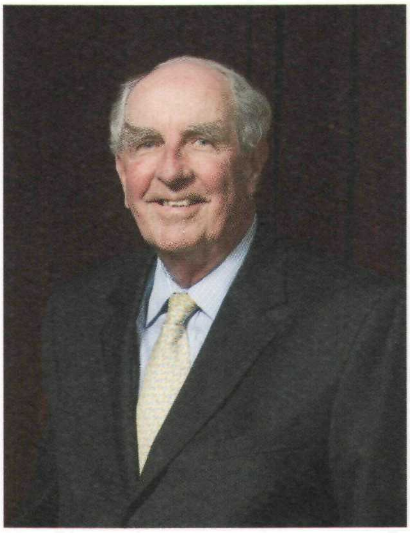
The primary reasons for our net income decline in 2009 can be explained by examining two line items in the Company's income statement. Those two lines are: FDIC Insurance Premium expense and Provision for Credit Losses.

During 2009, the FDIC imposed a one-time special assessment on banks and increased overall premium rates. For Shore Bancshares, this special assessment and rate restructure, compounded by our continued deposit growth, resulted in an increase in FDIC insurance expense of $1.722 million for 2009. At the end of 2009, the FDIC decided to collect three years of insurance premiums in advance, rather than impose a second special assessment. This decision required us to re-characterize $5.424 million in liquid earning assets as prepaid expenses.

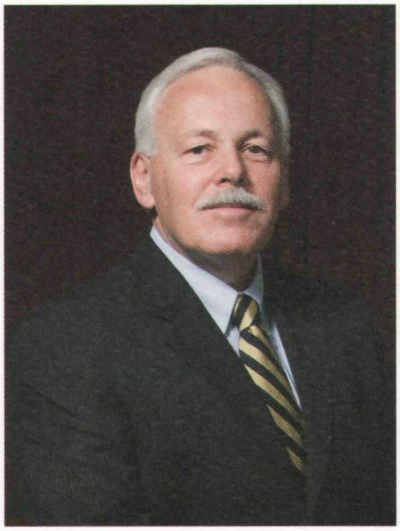
The second significant expense increase we realized in 2009 was the provision for credit losses. The Company recorded a provision for credit losses of $8.986 million compared to $3.337 million in 2008. The increased provision was in response to credit quality issues identified in the Company's ongoing credit review and monitoring policies. The Company recognized elevated losses and higher levels of problem loans in both the secured real estate and the commercial loan categories, as many individual borrowers and small businesses struggled with the receding economy and weak housing market.

Clearly, the underlying factors driving our need to significantly increase reserves for possible credit losses are all tied to the deterioration of regional economic conditions that began in 2008 and continued throughout 2009. However, our home markets on the Delmarva Peninsula have not been as hard hit as many other areas on the East Coast and we are cautiously optimistic that the strength and vitality of the areas covered by our footprint will continue to trend relatively favorably. Also on a more positive note, despite the overall declining yield on earning assets, the Company sequentially improved net interest income during the second, third and fourth quarters of 2009. Our net interest income for the year increased 3.7% totaling $41.4 million, producing a very respectable net interest margin for the year of 3.90%. In addition, excluding FDIC insurance, the Company held the growth of noninterest expenses to a modest increase of just $156 thousand. The Company produced strong balance sheet growth in 2009. Total assets increased 10.7%, totaling $1.157 billion. Total loans increased $28 million or 3.2% to $916.6 million, total deposits grew 17.2% to $990.9 million, and borrowings declined $39.1 million or 64.2% as we were able to principally fund the balance sheet growth via increased deposits.

Notably, in addition to strong retail deposit growth, one significant deposit relationship with the Promontory Interfinancial Network's IND program brought approximately $85 million in fully insured deposits to the Company. The liquidity provided by overall deposit growth of $145.6 million enabled the Company to pay down short and long term borrowings by $39.1 million, increase investment securities by $20.2 million and fed funds sold by $50.6 million, in addition to funding the aforementioned $28 million in loan growth.



W. Moorhead Vermilye
President and CEO



Christopher F. Spurry
Chairman of the Board

Banking and related services

During 2009, the Company completed the conversion of its core processing system to a new vendor. This was a complex process that began in 2008. The magnitude of this project cannot be overstated as it has required a company-wide effort that has touched every employee in some way. Retraining all bank employees consumed a huge amount of time and will be an ongoing process as we begin to utilize the full capabilities of the new system. As a result of the new processing platform, we should be substantially better equipped to compete with larger regional banks on more sophisticated product offerings.

During 2009, the Talbot Bank opened a new branch in Trappe, Maryland. The location had not been previously banked and was selected as it bridges the bank's existing Talbot County branches with the Dorchester County branch in Cambridge. We see growth potential for the Trappe area in the future, and in the meantime this service location is being operated at very low cost to the bank.

At the end of 2009, our banking subsidiary The Centreville National Bank of Maryland converted from a national bank charter to a Maryland state bank charter. This change was prompted by management's desire to have the same charters at each of our Maryland bank subsidiaries. In conjunction with this change, the bank was required to eliminate "National" from its name, and on December 31, 2009 its name officially became simply CNB. Management believes "CNB" allows the bank to retain local recognition while having a more marketable name as it expands into new locations and communities on the Delmarva Peninsula.

Insurance activities

Our insurance division continues to work through "soft" market conditions and experienced a decline in commission income of $959 thousand for the year. However, new business growth was strong during 2009; although premiums and resultant commissions were greatly affected by reduced customer sales volumes, employee payrolls, business downsizing and closures. We believe that our efforts to expand our customer base and strengthen existing relationships will contribute to significant increases in insurance revenues when the market returns to more normal operating conditions. The insurance division also continued to work on new producer development in 2009 as a foundation for sustainable future growth.

Strategic Initiatives

We continue to evaluate selected opportunities to expand our footprint on the Delmarva Peninsula and to grow our banking and insurance operations in order to further enhance stockholder value. Given the current economic and regulatory environments, it is a difficult challenge, but we believe the attractiveness of our franchise gives us a competitive advantage as a potential aggregator.

2010 expectations

We expect 2010 to be another challenging year, especially if the speed of our national and local economic recovery does not accelerate. Managing asset quality and increasing capital will remain our top priorities. Beyond that, we will strive to achieve modest loan growth, to improve our net interest margin, and to optimize the resulting returns to stockholders during 2010. We are committed to providing the very best products and exceptional levels of customer service in our markets, not only in our community banks, but also in our wealth management and insurance divisions. We expect to continue to demonstrate that we are the premier financial institution on the Delmarva Peninsula, and to continue to out-perform our local competitors and regional peers.

Our Board of Directors, management team and employees thank you for your ongoing support and confidence.

Sincerely,

W. Moorhead Vermilye

Christopher F. Spurry

LOCATIONS

SHORE BANCSHARES, INC.

Executive Office
18 East Dover Street
Easton, MD 21601
Phone (410) 763-7800

Headquarters
28969 Information Lane
Easton, MD 21601
Phone (410) 763-7800

www.shbi.com

BANKING

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 Avenue
Easton, MD 21601
(410) 819-3015

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

Elliott Road Branch
8275 Elliott Road
Easton, MD 21601
(410) 819-0181

Sunburst Branch
424 Dorchester Avenue
Cambridge, MD 21613
(410) 476-4407
(410) 228-8402

Tilghman Branch
5804 Tilghman Island Road
Tilghman, MD 21671
(410) 886-9802

Trappe Branch
29349 Maple Avenue, Suite 1
Trappe, MD 21673
(410) 476-3181

CNB

Main Office
109 N. Commerce Street
Centreville, MD 21617
(410) 758-1600
(877) 758-1600

Route 213 Branch
2609 Centreville Road
Centreville, MD 21617
(410) 758-2414

Chester Branch
300 Castle Marina Road
Chester, MD 21619
(410) 604-6270

Chestertown Branch
305 High Street
Chestertown, MD 21620
(410) 778-1299

Denton Branch
850 South 5th Avenue
Denton, MD 21629
(410) 820-4007

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

Hillsboro Branch
22151 Wes Street
Ridgely, MD 21660
(410) 820-2121

Stevensville Branch
408 Thompson Creek Road
Stevensville, MD 21666
(410) 643-2233

Washington Square Branch
899 Washington Avenue
Chestertown, MD 21620
(410) 810-0591

THE FELTON BANK

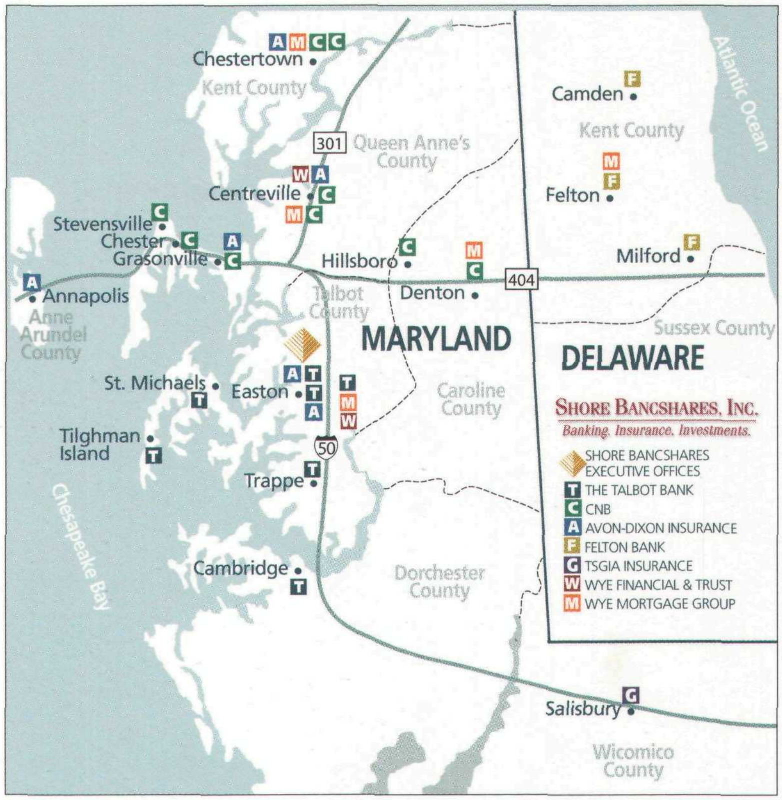
Main Office
120 W. Main Street
Felton, DE 19943
(302) 284-4600
(800) 989-4383

Milford Branch
698A N. DuPont Blvd.
Milford, DE 19963
(302) 424-4600

Camden Branch
263 Wal-Mart Drive
Camden, DE 19934
(302) 698-1432

WYE MORTGAGE GROUP, LLC

17 E. Dover Street, Suite 101
Easton, MD 21601
(410) 770-8786
(888) 204-8908



INSURANCE

THE AVON-DIXON AGENCY, LLC

Headquarters
28969 Information Lane
Easton, MD 21601
(410) 822-0506
(800) 242-8758

Easton Office
106 N. Harrison Street
Easton, MD 21601
(410) 822-0506
(800) 242-8758

Chestertown Office
899 Washington Avenue
Chestertown, MD 21620
(410) 758-0757

Grasonville Office
202 Pullman Crossing
Grasonville, MD 21638
(410) 822-0506
(800) 734-4176

The Avon-Dixon Agency
t/a W. M. Freestate & Son
105 Lawyers Row
Centreville, MD 21617
(410) 758-0757
(800) 462-0658

ELLIOTT WILSON INSURANCE, LLC

106 N. Harrison Street
Easton, MD 21601
(410) 820-7797
(800) 235-9885

JACK MARTIN & ASSOCIATES, INC.

135 Old Solomon's Island Road
Annapolis, MD 21401
(410) 626-1000
(800) 497-8101

TRI-STATE GENERAL INSURANCE AGENCY, LTD.

One Plaza East, 4th Floor
Salisbury, MD 21802
(410) 546-1255
(800) 556-7894

INVESTMENTS

WYE FINANCIAL & TRUST

Main Office
16 N. Washington Street, Suite 1
Easton, MD 21601
(410) 763-8543

Centreville Office
109 N. Commerce Street
Centreville, MD 21617
(410) 763-8543

NASDAQ: SHBI
(410) 763-7800

Seated, left to right:
Herbert L. Andrew, III, James A. Judge,
Blenda W. Armistead, W. Moorhead Vermilye,
Lloyd L. "Scott" Beatty

Standing, left to right:
Jerry F. Pierson, John H. Wilson, F. Winfield Trice, Jr.,
Christopher F. Spurry, Richard C. Granville,
William W. "Buck" Duncan

(Not pictured) Neil R. LeCompte

2009 SHORE BANCSHARES, INC. BOARD OF DIRECTORS

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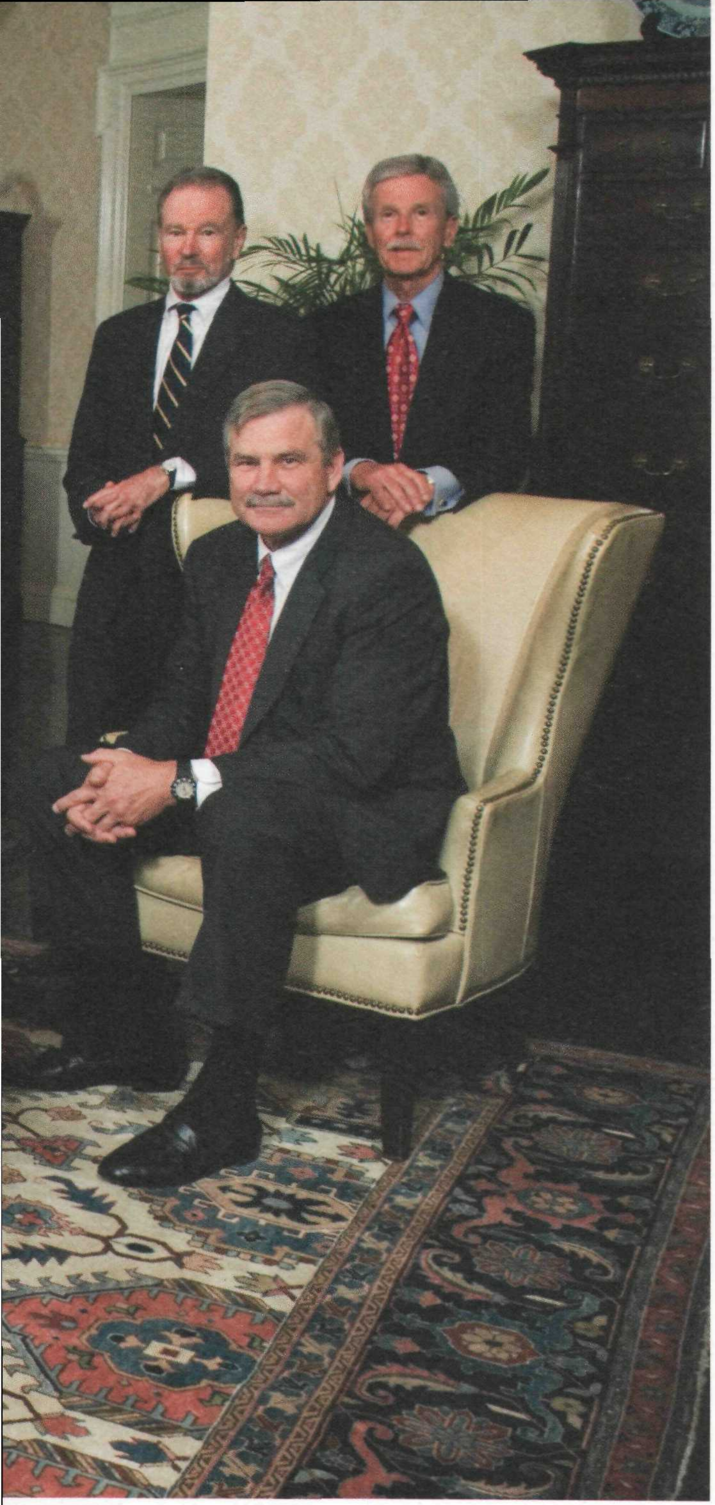

2009 SHORE BANCSHARES, INC. OFFICERS

W. Moorhead Vermilye, *President & CEO*
Lloyd L. "Scott" Beatty, Jr., *Executive Vice President & COO*
Susan E. Leaverton, *Treasurer & CFO*
W. David Morse, *Secretary*
Carol I. Brownawell, *Assistant Secretary*
Andrea G. Bayline, *Vice President, Internal Audit*
Timothy J. Berrigan, *Vice President & CIO*
Pamela J. Hunt, *Vice President & CHRO*
Laurie H. Yorkilous, *Director of Marketing*

BOARD OF DIRECTORS

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THE TALBOT BANK OF EASTON, MARYLAND

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CNB

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WM. E. SYLVESTOR, JR.
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F. WINFIELD TRICE, JR.
MARY ELLEN VALLIANT

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Thomas E. Beery	*Senior Vice President & SLO*
Charles E. Ruch, Jr.	*Senior Vice President & Senior Credit Officer*

THE FELTON BANK

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JAMES W. TORBERT
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W. MOORHEAD VERMILYE

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Susan E. Leaverton	*Vice President & CFO*
Robin M. Deputy	*Vice President & Sr. Operations Officer*
Dianne L. Webb	*Vice President*
James C. Johnson	*Vice President/ Commercial Lender*

WYE MORTGAGE GROUP, LLC

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Rick Rider	*President*

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JACK BROOKS
LEONARD "JAY" DAYTON, JR.
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DIANA H. JOHNSON
WILLIAM L. LANE, JR., *CHAIRMAN*
DAVID C. LEE
EDWARD "NED" McDONALD
TERRY M. MEAD
JOHN H. WILSON

Officers

Terry M. Mead	*CEO*

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

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Terry M. Mead	*CEO*

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Terry M. Mead	*CEO*

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Edward A. Dickerson, III	*President*
Lloyd L. "Scott" Beatty, Jr.	*Vice President*
Brenda Dickerson	*Secretary/Treasurer*

INVESTMENTS

WYE FINANCIAL & TRUST
A DIVISION OF CNB

Officers

Elizabeth Spurry	*Senior Vice President, Business Development*
James M. Vermilye	*Senior Vice President, Trust Officer*
Richard B. Grieves	*Vice President*

SHORE BANCSHARES, INC.
Banking. Insurance. Investments.

SHORE BANCSHARES, INC.

Executive Office
18 East Dover Street
Easton, MD 21601
Phone (410) 763-7800
Fax (410) 820-4238

Headquarters
28969 Information Lane
Easton, MD 21601
Phone (410) 763-7800
Fax (410) 822-8893

www.shbi.com

BANKING

THE TALBOT BANK OF EASTON, MARYLAND
18 East Dover Street
Easton, MD 21601
Phone (410) 822-1400
Fax (410) 820-7180
www.talbot-bank.com

CNB
109 N. Commerce Street
Centreville, MD 21617
Phone (410) 758-1600
Fax (410) 758-2364
www.cnbmd.com

THE FELTON BANK
120 West Main Street
Felton, DE 19943
Phone (302) 284-4600
Fax (302) 284-9791
www.feltonbank.com

WYE MORTGAGE GROUP, LLC
17 E. Dover Street, Suite 101
Easton, MD 21601
Phone (410) 770-8786
Fax (410) 819-3048
www.wyemortage.com

NASDAQ: SHBI
(410) 763-7800

INSURANCE

THE AVON-DIXON AGENCY, LLC
28969 Information Lane
Easton, MD 21601
Phone (410) 822-0506
Fax (410) 820-5629
www.avondixon.com

ELLIOTT WILSON INSURANCE, LLC
106 N. Harrison Street
Easton, MD 21601
Phone (410) 820-7797
Fax (410) 820-7754
www.avondixon.com

JACK MARTIN & ASSOCIATES, INC.
135 Old Solomon's Island Road
Annapolis, MD 21401
Phone (410) 626-1000
Fax (410) 626-9966
www.jackmartin.com

TRI-STATE GENERAL INSURANCE AGENCY, LTD.
One Plaza East, 4th Floor
Salisbury, MD 21802
Phone (410) 546-1255
Fax (800) 518-1904
www.tsgia.com

INVESTMENTS

WYE FINANCIAL & TRUST
16 N. Washington Street, Suite 1
Easton, MD 21601
Phone (410) 763-8543
Fax (410) 763-8557
www.wyetrust.com

TRANSFER AGENT

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