

Shore Bancshares, Inc. | 2014 Annual Report



Selected Financial Data

(Dollars in thousands, except per share data)	Years Ended December 31,				
	2014	2013	2012	2011	2010
RESULTS OF OPERATIONS:					
Interest income	\$ 38,289	\$ 41,351	\$ 45,901	\$ 50,852	\$ 55,461
Interest expense	4,247	6,475	10,562	11,088	12,822
Net interest income	34,042	34,876	35,339	39,764	42,639
Provision for credit losses	3,350	27,784	27,745	19,470	21,119
Net interest income after provision for credit losses	30,692	7,092	7,594	20,294	21,520
Noninterest income	16,781	17,459	15,758	17,318	18,041
Noninterest expense	39,361	40,686	39,555	39,167	41,720
Income (loss) before income taxes	8,112	(16,135)	(16,203)	(1,555)	(2,159)
Income tax expense (benefit)	3,061	(6,501)	(6,565)	(658)	(492)
Net income (loss)	\$ 5,051	\$ (9,634)	\$ (9,638)	\$ (897)	\$ (1,667)
PER COMMON SHARE DATA:					
Net income (loss) – basic	\$ 0.46	\$ (1.14)	\$ (1.14)	\$ (0.11)	\$ (0.20)
Net income (loss) – diluted	0.46	(1.14)	(1.14)	(0.11)	(0.20)
Dividends paid	-	-	0.01	0.09	0.24
Book value (at year end)	11.13	12.19	13.48	14.34	14.51
Tangible book value (at year end) ¹	10.08	10.31	11.56	12.37	12.32
FINANCIAL CONDITION (at year end):					
Loans	\$ 710,746	\$ 711,919	\$ 785,082	\$ 841,050	\$ 895,404
Assets	1,100,402	1,054,124	1,185,807	1,158,193	1,130,311
Deposits	949,004	933,468	1,049,273	1,009,919	979,516
Long-term debt	-	-	-	455	932
Stockholders' equity	140,469	103,299	114,026	121,249	122,513
PERFORMANCE RATIOS (for the year):					
Return on average total assets	0.47%	(0.89)%	(0.82)%	(0.08)%	(0.15)%
Return on average stockholders' equity	4.04	(8.64)	(8.07)	(0.74)	(1.33)
Net interest margin	3.43	3.48	3.23	3.74	4.02
Efficiency ratio ²	77.45	77.59	77.17	68.35	68.75
Dividend payout ratio	-	-	(0.88)	(81.82)	(120.00)
Average stockholders' equity to average total assets	11.66	10.31	10.18	10.66	11.05
ASSET QUALITY RATIOS (for the year):					
Nonperforming assets to total assets	1.57%	2.11%	3.76%	5.48%	3.95%
Nonperforming assets and accruing TDRs to total assets	3.09	4.58	8.18	7.66	6.16
Allowance for credit losses to average loans	1.09	1.40	1.96	1.64	1.57
Allowance for credit losses to nonaccrual loans	57.14	59.10	43.84	27.81	39.26
Allowance for credit losses to nonaccrual loans and TDRs	25.53	24.25	18.00	18.66	23.25

¹Total stockholders' equity, net of goodwill and other intangible assets, divided by the number of shares of common stock outstanding at year end.

²Noninterest expense as a percentage of total revenue (net interest income plus total noninterest income). Lower ratios indicate improved productivity.

Dear Shareholders:

In reflection, 2014 was a year like no other, a significant turning point setting the course for our next era with our most significant achievement, a successful capital raise of \$31.2 million completed on May 21, 2014. Our attention to strategy which began in 2013 has already shown favorable results and a reversal of the last few years of quarter losses.

Shore Bancshares, Inc. ends the year reporting a net income of \$1.226 million or \$0.10 per diluted common share for the fourth quarter of 2014, compared to net income of \$1.175 million or \$0.14 per diluted common share for the fourth quarter of 2013. The Company reported net income of \$5.05 million or \$0.46 per diluted share for fiscal year 2014, compared to a net loss of \$9.6 million or \$(1.14) per diluted common share for fiscal year 2013.

As we focus our attention to the future growth of our company, we began the year by launching a Voice of Employee Opinion Survey to help us understand and respond to the needs and concerns of our employees. The feedback from the survey will be instrumental in helping us redefine our vision, value and story of the company and how we want to move into the future. To further enhance our capital and cash liquidity positions, we benefited from the sale of Tri-State General Insurance Agency on June 6, 2014, a wholesale insurance agency, for a net gain of \$111 thousand as well as the reduction of intangible assets of \$2.7 million in exchange for cash. We determined that the Tri-State General business model no longer met our strategic objectives and therefore the decision was made to sell this line of business.

We continue to support organic growth by re-engaging our business development efforts across all of our business lines and by enhancing our client relationships to increase deposit penetration and multi-product usage. Internal initiatives to help leverage the relationships across all of our companies are underway. In the fourth quarter we were able to increase loans outstanding thereby reversing what had been a three year decline in loans.

To further improve the product and services offered to our banking clients, a complete review of our personal and business deposit products was completed in August of 2014. The emphasis of this initiative was to standardize our products and services across our two banks, while expanding convenience services to our clients who travel outside of our traditional branch network by offering a mobile check deposit service.

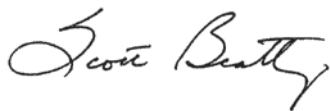
In 2014 we hired new staff to further develop our Enterprise Risk Management program and deliver more robust training and education opportunities to our employees.

Investing in our communities continues to be a major focus throughout all of our companies in 2014, as we help clients and businesses grow in the counties we serve. Our employees not only give back in sharing their professional experience and services, more importantly they give of themselves through volunteering their time at various local non-profit organizations helping to serve the people and communities in which we live and work.

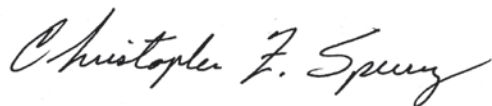
We are propelled by the milestones achieved during 2014 as we embrace our new company vision in 2015 - "Our mission is your success," with the emphasis on your success! On the facing pages of this report, we illustrate how our employees, clients, communities and shareholders will benefit from our emphasis on "your success".

We thank you, our shareholders, for your continuing support and investment in the future of our company.

Sincerely,



Lloyd L. "Scott" Beatty, Jr.



Christopher F. Spurry



Pictured: Chairman, Chris Spurry (left) honoring President and CEO, Scott Beatty (right) for his accomplishments in 2014 during an all employee event.

Employees – *Our employees will not want for opportunities.*



Photo: Employees celebrate at an all employee event.

At Shore Bancshares, the culture of our Company is extremely important to us and as a result we devoted significant time and energy to improve this in 2014, by focusing on our most important assets “our employees” as well as our clients, communities and shareholders.

In February of 2014, Shore Bancshares and its community of companies began the year by initiating a Voice of Employee Opinion Survey. Each employee was asked to respond to a series of questions to help us understand the current environment of Shore Bancshares as well as to understand employee points of view and needs. The feedback from the surveys and meetings was used as the foundation to help us in the next stage of our development by redefining our vision, values and story to reflect the characteristics we believe will make us more successful as we move ahead.

The next step in our organizational transformation is to ensure that our performance goals align with our new vision, values and story. By providing clarity on what “good” looks like in our employee’s performance, we are making the appropriate adjustments to our internal communications, learning, training and development

practices and other business processes to create a winning culture with employee engagement.

At Shore Bancshares, we believe in creating an environment and culture that supports and fosters engagement and opportunities for our employees. Employees are actively participating in focus groups and work streams to help us transform our business strategies and to continuously help us improve our business. Our employees are the foundation of who we are and we clearly appreciate the role they play in sustaining strong performance.

Shareholders – *Our shareholders will not want for a return.*

On May 21, 2014, we completed a very successful public offering. The total net proceeds to Shore Bancshares, Inc. from the public offering were \$31.2 million.

We deployed \$20 million of the proceeds to increase the capital of The Talbot Bank of Easton, Maryland, a bank subsidiary of the Company to satisfy regulatory capital requirements stemming from the bank’s Consent Order with the FDIC from May of 2013. By down streaming this capital to The Talbot Bank, we have positioned the bank to maintain a strong capital position which will allow us to serve our local communities for years to come. With the capital raise we were able to gain support from prominent investors who specialize in community banking reflecting the confidence that these respected investors have in the future of our Company. Other compelling investment strategies of 2014 included investing in our credit infrastructure, strengthening our noninterest revenue sources, continual emphasis on our business development and a strategic plan that positions us for growth.



Photo: Shore Bancshares, Inc. Headquarters

The Company has been highly disciplined in expense control completing a branch rationalization study yielding efficiencies in the staffing model as well as a branch closing to better leverage the expense base for growth. The same activities have commenced in our insurance operations with greater emphasis on efficiency through the use of technology and partnerships with third party companies to help drive insurance revenues.

Communities – *Our communities will not want for our involvement.*

We want our customers to understand the vital role that our companies play in their respective communities. Our customers' deposits fund economic growth in our communities and all loan decisions are made locally. We truly reinvest in our communities unlike the money center and regional banks. The additional capital enables us to position our companies for growth, remain independent, and be the leading banking, insurance and wealth management services providers on the Delmarva Peninsula. What this really means to our communities is that we are available to lend money and provide services to both retail and commercial customers across the communities in which we serve.

Shore Bancshares and its affiliates currently employ in excess of 300 people across its market in seven counties. Our employees are actively involved in their respective communities. In 2014, the employees of Shore Bancshares and its community of companies amassed in excess of 16,000 hours of community service. Shore Bancshares and its affiliates have historically played a vital role in both the economic and quality of life in our communities and our Company story highlights the importance this takes in the day to day lives of our employees.



Photo: Brenda Wooden, Tred Avon Square Branch Manager, The Talbot Bank, was the 2014 recipient of the NAACP Dorothy Webb Black Community Service Award.

Clients – *Our clients will not want for service.*



Pictured from left to right: David Miller, President, All-Span, Inc.; John Augustus, V.P., Commercial Banking Officer, CNB; Herb Troyer, V.P., Owner, All-Span, Inc.; J.J. Carter, V.P., Owner, All-Span, Inc.

Providing quality, safe and reliable products and services to our customers is a high priority. In 2014, our banks and insurance agency introduced new products and services to help the growing needs of our personal and business customers. New services include mobile check deposit, a return check processing service for businesses, enhancements to eStatements including electronic delivery of documents and an electronic signature service allowing our insurance clients to electronically sign and return documents securely to us.

In addition, our bank deposit products and service fees were reviewed against our competitors, carefully evaluating them and making adjustments as needed. Our bank, CNB opened a new branch in Dover, Delaware at 800 S Governors Avenue on January 21, 2015. Customers of The Talbot Bank and CNB now have access to 20 locations across Maryland's Eastern Shore and Delaware. Lastly, the Avon Dixon Agency, through a collaborative process with its insurance carrier, now has access to superior excess liability coverage available only to clients of Talbot Bank, CNB and Wye Financial & Trust.

At Shore Bancshares, we believe that focusing in these four areas will help secure our future success. Investments made here will improve the wellbeing of our clients, employees, communities and shareholders.

Board of Directors

SHORE BANCSHARES, INC.

Blenda W. Armistead
Investor

David J. Bates
Investor

Lloyd L. "Scott" Beatty, Jr.
President and Chief Executive Officer
Shore Bancshares, Inc.

James A. Judge
Certified Public Accountant
Anthony Judge & Ware, LLC

Frank E. Mason, II
President and Chief Executive Officer
JASCO

David W. Moore
President and Chief Executive Officer
Milford Housing Development Corporation

Christopher F. Spurry
Chairman
President, Spurry and Associates, Inc.

W. Moorhead Vermilye
Senior Business Development Officer
The Talbot Bank

John H. Wilson
President, Coastal South of MD, Inc.

Officers

Lloyd L. "Scott" Beatty, Jr.
President and Chief Executive Officer

George S. Rapp
Vice President and Chief Financial Officer

W. David Morse
Secretary and Legal Counsel

Donna J. Stevens
Senior Vice President
Chief Operations Officer

Timothy J. Berrigan
Vice President and Chief Information Officer

Pamela J. Dill
Vice President and Chief Human Relations Officer

Debra H. Rich
Vice President and Chief Marketing & Project Officer

BANKING

The Talbot Bank of Easton Maryland

Herbert L. Andrew, III, *Chairman*
Blenda W. Armistead
Lloyd L. "Scott" Beatty, Jr.
Carole Ann Clem
R. Michael Clemmer, Jr.
John W. Dillon
David A. Fike
Steve M. Shearer
Christopher F. Spurry
David P. Valliant
W. Moorhead Vermilye

Officers

Patrick M. Bilbrough
President and Chief Executive Officer

Laura P. Heikes
Senior Vice President
Branch Administration Officer

Kathleen Kurtz
Senior Vice President
Senior Credit Officer

Kevin W. Moran
Senior Vice President
Senior Lending Officer

CNB

Ann B. Collier
Mark M. Freestate
Thomas K. Helfenbein
James A. Judge
Clyde V. Kelly, III, *Chairman*
David W. Moore
Wm. Maurice Sanger
Jeffrey E. Thompson, *Vice Chairman*
Mary Ellen M. Valliant

Officers

Edward C. Allen
President and Chief Executive Officer

Charles E. Ruch, Jr.
Senior Vice President
Chief Credit Officer

Lynn Payne
Vice President and Chief Financial Officer

INSURANCE

The Avon-Dixon Agency, LLC Elliott Wilson Insurance, LLC Jack Martin & Associates, Inc.

Lloyd L. "Scott" Beatty, Jr.
James "Dick" Deerin, Jr.
Mark M. Freestate
Mary Ann Henker
Diana Johnson
William L. Lane Jr., *Chairman*
Edward "Ned" McDonald
Richard C. Trippe, Jr.
Morgan Wells
John H. Wilson

Officers

Richard C. Trippe, Jr.
President and Chief Executive Officer

William L. Lane, Jr.
Executive Vice President

Mark M. Freestate
Executive Vice President



SHORE BANCSHARES, INC.

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 Easton, MD 21601
 410.763.7800
 shorebancshares.com

BANKING

The Talbot Bank of Easton, Maryland

18 E. Dover Street
 Easton, MD 21601
 410.822.1400
 800.673.8258
 talbot-bank.com

CNB

109 N. Commerce Street
 Centreville, MD 21617
 410.758.1600
 877.758.1600
 cnb-bank.com

INSURANCE

Avon-Dixon Agency
 106 N. Harrison Street
 Easton, MD 21601
 410.822.0506
 800.242.8758
 avondixon.com

Elliott Wilson Insurance
 106 N. Harrison Street
 Easton, MD 21601
 410.820.7797
 800.235.9885
 elliottwilsonins.com

Jack Martin & Associates
 135 Old Solomons Island Road
 Annapolis, MD 21401
 410.626.1000
 800.497.5804
 jackmartin.com

INVESTMENTS

Wye Financial & Trust
 16 N. Washington Street
 Easton, MD 21601
 410.763.8543
 wyefinancialandtrust.com

TRANSFER AGENT

Broadridge Corporate Issuer Solutions
 P.O. Box 1342
 Brentwood, NY 11717
 866.232.0392
 720.358.3588
 Investor Relations Contact:
 Mr. George S. Rapp
 410.822.3855
 George.Rapp@SHBI.com
 NASDAQ:SHBI

Our Story

Shore Bancshares is the largest financial holding company located on the Delmarva Peninsula. With total assets in excess of a billion dollars we are large enough and strong enough to provide a full complement of services – banking, insurance, wealth management and brokerage.

So what makes us different? We care. We care about people and we care about your success.

Shore Bancshares is built around the character of our people and our communities. We are a company built on integrity, dedicated to our clients, our employees, our communities and our shareholders.

We care about our employees. We value their dedication and are committed to providing opportunities for them to develop and succeed to their full potential.

We care about our clients and our communities. We value the relationships we've earned by being trusted advisors and providers of financial services over the past 100 + years. We are committed to continuing that legacy, to building long term relationships and to providing exceptional service.

We care about our shareholders. We value their trust in us and we're committed to providing them a return on their investment.

Our commitment is critically important to the financial health of our communities. We make good things happen because we are your neighbor. We know you by name. It's not just about the business of banking, insurance or investments. In addition to our economic impact, annually, our employees provide over 16,000 hours of volunteer service. We care about people and what's important to you.

Our mission is your success.

SHORE BANCSHARES, INC.

Good things are happening here.™

shorebancshares.com NASDAQ:SHBI

COMMUNITY of COMPANIES

