

2016

ANNUAL REPORT



BANKING | INSURANCE | INVESTMENTS

Shore Bancshares

COMMUNITY *of* COMPANIES



Years Ended December 31

(Dollars in thousands, except per share data)	2016	2015	2014	2013	2012
RESULTS OF OPERATIONS:					
Interest income	\$ 40,652	\$ 38,871	\$ 38,289	\$ 41,351	\$ 45,901
Interest expense	2,403	3,346	4,247	6,475	10,562
Net interest income	38,249	35,525	34,042	34,876	35,339
Provision for credit losses	1,848	2,075	3,350	27,784	27,745
Net interest income after provision for credit losses	36,401	33,450	30,692	7,092	7,594
Noninterest income	16,645	15,416	16,781	17,459	15,758
Noninterest expense	37,147	37,350	39,361	40,686	39,555
Income (loss) before income taxes	15,899	11,516	8,112	(16,135)	(16,203)
Income tax expense (benefit)	6,261	4,408	3,061	(6,501)	(6,565)
Net income (loss)	\$ 9,638	\$ 7,108	\$ 5,051	\$ (9,634)	\$ (9,638)
PER COMMON SHARE DATA:					
Net income (loss)- basic	\$ 0.76	\$ 0.56	\$ 0.46	\$ (1.14)	\$ (1.14)
Net income (loss)- diluted	0.76	0.56	0.46	(1.14)	(1.14)
Dividends paid	0.14	0.04	-	-	0.01
Book value (at year end)	12.18	11.64	11.13	12.19	13.48
Tangible book value (at year end) ¹	11.16	10.59	10.08	10.31	11.56
FINANCIAL CONDITION (at year end):					
Loans	\$ 871,525	\$ 795,114	\$ 710,746	\$ 711,919	\$ 785,082
Assets	1,160,271	1,135,143	1,100,402	1,054,124	1,185,807
Deposits	997,489	975,464	949,004	933,468	1,049,273
Stockholders' equity	154,299	146,967	140,469	103,299	114,026
PERFORMANCE RATIOS (for the year):					
Return on average total assets	0.84%	0.64%	0.47%	(0.89)%	(0.82)%
Return on average stockholders' equity	6.32	4.93	4.04	(8.64)	(8.07)
Net interest margin	3.56	3.43	3.43	3.48	3.23
Efficiency ratio ²	67.43	73.21	77.45	77.59	77.17
Dividend payout ratio	18.42	7.14	-	-	(0.88)
Average stockholder's equity to average total assets	13.36	13.04	11.66	10.31	10.18
ASSET QUALITY RATIOS (for the year):					
Nonperforming assets to total assets	0.99%	1.44%	1.57%	2.11%	3.76%
Nonperforming assets and accruing TDRs to total assets	2.11	2.81	3.09	4.58	8.18
Allowance for credit losses to average loans	1.06	1.11	1.09	1.40	1.96
Allowance for credit losses to nonaccrual loans	97.26	68.77	57.14	59.10	43.84
Allowance for credit losses to nonaccrual loans and TDRs	39.71	30.14	25.53	24.25	18.00

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:

We closed 2016 on a high note, with reported net income of \$9.638 million or \$0.76 per diluted common share for the fiscal year compared to net income of \$7.108 million or \$0.56 per diluted common share for fiscal year 2015, an increase of \$2.530 million or 35.6%. We attribute our success in 2016 to the consolidation of our subsidiary banks (CNB and The Talbot Bank) to form a common brand and new name, Shore United Bank; higher net interest income resulting from increased loan volume; and a decrease in provisions for credit losses. Each quarter finished strong which enabled us to return payment of quarterly cash dividends to our shareholders. We remain committed to our strategy for growth, staying focused on continuing this trend, and sharing the success with our shareholders, employees, and communities.

Looking forward, we understand the importance of having a strong team who will help us achieve our strategic goals. In 2016-2017, we hired new leaders throughout our community of companies to help us with our mission. At Shore United Bank, we have a new Chief Retail Banking Officer who will support our Delaware and Maryland branches and a Market Executive to help us grow the east and south markets of Delaware, Maryland and Virginia. At Shore Bancshares Inc., we were successful in our search to hire a new Chief Human Resources Officer to replace a team member who retired after 42 years of service. Our investment subsidiary Wye Financial & Trust, has a new member on their team to help us cultivate wealth management and trust relationships in the Delaware market.

We believe in building a solid platform through our people and our communities that will contribute and facilitate collaboration and growth. In addition to the net positive effect on our financials in 2016, our employees volunteered over 17,000 hours, donated more than 3,000 lbs. of food, and supported 275 plus organizations in the following categories; community development, youth and education, environment and agriculture, and health and human services.

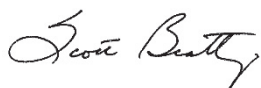
Another core strategic objective in 2016 was the creation of a common brand using colors, fonts, and a common logo, throughout our community of companies. Later this year, we will complete this goal when our insurance company Avon-Dixon Agency and its subsidiaries adopt these brand standards to further connect all of our companies with a consistent look.

As we kick off a new year, we announced in January our intent to purchase three branches on the western shore of Maryland, to expand our footprint in Baltimore and Howard Counties. Later this year, we plan to open a new Loan Production Office in Worcester County, Maryland. We believe the purchase of these branches and our new Loan Production Office will generate growth in our net interest income while diversifying our loan portfolio.

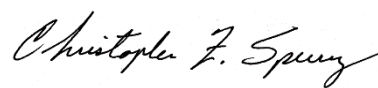
With the consolidation of our banks behind us and a new common brand name; strategic leaders in position to expand and serve our communities; and improved earnings and a strong balance sheet, we are confident that our company culture and the business climate ahead will propel us forward and drive success.

In closing, we would be remiss if we did not thank you our shareholders and our board of directors for their continual support and guidance. We remain vigilant in looking for new opportunities that will further improve our Company's value and the total return to shareholders.

Sincerely,



Lloyd L. "Scott" Beatty, Jr.
President & CEO, Shore Bancshares, Inc.



Christopher F. Spurry
Board Chairman



CORPORATE VISION
OUR EMPLOYEES WILL NOT WANT FOR OPPORTUNITIES.

Shore Star Award Winners

Employees Recognized
For Living The Company's
Vision And Values



At Shore Bancshares, we recognize and reward our employees for their actions that support our company's vision and values and help us achieve our strategic goals through our Shore Star Recognition Program. We encourage all employees to participate in the program by living our vision and values each day and

by acknowledging the hard work and exceptional achievements of their peers. Employees may submit a "Spot Award" to recognize an employee "on the spot" for exceeding expectations, or they may nominate an employee who consistently goes above and beyond for a Shore Star Award. In 2016, 86 employees across

our community of companies were recognized by their co-workers with a Spot Award. At the end of each year, a committee reviews the Star Award nominations and selects an employee who lives our company's vision for each stakeholder category; clients, employees, community, and shareholders, as well as an overall winner. In 2016, our Shore Star Award winners were (left to right):

Robin O'Brien - **OVERALL WINNER**

Lisa Rosengren - **EMPLOYEES**

Wendy Tilghman - **SHAREHOLDERS**

Annette Mitchell - **CLIENTS**

Joyce Malik - **COMMUNITY**



Partnership With Salisbury University

Mid-Atlantic Sales and Marketing Institute (MASMI)



CORPORATE VISION
OUR COMMUNITIES WILL NOT WANT FOR OUR INVOLVEMENT.

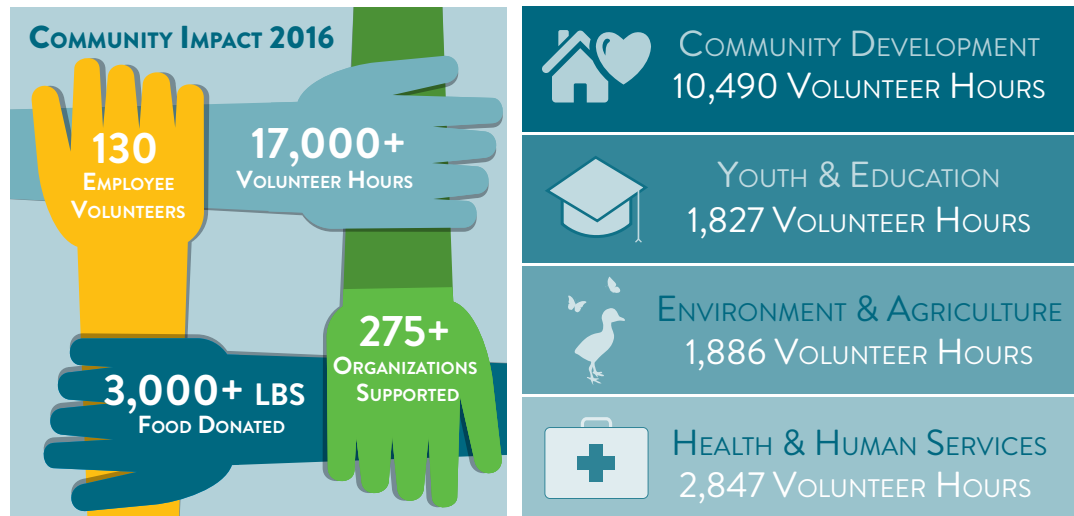
In February, we announced our support and partnership with Salisbury University’s Mid-Atlantic Sales and Marketing Institute (MASMI) program as a leading Silver Partner of the organization. As a MASMI partner, we have access to talented students who are prepared and focused in the profession of selling and sales management. We are also given the opportunity to assist in curriculum development and gain access to sales research conducted by the Perdue School faculty.

With this partnership, we have the opportunity to participate in a senior sales class role play, attend private recruiting sessions, engage with qualified candidates at the University’s Sales Career Fair, and host an intern for the day program. “The partnership between Shore Bancshares and MASMI gives us the opportunity to help students as well as our companies when they are looking to hire qualified sales people to fill positions in banking, insurance, and investments,” said Lloyd L. “Scott” Beatty, Jr. president and chief executive officer at Shore Bancshares.

In November, we hosted eleven junior and senior sales and marketing students that were selected to participate in the Intern for the Day Program. The students began their day by receiving an overview of our company’s structure and then they were directed to one of our company’s locations to shadow a sales team member for the day.

Community

Employee Volunteers





CORPORATE VISION
OUR SHAREHOLDERS WILL NOT WANT FOR A RETURN.

CNB and The Talbot Bank united as one; Shore United Bank



Consistent with our strategic initiative to consolidate and integrate our two banking subsidiaries, we completed the merger of The Talbot Bank and CNB under the new name of Shore United Bank in July of 2016. The name and logo were carefully selected to reflect the historical connection between The Talbot Bank and CNB through Shore Bancshares and demonstrate the union of the same great people, products, and service from both banks. The new teal brand color is a combination of the original Talbot Bank and CNB logo colors and the sail is symbolic of our mission to help propel our clients forward and navigate toward their financial goals. Our holding company, Shore Bancshares, Inc. and our investment division, Wye Financial & Trust, have also adopted the sail and brand colors in their logo to further demonstrate our connection across our companies.

Some of the obvious gains of this merger include the consolidation of processes and the change in regulations that now eliminate duplication efforts and costs related to regulatory compliance.

The merger of our two banks makes us a stronger financial institution overall, increasing the bank's asset size to \$1.1 billion. The unification of these two banks also increases our legal lending limit to \$18 million. With a larger legal lending limit, we are now able to be more competitive with national banks and other regional banks in our service area. Now, through a common brand name, we have created operational efficiencies, a consistent culture, and united branding under Shore United Bank.



CORPORATE VISION
OUR CLIENTS WILL NOT WANT FOR SERVICE.

BANKING

To maximize our client experiences, we continue to explore and introduce alternative delivery channels. In 2016, we introduced Instant Issue Debit Cards, made enhancements to our Online Banking platform and began offering debit cards to our business clients.

As we look to offer more convenience in our products and services, we focus even more on protecting our networks, computers, and customer data. With the recent increase and sophistication of cyber-fraud, protecting our clients' privacy continues to be our highest priority. We are diligent in the monitoring of our systems and analysis of our risk assessments to continuously provide proactive solutions to secure our systems.

Our internal information technology professionals provide information security training and testing, and website tips for clients to reduce their risk of loss due to cyber-fraud.

Because we are committed to the success of our communities, we also offer opportunities outside of traditional banking solutions to serve and connect with our clients. In 2016, we kicked off a travel program, inviting our clients and prospects to travel with us to local events and tourist attractions they may not have had an opportunity to do on their own. We look forward to expanding this initiative in 2017.



INSURANCE

Avon-Dixon Agency finished strong in 2016, with \$9 million in revenue and over \$64 million in premiums sold. With a strong team of talented sales and service professionals in place, Avon-Dixon is looking to expand their individual benefits, trucking, commercial, and boat and yacht lines in 2017.

In 2016, our insurance subsidiary Freestate and Son Insurance, a division of Avon-Dixon Agency, relocated from Lawyer's Row to 4-H Park Road in Centreville, Maryland. A ribbon cutting ceremony was held to welcome clients to their new location.

INVESTMENTS

Our investment division, Wye Financial & Trust, welcomed three new staff members to their team in 2016, allowing us to expand our trust and investment services to the Delaware market.

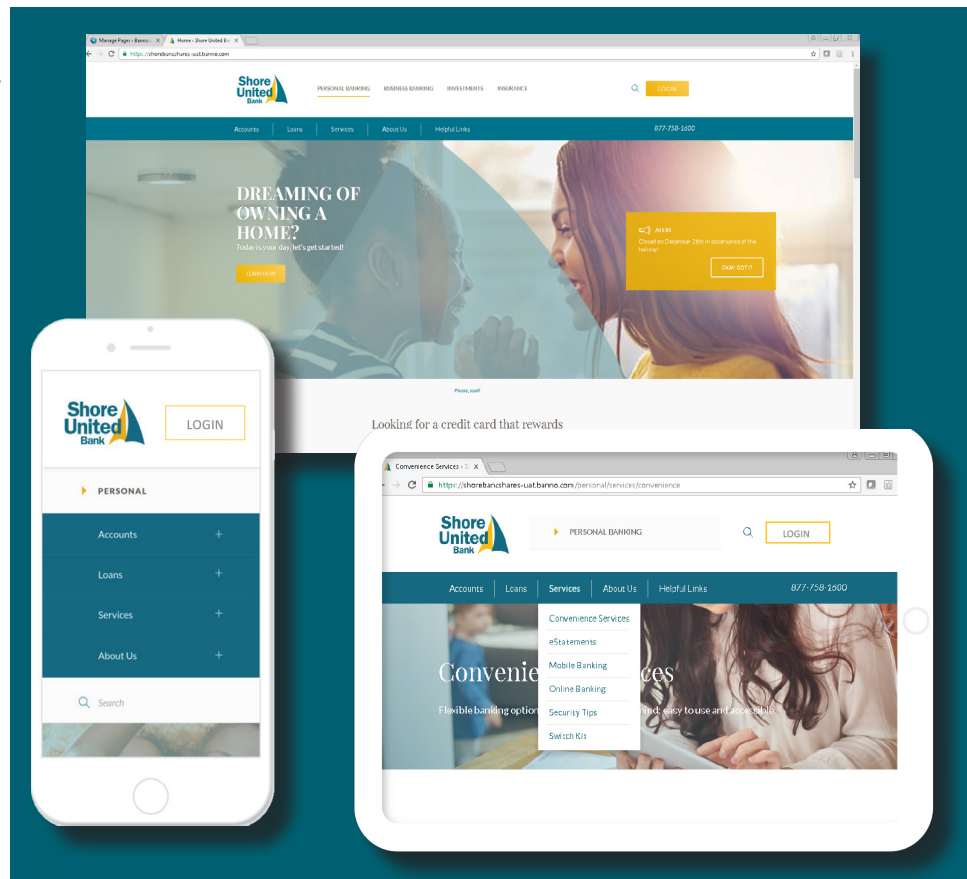


Expanding Our Footprint

In January of 2017, we announced that our banking subsidiary, Shore United Bank, entered into a purchase and assumption agreement to acquire three branches located in the greater Baltimore, Maryland metropolitan area with approximately \$214 million in deposits, \$152 million of performing loans and \$40 million of cash at that time from Northwest Bank, the bank subsidiary of Northwest Bancshares, Inc. (NASDAQ: NWBI). This acquisition will provide Shore United Bank with the opportunity to expand its footprint in Maryland by extending its branch network from the Eastern Shore to the greater Baltimore area communities of Elkridge, Owings Mills, and Arbutus. Subject to customary closing conditions, including the receipt of all necessary regulatory approvals, the acquisition is expected to be completed during the second quarter of 2017.

Investing In Technology

Looking forward to 2017, we have many good things happening. We will be uniting the websites for our banking, investment, and insurance divisions into one responsive website. Responsive design provides an optimal viewing experience across a wide range of devices. With more people using smartphones and tablets to conduct business online, it is important for us to invest in technology that will enhance our clients' experience.





Consistent Branding



In addition to the new website, the insurance division will also be introducing new logos in 2017, integrating the sail, font, and brand colors from our bank and investment logos which will connect our community of companies through consistent branding.

Growing Together

As our companies continue to grow, so does our need for more space. The Avon-Dixon Agency personal, business, marine, benefits and their trucking division, Elliott Wilson Insurance, will be relocating from 106 N. Harrison Street in Easton to 28640 Mary's Court in Easton during the second quarter of 2017. In October 2016,

contractors broke ground on the new building and Avon-Dixon celebrated with an official ground breaking ceremony at their future office site. The new building will allow sales and support staff across all insurance lines to be located under one roof. Our insurance team is looking forward to supporting our clients in their new location.





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