

SHORE BANCSHARES INC
Form 10-Q
May 10, 2011

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Quarterly Period Ended March 31, 2011

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission file number 0-22345

SHORE BANCSHARES, INC.
(Exact name of registrant as specified in its charter)

Maryland
(State or Other Jurisdiction of
Incorporation or Organization)

52-1974638
(I.R.S. Employer
Identification No.)

18 East Dover Street, Easton, Maryland
(Address of Principal Executive Offices)

21601
(Zip Code)

(410) 763-7800
Registrant's Telephone Number, Including Area Code

N/A
Former name, former address and former fiscal year, if changed since last report.

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter periods that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No (Not Applicable)

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting

Edgar Filing: SHORE BANCSHARES INC - Form 10-Q

company” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	<input type="checkbox"/>	Accelerated filer	<input checked="" type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input type="checkbox"/>

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes No

APPLICABLE ONLY TO CORPORATE ISSUERS

Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the latest practicable date: 8,443,436 shares of common stock outstanding as of April 29, 2011.

INDEX

	Page
Part I. Financial Information	2
Item 1. Financial Statements	2
Consolidated Balance Sheets - March 31, 2011 (unaudited) and December 31, 2010	2
Consolidated Statements of Operations - For the three months ended March 31, 2011 and 2010 (unaudited)	3
Consolidated Statements of Changes in Stockholders' Equity - For the three months ended March 31, 2011 and 2010 (unaudited)	4
Consolidated Statements of Comprehensive Loss - For the three months ended March 31, 2011 and 2010 (unaudited)	5
Consolidated Statements of Cash Flows - For the three months ended March 31, 2011 and 2010 (unaudited)	6
Notes to Consolidated Financial Statements (unaudited)	7
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	22
Item 3. Quantitative and Qualitative Disclosures about Market Risk	30
Item 4. Controls and Procedures	30
Part II. Other Information	30
Item 1A. Risk Factors	30
Item 6. Exhibits	31
Signatures	31
Exhibit Index	32

PART I – FINANCIAL INFORMATION

Item 1. Financial Statements.

SHORE BANCSHARES, INC.
CONSOLIDATED BALANCE SHEETS
(Dollars in thousands, except per share amounts)

	March 31, 2011 (Unaudited)	December 31, 2010
ASSETS		
Cash and due from banks	\$ 19,074	\$ 19,680
Interest-bearing deposits with other banks	31,311	21,593
Federal funds sold	39,597	36,691
Investment securities:		
Available for sale, at fair value	100,234	99,055
Held to maturity, at amortized cost – fair value of \$6,843 (2011) and \$6,851 (2010)	6,686	6,727
Loans	884,715	895,404
Less: allowance for credit losses	(17,471)	(14,227)
Loans, net	867,244	881,177
Premises and equipment, net	14,304	14,483
Goodwill	13,678	13,678
Other intangible assets, net	4,711	4,840
Other real estate and other assets owned, net	4,802	3,702
Other assets	29,693	28,685
TOTAL ASSETS	\$ 1,131,334	\$ 1,130,311
LIABILITIES		
Deposits:		
Noninterest-bearing demand	\$ 122,490	\$ 124,188
Interest-bearing demand	137,108	128,426
Money market and savings	262,983	255,515
Certificates of deposit \$100,000 or more	256,281	263,665
Other time	207,624	207,722
Total deposits	986,486	979,516
Short-term borrowings	12,078	16,041
Accrued expenses and other liabilities	10,912	11,309
Long-term debt	932	932
TOTAL LIABILITIES	1,010,408	1,007,798
STOCKHOLDERS' EQUITY		
Common stock, par value \$.01 per share; shares authorized – 35,000,000; shares issued and outstanding – 8,443,436 (2011) and (2010)	84	84
Warrant	1,543	1,543
Additional paid in capital	30,290	30,242
Retained earnings	90,868	92,458
Accumulated other comprehensive loss	(1,859)	(1,814)

TOTAL STOCKHOLDERS' EQUITY	120,926	122,513
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$1,131,334	\$ 1,130,311

See accompanying notes to Consolidated Financial Statements.

SHORE BANCSHARES, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)
(Dollars in thousands, except per share amounts)

	For the Three Months Ended March 31,	
	2011	2010
INTEREST INCOME		
Interest and fees on loans	\$ 12,001	\$ 12,874
Interest and dividends on investment securities:		
Taxable	657	882
Tax-exempt	38	59
Interest on federal funds sold	16	12
Interest on deposits with other banks	6	1
Total interest income	12,718	13,828
INTEREST EXPENSE		
Interest on deposits	2,833	3,385
Interest on short-term borrowings	13	32
Interest on long-term debt	10	16
Total interest expense	2,856	3,433
NET INTEREST INCOME	9,862	10,395
Provision for credit losses	6,390	7,617
NET INTEREST INCOME AFTER PROVISION FOR CREDIT LOSSES	3,472	2,778
NONINTEREST INCOME		
Service charges on deposit accounts	704	786
Trust and investment fee income	376	416
Gains on sales of investment securities	79	-
Insurance agency commissions	2,510	2,889
Other noninterest income	726	791
Total noninterest income	4,395	4,882
NONINTEREST EXPENSE		
Salaries and wages	4,246	4,490
Employee benefits	1,153	1,281
Occupancy expense	596	622
Furniture and equipment expense	272	300
Data processing	851	631
Directors' fees	107	121
Amortization of other intangible assets	129	129
Insurance agency commissions expense	375	428
FDIC insurance premium expense	460	481
Other noninterest expenses	1,702	1,838
Total noninterest expense	9,891	10,321

Edgar Filing: SHORE BANCSHARES INC - Form 10-Q

LOSS BEFORE INCOME TAX BENEFIT	(2,024)	(2,661)
Income tax benefit	(941)	(1,099)
NET LOSS	\$ (1,083)	\$ (1,562)
Basic net loss per common share	\$ (0.13)	\$ (0.19)
Diluted net loss per common share	\$ (0.13)	\$ (0.19)
Dividends paid per common share	\$ 0.06	\$ 0.06

See accompanying notes to Consolidated Financial Statements.

SHORE BANCSHARES, INC.
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (Unaudited)
For the Three Months Ended March 31, 2011 and 2010
(Dollars in thousands, except per share amounts)

	Common Stock	Warrant	Additional Paid in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
Balances, January 1, 2011	\$84	\$1,543	\$30,242	\$92,458	\$ (1,814)	\$ 122,513
Comprehensive loss:						
Net loss	-	-	-	(1,083)	-	(1,083)
Unrealized losses on available-for-sale securities, net of taxes	-	-	-	-	(269)	(269)
Unrealized gains on cash flow hedging activities, net of taxes	-	-	-	-	224	224
Total comprehensive loss						(1,128)
Stock-based compensation	-	-	48	-	-	48
Cash dividends paid (\$0.06 per share)	-	-	-	(507)	-	(507)
Balances, March 31, 2011	\$84	\$1,543	\$30,290	\$90,868	\$ (1,859)	\$ 120,926
Balances, January 1, 2010	\$84	\$1,543	\$29,872	\$96,151	\$ 160	\$ 127,810
Comprehensive loss:						
Net loss	-	-	-	(1,562)	-	(1,562)
Unrealized gains on available-for-sale securities, net of taxes	-	-	-	-	44	44
Unrealized losses on cash flow hedging activities, net of taxes	-	-	-	-	(794)	(794)
Total comprehensive loss						(2,312)
Stock-based compensation	-	-	116	-	-	116
Cash dividends paid (\$0.06 per share)	-	-	-	(506)	-	(506)
Balances, March 31, 2010	\$84	\$1,543	\$29,988	\$94,083	\$ (590)	\$ 125,108

See accompanying notes to Consolidated Financial Statements.

SHORE BANCSHARES, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS (Unaudited)
(Dollars in thousands)

	For the Three Months Ended March 31,	
	2011	2010
Net loss	\$ (1,083)	\$ (1,562)
Other comprehensive loss:		
Securities available for sale:		
Unrealized holding (losses) gains on available-for-sale securities	(372)	74
Tax effect	150	(30)
Reclassification of gains recognized in net income	(79)	-
Tax effect	32	-
Net of tax amount	(269)	44
Cash flow hedging activities:		
Unrealized holding gains (losses) on cash flow hedging activities	377	(1,331)
Tax effect	(153)	537
Net of tax amount	224	(794)
Total other comprehensive loss	(45)	(750)
Comprehensive loss	\$ (1,128)	\$ (2,312)

See accompanying notes to Consolidated Financial Statements.

SHORE BANCSHARES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)
(Dollars in thousands)

	For the Three Months Ended March 31,	
	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	\$ (1,083)	\$ (1,562)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Provision for credit losses	6,390	7,617
Depreciation and amortization	725	564
Discount accretion on debt securities	(25)	(27)
Stock-based compensation expense	69	115
Excess tax benefits from stock-based arrangements	(21)	1
Deferred income taxes	(1,552)	(1,103)
Gains on sales of securities	(79)	-
Gains on disposals of premises and equipment	(3)	-
Losses on sales of other real estate owned	40	-
Write-downs of other real estate owned	163	247
Net changes in:		
Insurance premiums receivable	110	(355)
Accrued interest receivable	812	24
Other assets	30	459
Accrued interest payable	44	(165)
Other liabilities	(463)	(725)
Net cash provided by operating activities	5,157	5,090
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from maturities and principal payments of securities available for sale	14,979	11,742
Proceeds from sales of securities available for sale	12,061	-
Purchases of securities available for sale	(28,886)	(18,299)
Proceeds from maturities and principal payments of securities held to maturity	35	115
Net decrease in loans	5,713	5,520
Purchases of premises and equipment	(93)	(660)
Proceeds from sales of premises and equipment	4	-
Proceeds from sales of other real estate owned	527	63
Net cash provided by (used in) investing activities	4,340	(1,519)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase in demand, money market and savings deposits	14,452	5,844
Net decrease in certificates of deposit	(7,482)	(6,031)
Excess tax benefits from stock-based arrangements	21	(1)
Net decrease in short-term borrowings	(3,963)	(6,403)
Common stock dividends paid	(507)	(506)
Net cash provided by (used in) financing activities	2,521	(7,097)
Net increase (decrease) in cash and cash equivalents	12,018	(3,526)
Cash and cash equivalents at beginning of period	77,964	75,646
Cash and cash equivalents at end of period	\$ 89,982	\$ 72,120

Supplemental cash flows information:

Interest paid	\$ 2,813	\$ 3,598
Income taxes paid	\$ 817	\$ 91
Transfers from loans to other real estate owned	\$ 1,830	\$ 141

See accompanying notes to Consolidated Financial Statements.

Shore Bancshares, Inc.
Notes to Consolidated Financial Statements
For the Three Months Ended March 31, 2011 and 2010
(Unaudited)

Note 1 - Basis of Presentation

The consolidated financial statements include the accounts of Shore Bancshares, Inc. and its subsidiaries with all significant intercompany transactions eliminated. The consolidated financial statements conform to accounting principles generally accepted in the United States of America (“GAAP”) and to prevailing practices within the banking industry. The accompanying interim financial statements are unaudited; however, in the opinion of management all adjustments necessary to present fairly the consolidated financial position at March 31, 2011, the consolidated results of operations and comprehensive loss for the three months ended March 31, 2011 and 2010, and changes in stockholders’ equity and cash flows for the three months ended March 31, 2011 and 2010, have been included. All such adjustments are of a normal recurring nature. The amounts as of December 31, 2010 were derived from the 2010 audited financial statements. The results of operations for the three months ended March 31, 2011 are not necessarily indicative of the results to be expected for any other interim period or for the full year. This Quarterly Report on Form 10-Q should be read in conjunction with the Annual Report of Shore Bancshares, Inc. on Form 10-K for the year ended December 31, 2010. For purposes of comparability, certain reclassifications have been made to amounts previously reported to conform with the current period presentation.

When used in these notes, the term “the Company” refers to Shore Bancshares, Inc. and, unless the context requires otherwise, its consolidated subsidiaries.

Note 2 – Earnings Per Share

Basic earnings/(loss) per common share are calculated by dividing net income/(loss) available to common stockholders by the weighted average number of common shares outstanding during the period. Diluted earnings/(loss) per common share are calculated by dividing net income/(loss) available to common stockholders by the weighted average number of common shares outstanding during the period, adjusted for the dilutive effect of stock-based awards and warrant. There is no dilutive effect on the loss per share during loss periods. The following table provides information relating to the calculation of earnings/(loss) per common share:

(In thousands, except per share data)	For the Three Months Ended March 31,	
	2011	2010
Net loss available to common shareholders	\$ (1,083)	\$ (1,562)
Weighted average shares outstanding - Basic	8,443	8,436
Dilutive effect of stock-based awards	-	-
Weighted average shares outstanding - Diluted	8,443	8,436
Loss per common share - Basic	\$ (0.13)	\$ (0.19)
Loss per common share - Diluted	\$ (0.13)	\$ (0.19)

The calculations of diluted earnings/(loss) per share for the three months ended March 31, 2011 excluded seven thousand weighted average stock-based awards and that portion of a warrant to purchase 173 thousand weighted average shares of common stock because the effect would have been antidilutive. The calculations of diluted earnings/(loss) per share for the three months ended March 31, 2010 excluded nine thousand weighted average stock-based awards and that portion of a warrant to purchase 173 thousand weighted average shares of common stock because the effect would have been antidilutive.

Note 3 – Investment Securities

The amortized cost and estimated fair values of investment securities are as follows:

(Dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available-for-sale securities:				
March 31, 2011:				
Obligations of U.S. Government agencies and corporations	\$47,474	\$656	\$131	\$47,999
Mortgage-backed securities	51,019	886	248	51,657
Other equity securities	570	8	-	578
Total	\$99,063	\$1,550	\$379	\$100,234
December 31, 2010:				
Obligations of U.S. Government agencies and corporations	\$58,052	\$921	\$69	\$58,904
Mortgage-backed securities	38,817	933	173	39,577
Other equity securities	566	8	-	574
Total	\$97,435	\$1,862	\$242	\$99,055
Held-to-maturity securities:				
March 31, 2011:				
Obligations of states and political subdivisions	\$6,686	\$161	\$4	\$6,843
December 31, 2010:				
Obligations of states and political subdivisions	\$6,727	\$143	\$19	\$6,851

The amortized cost and estimated fair values of investment securities by maturity date at March 31, 2011 are as follows:

(Dollars in thousands)	Available for sale		Held to maturity	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in one year or less	\$8,046	\$8,193	\$101	\$102
Due after one year through five years	20,906	21,056	3,050	3,118
Due after five years through ten years	9,321	9,555	2,524	2,603
Due after ten years	60,220	60,852	1,011	1,020
	98,493	99,656	6,686	6,843
Equity securities	570	578	-	-
Total	\$99,063	\$100,234	\$6,686	\$6,843

The maturity dates for debt securities are determined using contractual maturity dates.

Gross unrealized losses and fair value by length of time that the individual available-for-sale securities have been in a continuous unrealized loss position at March 31, 2011, are as follows:

(Dollars in thousands)	Less than 12 Months		More than 12 Months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Available-for-sale securities:						
U.S. Gov't. agencies and corporations	\$16,160	\$131	\$-	\$-	\$16,160	\$131
Mortgage-backed securities	23,447	248	-	-	23,447	248
Total	\$39,607	\$379	\$-	\$-	\$39,607	\$379

The available-for-sale securities have a fair value of approximately \$100.2 million. Of these securities, approximately \$39.6 million have unrealized losses when compared to their amortized cost. The securities with the unrealized losses in the available-for-sale portfolio all have modest duration risk, low credit risk, and minimal losses (approximately 0.38%) when compared to total amortized cost. The unrealized losses on debt securities that exist are the result of market changes in interest rates since original purchase. Because the Company does not intend to sell these debt securities and it is not more likely than not that the Company will be required to sell these securities before recovery of their amortized cost bases, which may be at maturity, the Company considers the unrealized losses in the available-for-sale portfolio to be temporary.

Gross unrealized losses and fair value by length of time that the individual held-to-maturity securities have been in a continuous unrealized loss position at March 31, 2011, are as follows:

(Dollars in thousands)	Less than 12 Months		More than 12 Months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Held-to-maturity securities:						
Obligations of states and political subdivisions	\$660	\$4	\$-	\$-	\$660	\$4

The held-to-maturity securities have a fair value of approximately \$6.8 million. Approximately \$660 thousand of these securities have unrealized losses when compared to their amortized cost. All of the securities with unrealized losses are municipal securities with modest duration risk, low credit risk, and minimal losses (approximately 0.06%) when compared to total amortized cost. The unrealized losses that exist are the result of market changes in interest rates since the original purchase. Because the Company does not intend to sell these securities and it is not more likely than not that the Company will be required to sell these securities before recovery of their amortized cost bases, which may be at maturity, the Company considers that the unrealized losses in the held-to-maturity portfolio to be temporary.

Note 4 – Loans and allowance for credit losses

The Company makes residential mortgage, commercial and consumer loans to customers primarily in the Maryland counties of Talbot, Queen Anne's, Kent, Caroline and Dorchester and in Kent County, Delaware. The principal categories of the loan portfolio at March 31, 2011 and December 31, 2010 are summarized as follows:

(Dollars in thousands)

March 31, 2011 December 31, 2010

Edgar Filing: SHORE BANCSHARES INC - Form 10-Q

Real estate – construction	\$ 135,354	\$ 143,952
Real estate – residential	332,449	333,738
Real estate – commercial	322,996	318,726
Commercial	78,324	82,787
Consumer	15,592	16,201
Total loans	884,715	895,404
Allowance for credit losses	(17,471)	(14,227)
Total loans, net	\$ 867,244	\$ 881,177

9

Loans include deferred costs net of deferred fees of \$103 thousand at March 31, 2011 and \$38 thousand at December 31, 2010.

The following table presents a summary of the activity in the allowance for credit losses:

(Dollars in thousands)	For the Three Months Ended	
	2011	2010
Allowance balance – beginning of period	\$ 14,227	\$ 10,876
Charge-offs:		
Real estate – construction	(686)	(3,509)
Real estate – residential	(2,091)	(991)
Real estate – commercial	(228)	-
Commercial	(246)	(1,224)
Consumer	(75)	(166)
Total	(3,326)	(5,890)
Recoveries:		
Real estate – construction	49	-
Real estate – residential	34	38
Real estate – commercial	-	101
Commercial	77	3
Consumer	20	46
Total	180	188
Net charge-offs	(3,146)	(5,702)
Provision for credit losses	6,390	7,617
Allowance balance – end of period	\$ 17,471	\$ 12,791

The following tables provide information on impaired loans by loan class as of March 31, 2011 and December 31, 2010.

(Dollars in thousands)	Unpaid principal balance	Recorded investment	Related allowance	Average recorded investment
March 31, 2011				
With no related allowance recorded:				
Real estate – construction	\$ 20,595	\$ 15,359	\$ -	\$ 16,310
Real estate – residential	9,026	7,448	-	8,288
Real estate – commercial	8,678	8,283	-	6,708
Commercial	2,847	2,487	-	3,166
Consumer	30	29	-	30
Total	41,176	33,606	-	34,502
With a related allowance recorded:				
Real estate – construction	-	-	-	-
Real estate – residential	5,960	5,850	1,053	3,344
Real estate – commercial	7,983	7,983	1,022	3,992
Commercial	1,521	1,321	1,147	661
Consumer	-	-	-	-
Total	15,464	15,154	3,222	7,997
Total:				
Real estate – construction	20,595	15,359	-	16,310
Real estate – residential	14,986	13,298	1,053	11,632
Real estate – commercial	16,661	16,266	1,022	10,700
Commercial	4,368	3,808	1,147	3,827
Consumer	30	29	-	30
Total	\$ 56,640	\$ 48,760	\$ 3,222	\$ 42,499

Edgar Filing: SHORE BANCSHARES INC - Form 10-Q

(Dollars in thousands)	Unpaid principal balance	Recorded investment	Related allowance	Average recorded investment
December 31, 2010				
With no related allowance recorded:				
Real estate – construction	\$ 22,643	\$ 17,261	\$ -	\$ 17,784
Real estate – residential	11,038	9,132	-	8,368
Real estate – commercial	5,558	5,133	-	3,827
Commercial	4,305	3,845	-	2,793
Consumer	30	30	-	56
Total	43,574	35,401	-	32,828
With a related allowance recorded:				
Real estate – construction	-	-	-	1,596
Real estate – residential	945	837	203	420
Real estate – commercial	-	-	-	-
Commercial	-	-	-	398
Consumer	-	-	-	-
Total	945	837	203	2,414
Total:				
Real estate – construction	22,643	17,261	-	19,380
Real estate – residential	11,983	9,969	203	8,788
Real estate – commercial	5,558	5,133	-	3,827
Commercial	4,305	3,845	-	3,191
Consumer	30	30	-	56
Total	\$ 44,519	\$ 36,238	\$ 203	\$ 35,242

A loan is considered impaired if it is probable that the Company will not collect all principal and interest payments according to the loan's contractual terms. An impaired loan may show deficiencies in the borrower's overall financial condition, payment history, support available from financial guarantors and/or the fair market value of collateral. The impairment of a loan is measured at the present value of expected future cash flows using the loan's effective interest rate, or at the loan's observable market price or the fair value of the collateral if the loan is collateral dependent. Generally, the Company measures impairment on such loans by reference to the fair value of the collateral. Income on impaired loans is recognized on a cash basis, and payments are first applied against the principal balance outstanding. Impaired loans do not include groups of smaller balance homogenous loans such as residential mortgage and consumer installment loans that are evaluated collectively for impairment. Reserves for probable credit losses related to these loans are based on historical loss ratios and are included in the allowance for credit losses.

Loans are evaluated on a case-by-case basis for impairment. Once the amount of impairment has been determined, the uncollectible portion is charged off. In some cases, a specific allocation within the allowance is made until such time a charge-off is made. At March 31, 2011, impaired loans had been reduced by partial charge-offs totaling \$7.9 million, or 13.9%, of the unpaid principal balance. In addition, \$3.2 million in specific reserves were established against \$15.2 million of impaired loans. At December 31, 2010, impaired loans had been reduced by partial charge-offs totaling \$8.3 million, or 18.6%, of the unpaid principal balance. In addition, \$203 thousand in specific reserves were established against \$837 thousand of impaired loans.

Gross interest income of \$720 thousand for the first three months of 2011, \$2.1 million for fiscal year 2010 and \$467

thousand for the first three months of 2010 would have been recorded if impaired loans had been current and performing in accordance with their original terms. No interest was recorded on such loans for the first three months of 2011 and for 2010.

The following tables provide details on the allowance for credit losses by loan class for the three months ended March 31, 2011 and 2010. The tables also include impairment information relating to the allowance for credit losses and loans as of March 31, 2011 and 2010. There were no loans acquired with deteriorated credit quality.

(Dollars in thousands)	Real estate - construction	Real estate - residential	Real estate - commercial	Commercial	Consumer	Unallocated	Total
For the three months ended March 31, 2011							
Allowance for credit losses:							
Beginning balance	\$ 3,327	\$ 4,833	\$ 3,665	\$ 1,422	\$ 637	\$ 343	\$ 14,227
Charge-offs	(686)	(2,091)	(228)	(246)	(75)	-	(3,326)
Recoveries	49	34	-	77	20	-	180
Provision	634	2,644	1,843	1,523	9	(263)	6,390
Ending balance	\$ 3,324	\$ 5,420	\$ 5,280	\$ 2,776	\$ 591	\$ 80	\$ 17,471
Individually evaluated for impairment	\$ -	\$ 1,053	\$ 1,022	\$ 1,147	\$ -	\$ -	\$ 3,222
Collectively evaluated for impairment	\$ 3,324	\$ 4,367	\$ 4,258	\$ 1,629	\$ 591	\$ 80	\$ 14,249
Total loans	\$ 135,354	\$ 332,449	\$ 322,996	\$ 78,324	\$ 15,592	\$ -	\$ 884,715
Individually evaluated for impairment	\$ 15,359	\$ 13,298	\$ 16,266	\$ 3,808	\$ 29	\$ -	\$ 48,760
Collectively evaluated for impairment	\$ 119,995	\$ 319,151	\$ 306,730	\$ 74,516	\$ 15,563	\$ -	\$ 835,955

(Dollars in thousands)	Real estate - construction	Real estate - residential	Real estate - commercial	Commercial	Consumer	Unallocated	Total
For the three months ended March 31, 2010							
Allowance for credit losses:							
Beginning balance	\$ 2,630	\$ 1,528	\$ 3,947	\$ 2,132	\$ 515	\$ 124	\$ 10,876
Charge-offs	(3,509)	(991)	-	(1,224)	(166)	-	(5,890)
Recoveries	-	38	101	3	46	-	188
Provision	3,914	2,751	(242)	986	121	87	7,617
Ending balance	\$ 3,035	\$ 3,326	\$ 3,806	\$ 1,897	\$ 516	\$ 211	\$ 12,791
Individually evaluated for impairment	\$ 422	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 422
Collectively evaluated for impairment	\$ 2,613	\$ 3,326	\$ 3,806	\$ 1,897	\$ 516	\$ 211	\$ 12,369
Total loans	\$ 158,519	\$ 324,070	\$ 316,259	\$ 87,399	\$ 18,947	\$ -	\$ 905,194
Individually evaluated for impairment	\$ 21,384	\$ 5,083	\$ 2,854	\$ 1,099	\$ 35	\$ -	\$ 30,455
Collectively evaluated for impairment	\$ 137,135	\$ 318,987	\$ 313,405	\$ 86,300	\$ 18,912	\$ -	\$ 874,739

Edgar Filing: SHORE BANCSHARES INC - Form 10-Q

The following tables provide information on loan risk ratings as of March 31, 2011 and December 31, 2010.

(Dollars in thousands)	Real estate - construction	Real estate - residential	Real estate - commercial	Commercial	Consumer	Total
March 31, 2011						
Pass/Performing	\$ 69,312	\$ 276,255	\$ 262,195	\$ 69,465	\$ 15,458	\$ 692,685
Special mention	29,264	19,015	14,697	1,520	9	64,505
Substandard	21,419	21,684	29,838	3,434	96	76,471
Doubtful	-	2,197	-	97	-	2,294
Nonaccrual	15,359	13,298	16,266	3,808	29	48,760
Total	\$ 135,354	\$ 332,449	\$ 322,996	\$ 78,324	\$ 15,592	\$ 884,715

(Dollars in thousands)	Real estate - construction	Real estate - residential	Real estate - commercial	Commercial	Consumer	Total
December 31, 2010						
Pass/Performing	\$ 83,344	\$ 283,895	\$ 260,040	\$ 73,502	\$ 16,043	\$ 716,824
Special mention	23,090	23,847	17,821	2,249	-	67,007
Substandard	20,257	13,752	35,732	3,088	128	72,957
Doubtful	-	2,275	-	103	-	2,378
Nonaccrual	17,261	9,969	5,133	3,845	30	36,238
Total	\$ 143,952	\$ 333,738	\$ 318,726	\$ 82,787	\$ 16,201	\$ 895,404

The following tables provide information on the aging of the loan portfolio as of March 31, 2011 and December 31, 2010.

(Dollars in thousands)	Current	30-59 days past due	Accruing 60-89 days past due	90 days or more past due	Total past due	Non-performing	Total
March 31, 2011							
Real estate – construction	\$ 119,308	\$ 637	\$ 50	\$ -	\$ 687	\$ 15,359	\$ 135,354
Real estate – residential	311,893	3,360	872	3,026	7,258	13,298	332,449
Real estate – commercial	299,583	2,029	3,158	1,960	7,147	16,266	322,996
Commercial	72,943	920	151	502	1,573	3,808	78,324
Consumer	15,465	70	10	18	98	29	15,592
Total	\$ 819,192	\$ 7,016	\$ 4,241	\$ 5,506	\$ 16,763	\$ 48,760	\$ 884,715

(Dollars in thousands)	Current	30-59 days past due	Accruing 60-89 days past due	90 days or more past due	Total past due	Non-performing	Total
December 31, 2010							
Real estate – construction	\$ 124,892	\$ 1,691	\$ 108	\$ -	\$ 1,799	\$ 17,261	\$ 143,952
Real estate – residential	314,914	4,046	1,355	3,454	8,855	9,969	333,738

Edgar Filing: SHORE BANCSHARES INC - Form 10-Q

Real estate – commercial	306,497	3,393	2,717	986	7,096	5,133	318,726
Commercial	77,833	470	465	174	1,109	3,845	82,787
Consumer	15,572	486	25	88	599	30	16,201
Total	\$839,708	\$10,086	\$4,670	\$4,702	\$19,458	\$36,238	\$895,404

14

	Current	30-59 days past due	Accruing 60-89 days past due	90 days or more past due	Total past due	Non- performing
March 31, 2011						
Real estate – construction	88.1	0.6	-	-	0.6	11.3
Real estate – residential	93.8	1.0	0.3	0.9	2.2	4.0
Real estate – commercial	92.8	0.6	1.0	0.6	2.2	5.0
Commercial	93.1	1.2	0.2	0.6	2.0	4.9
Consumer	99.2	0.4	0.1	0.1	0.6	0.2
Total	92.6	0.8	0.5	0.6	1.9	5.5

	Current	30-59 days past due	Accruing 60-89 days past due	90 days or more past due	Total past due	Non- performing
December 31, 2010						
Real estate – construction	86.8	1.1	0.1	-	1.2	12.0
Real estate – residential	94.4	1.2	0.4	1.0	2.6	3.0
Real estate – commercial	96.2	1.0	0.9	0.3	2.2	1.6
Commercial	94.0	0.6	0.6	0.2	1.4	4.6
Consumer	96.1	3.0	0.2	0.5	3.7	0.2
Total	93.8	1.2	0.5	0.5	2.2	4.0

Note 5 – Other Assets and Liabilities

The Company had the following other assets at March 31, 2011 and December 31, 2010.

(Dollars in thousands)	March 31, 2011	December 31, 2010
Nonmarketable investment securities	\$ 2,916	\$ 2,949
Insurance premiums receivable	631	741
Accrued interest receivable	4,248	5,060
Deferred income taxes	9,159	7,578
Interest rate caps (1)	2,139	2,022
Prepaid FDIC premium expense	3,727	4,073
Other assets	6,873	6,262
Total	\$ 29,693	\$ 28,685

The Company had the following other liabilities at March 31, 2011 and December 31, 2010.

(Dollars in thousands)	March 31, 2011	December 31, 2010
Accrued interest payable	\$ 904	\$ 860
Counterparty collateral - interest rate caps (1)	1,692	1,390
Other liabilities	8,316	9,059
Total	\$ 10,912	\$ 11,309

(1) See Note 8 for further discussion.

Note 6 - Stock-Based Compensation

At March 31, 2011, the Company maintained two equity compensation plans under which it may issue shares of common stock or grant other equity-based awards: (i) the Shore Bancshares, Inc. 2006 Stock and Incentive Compensation Plan (“2006 Equity Plan”); and (ii) the Shore Bancshares, Inc. 1998 Stock Option Plan (the “1998 Option Plan”). The Company's ability to grant options under the 1998 Option Plan expired on March 3, 2008 pursuant to the terms of that plan, but stock options granted thereunder were outstanding as of March 31, 2011.

Stock-based awards granted to date generally are time-based, vest in equal installments on each anniversary of the grant date over a three- to five-year period of time, and, in the case of stock options, expire 10 years from the grant date.

During the three months ended March 31, 2011 and 2010, the Company recognized pre-tax stock-based compensation expense of \$69 thousand and \$116 thousand, respectively. Stock-based compensation expense is recognized ratably over the requisite service period for all awards and is based on the grant-date fair value. Unrecognized stock-based compensation expense related to nonvested share-based compensation arrangements was \$355 thousand as of March 31, 2011. The weighted-average period over which this unrecognized expense was expected to be recognized was 1.4 years.

The following table summarizes restricted stock award activity for the Company under the 2006 Equity Plan for the three months ended March 31, 2011:

	Number of Shares	Weighted Average Grant Date Fair Value
Nonvested at beginning of period	44,127	\$ 16.76
Granted	-	-
Vested	(5,988)	18.89
Cancelled	-	-
Nonvested at end of period	38,139	\$ 16.42

The Company estimates the fair value of stock options using the Black-Scholes valuation model with weighted average assumptions for dividend yield, expected volatility, risk-free interest rate and expected lives (in years). The expected dividend yield is calculated by dividing the total expected annual dividend payout by the average stock price. The expected volatility is based on historical volatility of the underlying securities. The risk-free interest rate is based on the Federal Reserve Bank's constant maturities daily interest rate in effect at grant date. The expected life of the options represents the period of time that the Company expects the awards to be outstanding based on historical experience with similar awards. Stock-based compensation expense recognized in the consolidated statements of income for the three months ended March 31, 2011 and 2010 reflected forfeitures as they occurred.

The following table summarizes stock option activity for the Company for the three months ended March 31, 2011:

	Number of Shares	Weighted Average Exercise Price	Aggregate Intrinsic Value
Outstanding at beginning of year	8,420	\$ 13.17	
Granted	-	-	
Exercised	-	-	
Expired/Cancelled	(1,295)	13.17	
Outstanding at end of period	7,125	13.17	\$ -
Exercisable at end of period	7,125	\$ 13.17	\$ -

At March 31, 2011, all 7,125 outstanding options were exercisable, had a weighted average exercise price of \$13.17 per share, and had a remaining contract life of 1 year.

There was no aggregate intrinsic value in options outstanding and exercisable based on the \$9.75 market value per share of the Company's common stock at March 31, 2011. Because there were no options exercised during the first

three months of 2011 and 2010, there was no intrinsic value of stock options exercised and no cash received on exercise of options.

Note 7 – Fair Value Measurements

ASC 820, “Fair Value Measurements and Disclosures”, provides a framework for measuring and disclosing fair value under GAAP. This accounting guidance requires disclosures about the fair values of assets and liabilities recognized in the balance sheet, whether the measurements are made on a recurring basis or on a nonrecurring basis.

ASC 820 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. ASC 820 also establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

The Company utilizes fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. Securities available for sale and derivative assets and liabilities are recorded at fair value on a recurring basis. Additionally, from time to time, the Company may be required to record at fair value other assets on a nonrecurring basis, such as impaired loans and foreclosed assets (other real estate owned). These nonrecurring fair value adjustments typically involve application of lower of cost or market accounting or write-downs of individual assets.

Under ASC 820, assets and liabilities are grouped at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine their fair values. These hierarchy levels are:

Level 1 inputs – Unadjusted quoted prices in active markets for identical assets or liabilities that the entity has the ability to access at the measurement date.

Level 2 inputs – Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. These might include quoted prices for similar assets or liabilities in active markets, and inputs other than quoted prices that are observable for the asset or liability, such as interest rates and yield curves that are observable at commonly quoted intervals.

Level 3 inputs – Unobservable inputs for determining the fair values of assets or liabilities that reflect an entity's own assumptions about the assumptions that market participants would use in pricing the assets or liabilities.

The following is a description of valuation methodologies used for the Company's assets and liabilities recorded at fair value.

Investment Securities Available for Sale

Investment securities available for sale are recorded at fair value on a recurring basis. Fair value measurement is based on quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions. Level 1 securities include those traded on an active exchange such as the New York Stock Exchange, Treasury securities that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level 2 securities include mortgage-backed securities issued by government sponsored entities, municipal bonds and corporate debt securities. Securities classified as Level 3 include asset-backed securities in less liquid markets.

Loans

The Company does not record loans at fair value on a recurring basis; however, from time to time, a loan is considered impaired and a valuation allowance may be established if there are losses associated with the loan. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan are considered impaired. The fair value of impaired loans is estimated using one of several methods, including the collateral value, market value of similar debt, enterprise value, liquidation value and discounted cash flows. At March 31, 2011, substantially all impaired loans were evaluated based on the fair value of the collateral and were classified as Level 3 in the fair value hierarchy.

Other Real Estate and Other Assets Owned (Foreclosed Assets)

Foreclosed assets are adjusted for fair value upon transfer of loans to foreclosed assets. Subsequently, foreclosed assets are carried at the lower of carrying value and fair value. Fair value is based on independent market prices, appraised value of the collateral or management's estimation of the value of the collateral and classified as Level 3 in the fair value hierarchy.

Derivative Assets and Liabilities

Derivative instruments held or issued by the Company for risk management purposes are traded in over-the-counter markets where quoted market prices are not readily available. For those derivatives, the Company measures fair value using models that use primarily market observable inputs, such as yield curves and option volatilities, and include the value associated with counterparty credit risk. The Company classifies derivative instruments held or issued for risk management purposes as recurring Level 2. As of March 31, 2011, the Company's derivative instruments consisted solely of interest rate caps. Derivative assets and liabilities are included in other assets and liabilities, respectively, in the accompanying consolidated balance sheets.

Assets Recorded at Fair Value on a Recurring Basis

The table below presents the recorded amount of assets measured at fair value on a recurring basis at March 31, 2011. All assets measured at fair value on a recurring basis were classified as Level 2 in the fair value hierarchy at March 31, 2011 and December 31, 2010.

(Dollars in thousands)	Fair Value	Quoted Prices (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Securities available for sale:				
U.S. Government agencies	\$ 47,999	\$ -	\$ 47,999	\$ -
Mortgage-backed securities	51,657	-	51,657	-
Other equity securities	578	-	578	-
Total	\$ 100,234	\$ -	\$ 100,234	\$ -
Interest rate caps	\$ 2,139	\$ -	\$ 2,139	\$ -

Assets Recorded at Fair Value on a Nonrecurring Basis

The table below presents the recorded amount of assets measured at fair value on a nonrecurring basis at March 31, 2011.

(Dollars in thousands)	Fair Value	Quoted Prices (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans				
Real estate - construction	\$ 15,359	\$ -	\$ -	\$ 15,359
Real estate - residential	12,245	-	-	12,245
Real estate - commercial	15,244	-	-	15,244
Commercial	2,661	-	-	2,661
Consumer	29	-	-	29
Total	\$ 45,538	\$ -	\$ -	\$ 45,538
Other real estate owned and other assets owned	\$ 4,802	\$ -	\$ -	\$ 4,802

Impaired loans had a carrying amount of \$48.7 million at March 31, 2011 with a valuation allowance of \$3.2 million.

The tables below summarize the changes in the recorded amount of assets measured at fair value on a nonrecurring basis for the three months ended March 31, 2011. All assets measured at fair value on a nonrecurring basis were classified as Level 3 in the fair value hierarchy at March 31, 2011 and December 31, 2010.

(Dollars in thousands)	Real estate - construction	Real estate - residential	Real estate - commercial	Commercial	Consumer	Total
For the three months ended March 31, 2011						
Impaired loans:						
Beginning balance	\$ 17,261	\$ 9,766	\$ 5,133	\$ 3,845	\$ 30	\$ 36,035
Charge-offs	(535)	(1,712)	(228)	(100)	-	(2,575)
Payments	(124)	(1,915)	(1,921)	-	(1)	(3,961)
Transfers to other real estate owned	(1,372)	-	-	-	-	(1,372)
Return to performing	-	(1,295)	-	-	-	(1,295)
Additions	129	8,251	13,282	63	-	21,725
Changes in allowance	-	(850)	(1,022)	(1,147)	-	(3,019)
Ending balance	\$ 15,359	\$ 12,245	\$ 15,244	\$ 2,661	\$ 29	\$ 45,538

(Dollars in thousands)	Other real estate owned
For the three months ended March 31, 2011	
Beginning balance	\$ 3,702
Sales	(567)
Write-downs	(163)
Additions	1,830
Ending balance	\$ 4,802

The following disclosures relate to the fair value of the Company's financial instruments and include the methods and assumptions used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value:

Cash and Cash Equivalents

For short-term instruments, the carrying amount is a reasonable estimate of fair value.

Investment Securities

For all investments in debt securities, fair values are based on quoted market prices. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities.

Loans

The fair values of categories of fixed rate loans, such as commercial loans, residential mortgage, and other consumer loans, are estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities. Other loans, including variable rate loans, are adjusted for differences in loan characteristics.

Financial Liabilities

The fair value of demand deposits, savings accounts, and certain money market deposits is the amount payable on demand at the reporting date. The fair value of fixed-maturity certificates of deposit is estimated using the rates currently offered for deposits of similar remaining maturities. These estimates do not take into consideration the value of core deposit intangibles. Generally, the carrying amount of short-term borrowings is a reasonable estimate of fair value. The fair values of securities sold under agreements to repurchase (included in short-term borrowings) and long-term debt are estimated using the rates offered for similar borrowings.

Commitments to Extend Credit and Standby Letters of Credit

The majority of the Company's commitments to grant loans and standby letters of credit are written to carry current market interest rates if converted to loans. Because commitments to extend credit and letters of credit are generally unassignable by the Company or the borrower, they only have value to the Company and the borrower and, therefore, it is impractical to assign any value to these commitments.

The estimated fair values of the Company's financial instruments as of March 31, 2011 and December 31, 2010 are as follows:

(Dollars in thousands)	March 31, 2011		December 31, 2010	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets:				
Cash and cash equivalents	\$89,982	\$89,982	\$77,964	\$77,964
Investment securities	106,920	107,077	105,782	105,906
Loans	884,715	893,262	895,404	908,745
Less: allowance for loan losses	(17,471)	-	(14,227)	-
Total	\$1,064,146	\$1,090,321	\$1,064,923	\$1,092,615
Financial liabilities:				
Deposits	\$986,486	\$987,477	\$979,516	\$983,257
Short-term borrowings	12,078	12,078	16,041	16,041
Long-term debt	932	972	932	982
Total	\$999,496	\$1,000,527	\$996,489	\$1,000,280

Note 8 – Derivative Instruments and Hedging Activities

ASC 815, "Derivatives and Hedging", defines derivatives, requires that derivatives be carried at fair value on the balance sheet and provides for hedge accounting when certain conditions are met. Changes in the fair values of derivative instruments designated as "cash flow" hedges, to the extent the hedges are highly effective, are recorded in other comprehensive income, net of taxes. Ineffective portions of cash flow hedges, if any, are recognized in current period earnings. The net interest settlement on cash flow hedges is treated as an adjustment of the interest income or interest expense of the hedged assets or liabilities. The Company uses derivative instruments to hedge its exposure to changes in interest rates. The Company does not use derivatives for any trading or other speculative purposes.

During the second quarter of 2009, as part of its overall interest rate risk management strategy, the Company purchased interest rate caps to effectively fix the interest rate on \$70 million of the Company's money market deposit accounts at 2.97% for five years. The interest rate caps qualified for hedge accounting. The aggregate fair value of these derivatives was an asset of \$2.1 million at March 31, 2011 and \$2.0 million at December 31, 2010. The change in fair value included a \$377 thousand adjustment to record the effectiveness of the hedge offset by a \$260 thousand charge to interest expense associated with the hedged money market deposit accounts. The charge to interest expense associated with the hedged deposits over the next 12 months is expected to be \$1.5 million.

By entering into derivative instrument contracts, the Company exposes itself, from time to time, to counterparty credit risk. Counterparty credit risk is the risk that the counterparty will fail to perform under the terms of the derivative contract. When the fair value of a derivative contract is in an asset position, the counterparty has a liability to the Company, which creates credit risk for the Company. The Company attempts to minimize this risk by selecting

counterparties with investment grade credit ratings, limiting its exposure to any single counterparty and regularly monitoring its market position with each counterparty. Also to minimize risk, the Company obtained counterparty collateral which was recorded in other liabilities. The counterparty collateral was \$1.7 million at March 31, 2011 and \$1.4 million at December 31, 2010.

Note 9 – Commitments

In the normal course of business, to meet the financial needs of its customers, the Company's bank subsidiaries enter into financial instruments with off-balance sheet risk. These financial instruments include commitments to extend credit and standby letters of credit. Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Letters of credit and other commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Because many of the letters of credit and commitments are expected to expire without being drawn upon, the total commitment amount does not necessarily represent future cash requirements. At March 31, 2011, total commitments to extend credit were approximately \$146.7 million. The comparable amount was \$137.1 million at December 31, 2010. Outstanding letters of credit were approximately \$15.4 million at March 31, 2011 and \$15.6 million at December 31, 2010.

Note 10 – Segment Reporting

The Company operates two primary business segments: Community Banking and Insurance Products and Services. Through the Community Banking business, the Company provides services to consumers and small businesses on the Eastern Shore of Maryland and Delaware through its 19-branch network. Community banking activities include small business services, retail brokerage, trust services and consumer banking products and services. Loan products available to consumers include mortgage, home equity, automobile, marine, and installment loans, credit cards and other secured and unsecured personal lines of credit. Small business lending includes commercial mortgages, real estate development loans, equipment and operating loans, as well as secured and unsecured lines of credit, credit cards, accounts receivable financing arrangements, and merchant card services.

Through the Insurance Products and Services business, the Company provides a full range of insurance products and services to businesses and consumers in the Company's market areas. Products include property and casualty, life, marine, individual health and long-term care insurance. Pension and profit sharing plans and retirement plans for executives and employees are available to suit the needs of individual businesses.

Selected financial information by business segments for the first three months of 2011 and 2010 is included in the following table:

(Dollars in thousands)	Community Banking	Insurance Products and Services	Parent Company	Consolidated Total
2011				
Interest income	\$ 12,683	\$ 35	\$ -	\$ 12,718
Interest expense	(2,846)	-	(10)	(2,856)
Provision for credit losses	(6,390)	-	-	(6,390)
Noninterest income	1,694	2,656	45	4,395
Noninterest expense	(5,937)	(2,399)	(1,555)	(9,891)
Net intersegment (expense) income	(1,493)	(109)	1,602	-
Loss before tax benefit	(2,289)	183	82	(2,024)
Income tax benefit	1,064	(85)	(38)	941
Net loss	\$ (1,225)	\$ 98	\$ 44	\$ (1,083)
Total assets	\$ 1,110,148	\$ 18,266	\$ 2,920	\$ 1,131,334

2010

Edgar Filing: SHORE BANCSHARES INC - Form 10-Q

Interest income	\$ 13,784	\$ 44	\$ -	\$ 13,828
Interest expense	(3,404)	-	(29)	(3,433)
Provision for credit losses	(7,617)	-	-	(7,617)
Noninterest income	1,832	3,050	-	4,882
Noninterest expense	(6,058)	(2,470)	(1,793)	(10,321)
Net intersegment (expense) income	(1,447)	(130)	1,577	-
Loss before tax benefit	(2,910)	494	(245)	(2,661)
Income tax benefit	1,202	(204)	101	1,099
Net loss	\$ (1,708)	\$ 290	\$ (144)	\$ (1,562)
Total assets	\$ 1,122,636	\$ 20,531	\$ 3,177	\$ 1,146,344

21

Note 11 – New Accounting Pronouncements

ASU No. 2010-28, “Intangibles - Goodwill and Other (Topic 350) - When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts.” ASU 2010-28 modifies Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts. For those reporting units, an entity is required to perform Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. In determining whether it is more likely than not that a goodwill impairment exists, an entity should consider whether there are any adverse qualitative factors indicating that an impairment may exist such as if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. ASU 2010-28 became effective for the Company on January 1, 2011 and did not have a significant impact on the Company’s financial statements.

ASU No. 2011-02, “Receivables (Topic 310) - A Creditor’s Determination of Whether a Restructuring Is a Troubled Debt Restructuring.” ASU 2011-02 clarifies which loan modifications constitute troubled debt restructurings and is intended to assist creditors in determining whether a modification of the terms of a receivable meets the criteria to be considered a troubled debt restructuring, both for purposes of recording an impairment loss and for disclosure of troubled debt restructurings. In evaluating whether a restructuring constitutes a troubled debt restructuring, a creditor must separately conclude, under the guidance clarified by ASU 2011-02, that both of the following exist: (a) the restructuring constitutes a concession; and (b) the debtor is experiencing financial difficulties. ASU 2011-02 will be effective for the Company on July 1, 2011, and applies retrospectively to restructurings occurring on or after January 1, 2011. Adoption of ASU 2011-02 is not expected have a significant impact on the Company’s financial statements.

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations.

Unless the context clearly suggests otherwise, references to “the Company”, “we”, “our”, and “us” in the remainder of this report are to Shore Bancshares, Inc. and its consolidated subsidiaries.

Forward-Looking Information

Portions of this Quarterly Report on Form 10-Q contain forward-looking statements within the meaning of The Private Securities Litigation Reform Act of 1995. Statements that are not historical in nature, including statements that include the words “anticipate”, “estimate”, “should”, “expect”, “believe”, “intend”, and similar expressions, are expressions of our confidence, policies, and strategies, the adequacy of capital levels, and liquidity and are not guarantees of future performance. Such forward-looking statements involve certain risks and uncertainties, including economic conditions, competition in the geographic and business areas in which we operate, inflation, fluctuations in interest rates, legislation, and governmental regulation. These risks and uncertainties are described in detail in the section of the periodic reports that Shore Bancshares, Inc. files with the Securities and Exchange Commission (the “SEC”) entitled “Risk Factors” (see Item 1A of Part II of this report). Actual results may differ materially from such forward-looking statements, and we assume no obligation to update forward-looking statements at any time except as required by law.

Introduction

The following discussion and analysis is intended as a review of significant factors affecting the Company’s financial condition and results of operations for the periods indicated. This discussion and analysis should be read in conjunction with the unaudited consolidated financial statements and related notes presented in this report, as well as the audited consolidated financial statements and related notes included in the Annual Report of Shore Bancshares, Inc. on Form 10-K for the year ended December 31, 2010.

Shore Bancshares, Inc. is the largest independent financial holding company located on the Eastern Shore of Maryland. It is the parent company of The Talbot Bank of Easton, Maryland located in Easton, Maryland (“Talbot Bank”) and CNB located in Centreville, Maryland (together with Talbot Bank, the “Banks”). Until January 1, 2011, the

Company also served as the parent company to The Felton Bank located in Felton, Delaware. The Banks operate 19 full service branches in Kent County, Queen Anne’s County, Talbot County, Caroline County and Dorchester County in Maryland and Kent County, Delaware. The Company engages in the insurance business through three insurance producer firms, The Avon-Dixon Agency, LLC, Elliott Wilson Insurance, LLC and Jack Martin Associates, Inc.; a wholesale insurance company, TSGIA, Inc.; and two insurance premium finance companies, Mubell Finance, LLC and ESFS, Inc. (all of the foregoing are collectively referred to as the “Insurance Subsidiary”). Each of these entities is a wholly-owned subsidiary of Shore Bancshares, Inc. The Company engages in the mortgage brokerage business under the name “Wye Mortgage Group” through a minority series investment in an unrelated Delaware limited liability company.

The shares of common stock of Shore Bancshares, Inc. are listed on the NASDAQ Global Select Market under the symbol "SHBI".

Shore Bancshares, Inc. maintains an Internet site at www.shbi.com on which it makes available free of charge its Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and all amendments to the foregoing as soon as reasonably practicable after these reports are electronically filed with, or furnished to, the SEC.

Critical Accounting Policies

Our financial statements are prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"). The financial information contained within the financial statements is, to a significant extent, financial information contained that is based on measures of the financial effects of transactions and events that have already occurred. A variety of factors could affect the ultimate value that is obtained either when earning income, recognizing an expense, recovering an asset or relieving a liability.

Allowance for Credit Losses

The allowance for credit losses is an estimate of the losses that may be sustained in the loan portfolio. The allowance is based on two basic principles of accounting: (i) Topic 450, "Contingencies", of the Financial Accounting Standards Board's Accounting Standards Codification ("ASC"), which requires that losses be accrued when they are probable of occurring and estimable, and (ii) ASC Topic 310, "Receivables", which requires that losses be accrued based on the differences between the loan balance and the value of collateral, present value of future cash flows or values that are observable in the secondary market. Management uses many factors, including economic conditions and trends, the value and adequacy of collateral, the volume and mix of the loan portfolio, and our internal loan processes in determining the inherent loss that may be present in our loan portfolio. Actual losses could differ significantly from management's estimates. In addition, GAAP itself may change from one previously acceptable method to another. Although the economics of transactions would be the same, the timing of events that would impact the transactions could change.

Management has significant discretion in making the adjustments inherent in the determination of the provision and allowance for credit losses, including in connection with the valuation of collateral, the borrower's prospects of repayment, and in establishing allowance factors on the formula allowance and unallocated allowance components of the allowance. The establishment of allowance factors is a continuing exercise, based on management's continuing assessment of the totality of all factors, including, but not limited to, delinquencies, loss history, trends in volume and terms of loans, effects of changes in lending policy, the experience and depth of management, national and local economic trends, concentrations of credit, the quality of the loan review system and the effect of external factors such as competition and regulatory requirements, and their impact on the portfolio, and allowance factors may change from period to period, resulting in an increase or decrease in the amount of the provision or allowance, based upon the same volume and classification of loans. Changes in allowance factors will have a direct impact on the amount of the provision, and a corresponding effect on net income. Errors in management's perception and assessment of these factors and their impact on the portfolio could result in the allowance not being adequate to cover losses in the portfolio, and may result in additional provisions or charge-offs.

Three basic components comprise our allowance for credit losses: (i) a specific allowance; (ii) a formula allowance; and (iii) a nonspecific allowance. Each component is determined based on estimates that can and do change when the actual events occur. The specific allowance is established against impaired loans based on our assessment of the losses that may be associated with the individual loans; the specific allowance remains until charge offs are made. An impaired loan may show deficiencies in the borrower's overall financial condition, payment history, support available from financial guarantors and/or the fair market value of collateral. The formula allowance is used to estimate the loss

on internally risk-rated loans, exclusive of those identified as impaired. Loans identified as special mention, substandard, and doubtful are adversely rated. These loans are assigned higher allowance factors than favorably rated loans due to management's concerns regarding collectability or management's knowledge of particular elements regarding the borrower. Loans that are favorably rated are grouped by type (commercial real estate and construction, residential real estate, commercial or consumer). Each loan type is assigned an allowance factor based on management's estimate of the risk, complexity and size of individual loans within a particular category. The nonspecific allowance captures losses that have impacted the portfolio but have yet to be recognized in either the specific or formula allowance.

Goodwill and Other Intangible Assets

Goodwill represents the excess of the cost of an acquisition over the fair value of the net assets acquired. Other intangible assets represent purchased assets that also lack physical substance but can be distinguished from goodwill because of contractual or other legal rights or because the asset is capable of being sold or exchanged either on its own or in combination with a related contract, asset or liability. Goodwill and other intangible assets with indefinite lives are tested at least annually for impairment, usually during the third quarter, or on an interim basis if circumstances dictate. Intangible assets that have finite lives are amortized over their estimated useful lives and also are subject to impairment testing.

Impairment testing requires that the fair value of each of the Company's reporting units be compared to the carrying amount of its net assets, including goodwill. The Company's reporting units were identified based on an analysis of each of its individual operating segments. If the fair value of a reporting unit is less than book value, an expense may be required to write down the related goodwill or purchased intangibles to record an impairment loss.

Fair Value

The Company measures certain financial assets and liabilities at fair value. Significant financial instruments measured at fair value on a recurring basis are investment securities and interest rate caps. Impaired loans and other real estate owned are significant financial instruments measured at fair value on a nonrecurring basis.

The Company conducts a review each quarter for all investment securities which reflect possible impairment to determine whether unrealized losses are temporary. Valuations for the investment portfolio are determined using quoted market prices, if available. If quoted prices are not available, fair values are measured using methods such as independent pricing models or quotes for similar investment securities.

See Note 7, "Fair Value Measurements", in the Notes to Consolidated Financial Statements for a further discussion of fair value.

OVERVIEW

The Company reported a net loss for the first quarter of 2011 of \$1.1 million, or diluted loss per common share of \$(0.13), compared to a net loss of \$1.6 million, or diluted loss per common share of \$(0.19), for the first quarter of 2010. For the fourth quarter of 2010, the Company reported net income of \$850 thousand, or diluted earnings per common share of \$0.10. The provision for credit losses for the first quarter of 2011 was \$6.4 million, which was \$1.2 million lower than the provision for the first quarter of 2010 and \$2.0 million higher than the provision for the fourth quarter of 2010. Annualized return on average assets was (0.39)% for the three months ended March 31, 2011, compared to (0.55)% for the same period in 2010. Annualized return on average stockholders' equity was (3.59)% for the first quarter of 2011, compared to (4.95)% for the first quarter of 2010. For the fourth quarter of 2010, annualized return on average assets was 0.30% and return on average equity was 2.73%.

RESULTS OF OPERATIONS

Net Interest Income

Net interest income for the three months ended March 31, 2011 was \$9.9 million, compared to \$10.4 million for the same period last year. The decline was primarily due to a decrease in the balances of and yields earned on average earning assets. The net interest margin was 3.79% for the first quarter of 2011, a decrease of 16 basis points when compared to the first quarter of 2010. The combination of high levels of loan charge-offs and nonaccrual loans has negatively impacted our net interest income and net interest margin. Both net interest income and net interest margin declined in the first quarter of 2011 when compared to the fourth quarter of 2010, mainly due to a decrease in the yields earned on average earning assets.

Interest income was \$12.7 million for the first quarter of 2011, a decrease of 8.0% from the first quarter of 2010. Average earning assets decreased 1.2% during the first quarter of 2011 when compared to the same period in 2010, while yields earned decreased 36 basis points to 4.88%, mainly due to loan activity. Average loans decreased 2.5% and the yield earned on loans decreased 25 basis points. Loans comprised 83.6% of total average earning assets for the first quarter of 2011, lower than the 84.7% for the first quarter of 2010. Other earning assets reflected a shift from investment securities to interest-bearing deposits when comparing average balances for the first quarters of 2011 and 2010. Interest income decreased 8.0% when compared to the fourth quarter of 2010. Although average earning assets

increased slightly during the first quarter of 2011 when compared to the fourth quarter of 2010, yields earned decreased 32 basis points.

Interest expense was \$2.9 million for the three months ended March 31, 2011, a decrease of 16.8% when compared to the same period last year. Average interest-bearing liabilities decreased 1.0%, while rates paid decreased 26 basis points to 1.32%, primarily due to changes in time deposits (certificates of deposit \$100,000 or more and other time deposits). For the three months ended March 31, 2011, the average balance of certificates of deposit \$100,000 or more decreased slightly when compared to the same period last year, while the average rate paid on these certificates of deposit decreased 54 basis points to 2.24%. Average other time deposits decreased 5.2% and the rate paid on average other time deposits decreased 57 basis points, when comparing the first quarter of 2011 to the first quarter of 2010. When comparing the first quarter of 2011 to the fourth quarter of 2010, interest expense decreased 3.6% primarily due to rates paid on interest-bearing liabilities decreasing 3 basis points to 1.32%.

Analysis of Interest Rates and Interest Differentials

The following table presents the distribution of the average consolidated balance sheets, interest income/expense, and annualized yields earned and rates paid for the three months ended March 31, 2011 and 2010.

(Dollars in thousands)	For the Three Months Ended March 31, 2011			For the Three Months Ended March 31, 2010		
	Average Balance	Income(1)/ Expense	Yield/ Rate	Average Balance	Income(1)/ Expense	Yield/ Rate
Earning assets						
Loans (2), (3)	\$ 887,531	\$ 12,040	5.50 %	\$ 910,374	\$ 12,910	5.75 %
Investment securities						
Taxable	101,625	657	2.62	103,488	882	3.45
Tax-exempt	4,610	58	5.08	6,764	90	5.39
Federal funds sold	46,813	16	0.14	46,553	12	0.11
Interest-bearing deposits	21,585	6	0.12	8,246	1	0.06
Total earning assets	1,062,164	12,777	4.88 %	1,075,425	13,895	5.24 %
Cash and due from banks	19,316			14,422		
Other assets	65,426			67,914		
Allowance for credit losses	(15,647)			(12,154)		
Total assets	\$ 1,131,259			\$ 1,145,607		
Interest-bearing liabilities						
Demand deposits	\$ 131,628	73	0.22 %	\$ 127,986	80	0.25 %
Money market and savings deposits	260,841	595	0.93	256,818	428	0.68
Certificates of deposit						
\$100,000 or more	259,179	1,086	1.70	259,538	1,433	2.24
Other time deposits	208,301	1,079	2.10	219,731	1,444	2.67
Interest-bearing deposits	859,949	2,833	1.34	864,073	3,385	1.59
Short-term borrowings	14,165	13	0.37	18,032	32	0.71
Long-term debt	932	10	4.56	1,429	16	4.45
Total interest-bearing liabilities	875,046	2,856	1.32 %	883,534	3,433	1.58 %
Noninterest-bearing deposits	122,300			118,192		
Other liabilities	11,447			15,800		
Stockholders' equity	122,466			128,081		
Total liabilities and stockholders' equity	\$ 1,131,259			\$ 1,145,607		
Net interest spread						
		\$ 9,921	3.56 %		\$ 10,462	3.66 %
Net interest margin						
			3.79 %			3.95 %
Tax-equivalent adjustment						
Loans		\$ 39			\$ 36	
Investment securities		20			31	
Total		\$ 59			\$ 67	

(1) All amounts are reported on a tax equivalent basis computed using the statutory federal income tax rate of 34.0% for 2011 and 2010 exclusive of the alternative minimum tax rate and nondeductible interest expense.

(2) Average loan balances include nonaccrual loans.

(3) Interest income on loans includes amortized loan fees, net of costs, and all are included in the yield calculations.

Noninterest Income

Noninterest income for the first quarter of 2011 decreased \$487 thousand, or 10.0%, when compared to the first quarter of 2010. The decline was primarily due to a decline in insurance agency commissions of \$379 thousand resulting from lower contingency payments which are typically received in the first quarter of each year and are based on the prior year's performance. The increase in noninterest income of \$447 thousand, or 11.3%, when compared to the fourth quarter of 2010 was primarily due to an increase in insurance agency commissions of \$394 thousand due to contingency payments.

Noninterest Expense

Noninterest expense for the first quarter of 2011 decreased \$430 thousand, or 4.2%, when compared to the first quarter of 2010. Salaries and wages decreased \$244 thousand mainly due to lower bonus and stock-based compensation expense, employee benefits decreased \$128 thousand primarily due to lower profit sharing expense, and other noninterest expenses decreased \$136 thousand mainly due to lower expenses related to other real estate owned activities. Partially offsetting these decreases when compared to the first quarter of 2010 was a \$220 thousand increase in data processing mainly due to the charges relating to the merger of The Felton Bank into CNB. Noninterest expense increased \$809 thousand, or 8.9%, from the fourth quarter of 2010. Other employee benefits increased \$260 thousand mainly due to higher payroll taxes, data processing increased \$231 thousand primarily due to charges relating to the merger of The Felton Bank into CNB, and other noninterest expenses increased \$158 thousand mainly due to higher expenses related to collection and other real estate owned activities when compared to the fourth quarter of 2010.

Income Taxes

The Company reported an income tax benefit of \$941 thousand and \$1.1 million for the first three months of 2011 and 2010, respectively. The effective tax rate was a 46.5% benefit for the first quarter of 2011 and a 41.3% benefit for the first quarter of 2010.

ANALYSIS OF FINANCIAL CONDITION

Loans

Loans, net of unearned income, totaled \$884.7 million at March 31, 2011, a 1.2% decrease since December 31, 2010. Average loans were \$887.5 million for the three months ended March 31, 2011, which was 2.5% lower than the comparable amount for the same period last year. Loan growth slowed when comparing the first quarter of 2011 to the first quarter of 2010, as the weakened economy continued to create fewer loan opportunities to originate high-quality credits. At the same time we are experiencing slowing loan growth, net loan charge-offs continue at historically high levels. However, net loan charge-offs have moved downward from \$5.7 million in the first quarter of 2010 to \$3.1 million in the first quarter of 2011.

Our loan portfolio has a commercial real estate loan concentration, which is defined as a combination of construction and commercial real estate loans. Construction loans were \$135.4 million, or 15.3% of total loans, at March 31, 2011, compared to \$144.0 million, or 16.1% of total loans, at December 31, 2010. Commercial real estate loans were approximately \$323.0 million, or 36.5% of total loans, at March 31, 2011, compared to \$318.7 million, or 35.6% of total loans, at December 31, 2010. We do not engage in foreign or subprime lending activities.

Because most of our loans are secured by real estate, weaknesses in the current local real estate market and construction industry, and lack of improvement in general economic conditions have had a material adverse effect on the performance of our loan portfolio and the value of the collateral securing that portfolio. Factors affecting loan performance and our overall financial performance include higher provisions for credit losses, loan charge-offs and nonperforming assets.

Allowance for Credit Losses

We have established an allowance for credit losses, which is increased by provisions charged against earnings and recoveries of previously charged-off debts and is decreased by current period charge-offs of uncollectible debts. Management evaluates the adequacy of the allowance for credit losses on a quarterly basis and adjusts the provision for credit losses based upon this analysis. The evaluation of the adequacy of the allowance for credit losses is based on a risk rating system of individual loans, as well as on a collective evaluation of smaller balance homogenous loans based on factors such as past credit loss experience, local economic trends, nonperforming and

problem loans, and other factors which may impact collectibility. A loan is placed on nonaccrual when it is specifically determined to be impaired and principal and interest is delinquent for 90 days or more. Please refer to the discussion above under the caption "Critical Accounting Policies" for an overview of the underlying methodology management employs on a quarterly basis to maintain the allowance.

The provision for credit losses for the three months ended March 31, 2011 and 2010 was \$6.4 million and \$7.6 million, respectively. The provision for credit losses for the fourth quarter of 2010 was \$4.4 million. The continued historically large level of provision expense was the result of the overall increase in nonperforming assets and loan charge-offs, and management's assessment of credit quality issues. Because most of our loans are secured by real estate, declining property values and real estate sales are negatively impacting credit quality. However, we continue to emphasize credit quality and believe that our underwriting guidelines are strong. As problem loans are identified, management takes prompt action to quantify and minimize losses and also works with the borrowers in an effort to reach mutually acceptable resolutions.

Net charge-offs were \$3.1 million for the three months ended March 31, 2011, compared to \$5.7 million for the same period last year and \$3.3 million for the fourth quarter of 2010. Most of the charge-offs in the first quarter of 2011 were residential real estate loans while most of the charge-offs in the first quarter of 2010 were construction loans. A large portion of the loss on residential real estate loans during the first quarter of 2011 was from a single \$1.3 million residential property. The majority of losses on construction loans that occurred in the first quarter of 2010 related to one \$3.4 million construction loan relationship. The allowance for credit losses as a percentage of average loans increased to 1.97% for the first quarter of 2011, compared to 1.41% for the first quarter of 2010. Based on management's quarterly evaluation of the adequacy of the allowance for credit losses, it believes that the allowance for credit losses and the related provision were adequate at March 31, 2011 to provide for probable losses inherent in our loan portfolio.

The following table presents a summary of the activity in the allowance for credit losses:

(Dollars in thousands)	For the Three Months Ended			
	March 31,			
	2011		2010	
Allowance balance – beginning of period	\$ 14,227		\$ 10,876	
Charge-offs:				
Real estate – construction	(686)		(3,509)	
Real estate – residential	(2,091)		(991)	
Real estate – commercial	(228)		-	
Commercial	(246)		(1,224)	
Consumer	(75)		(166)	
Total	(3,326)		(5,890)	
Recoveries:				
Real estate – construction	49		-	
Real estate – residential	34		38	
Real estate – commercial	-		101	
Commercial	77		3	
Consumer	20		46	
Total	180		188	
Net charge-offs	(3,146)		(5,702)	
Provision for credit losses	6,390		7,617	
Allowance balance – end of period	\$ 17,471		\$ 12,791	
Average loans outstanding during the period	\$ 887,531		\$ 910,374	
Net charge-offs (annualized) as a percentage of average loans outstanding during the period	1.44	%	2.54	%
Allowance for credit losses at period end as a percentage of average loans	1.97	%	1.41	%

Nonperforming Assets

Nonperforming assets were \$53.6 million at March 31, 2011, compared to \$39.9 million at December 31, 2010. The increase in nonaccrual loans during the first quarter of 2011 was primarily in residential and commercial real estate loans, mainly related to three borrower relationships totaling approximately \$14.3 million. Total nonperforming assets to total loans and other real estate owned increased to 6.02% at March 31, 2011, compared to 4.44% at December 31, 2010. Loans 90 days or more past due and still accruing at March 31, 2011 increased to \$5.5 million from \$4.7 million at December 31, 2010. Nonaccrual loans and loans 90 days or more past due and still accruing included troubled debt restructurings of \$919 thousand and \$200 thousand, respectively, at March 31, 2011. The comparable troubled debt restructuring amounts were \$3.1 million and \$194 thousand, respectively, at December 31, 2010.

The following table summarizes our nonperforming assets and loans 90 days or more past due and still accruing:

(Dollars in thousands)	March 31, 2011		December 31, 2010	
Nonperforming assets				
Nonaccrual loans				
Real estate – construction	\$ 15,359		\$ 17,261	
Real estate – residential	13,298		9,969	
Real estate – commercial	16,266		5,133	
Commercial	3,808		3,845	
Consumer	29		30	
Total nonaccrual loans	48,760		36,238	
Other real estate owned	4,802		3,702	
Total nonperforming assets	53,562		39,940	
Loans 90 days or more past due and still accruing				
Real estate – construction	-		-	
Real estate – residential	3,026		3,454	
Real estate – commercial	1,960		986	
Commercial	502		174	
Consumer	18		88	
Total loans 90 days or more past due and still accruing	5,506		4,702	
Total nonperforming assets and 90 days or more past due loans	\$ 59,068		\$ 44,642	
Nonperforming assets to total loans and other real estate owned	6.02	%	4.44	%
Nonperforming assets to total assets	4.73	%	3.53	%
Nonperforming assets and 90 days or more past due loans, to total loans and other real estate owned	6.64	%	4.97	%
Nonperforming assets and 90 days or more past due loans to total assets	5.22	%	3.95	%

Investment Securities

Investment securities totaled \$106.9 million at March 31, 2011, a \$1.1 million, or 1.1%, increase since December 31, 2010. The average balance of investment securities was \$106.2 million for the three months ended March 31, 2011, compared to \$110.3 million for the same period in 2010. The tax equivalent yields on investment securities were 2.70% and 3.58% for the three months ended March 31, 2011 and 2010, respectively. The decrease in the 2011 investment securities average balance when compared to the 2010 average balance reflected a shift to interest-bearing deposits for liquidity purposes.

Deposits

Total deposits at March 31, 2011 were \$986.5 million, a \$7.0 million, or less than one percent, increase when compared to the \$979.5 million at December 31, 2010. The increase was primarily in interest-bearing demand, money market and savings deposits which reflected a shift from certificates of deposit \$100,000 or more. This shift was attributable to management's effort to reduce deposit pricing structures to reflect current market conditions and the Company's liquidity needs.

Short-Term Borrowings

Short-term borrowings at March 31, 2011 and December 31, 2010 were \$12.1 million and \$16.0 million, respectively. Short-term borrowings generally consist of securities sold under agreements to repurchase, overnight borrowings from correspondent banks and short-term advances from the Federal Home Loan Bank (the "FHLB"). Short-term advances are defined as those with original maturities of one year or less. At March 31, 2011 and December 31, 2010, short-term borrowings included only repurchase agreements. The decline since December 31, 2010 reflects less dependence on short-term borrowings for funding requirements.

Long-Term Debt

At March 31, 2011 and December 31, 2010, the Company had \$932 thousand in long-term debt. This debt was acquisition-related, incurred as part of the purchase price of TSGIA, Inc. and is payable to the seller thereof, who remains the President of that subsidiary. The interest rate on the debt is 4.08% and principal and interest are payable in annual installments for five years.

Liquidity and Capital Resources

We derive liquidity through increased customer deposits, maturities in the investment portfolio, loan repayments and income from earning assets. During the second quarter of 2009, we began participating in the IND program which resulted in increased deposits and liquidity. The program has a five-year term and has a guaranteed minimum funding level of \$70 million.

To the extent that deposits are not adequate to fund customer loan demand, liquidity needs can be met in the short-term funds markets through arrangements with correspondent banks. The Banks are also members of the FHLB, which provides another source of liquidity. Through the FHLB, the Banks had credit availability of approximately \$27.5 million and \$29.1 million at March 31, 2011 and December 31, 2010, respectively. The Banks have pledged, under a blanket lien, all qualifying residential loans under borrowing agreements with the FHLB. Management is not aware of any demands, commitments, events or uncertainties that are likely to materially affect our future ability to maintain liquidity at satisfactory levels.

Total stockholders' equity was \$120.9 million at March 31, 2011, compared to \$122.5 million at December 31, 2010. The net loss and dividends paid contributed to the decrease in stockholders' equity since the end of 2010. To sustain capital and enhance capital ratios, the Company's Board of Directors decreased the quarterly common stock dividend to \$0.06 from \$0.16 per share beginning with the dividend that was payable on February 26, 2010. On May 9, 2011, the Company announced that the Board had further reduced the quarterly common stock dividend to \$.01 per share, effective for the dividend payable May 31, 2011 to stockholders of record on May 19, 2011. The Board believes that

the most recent reduction should allow the Company to retain approximately \$1.7 million in common equity per year.

Bank regulatory agencies have adopted various capital standards for financial institutions, including risk-based capital standards. The primary objectives of the risk-based capital framework are to provide a more consistent system for comparing capital positions of financial institutions and to take into account the different risks among financial institutions' assets and off-balance sheet items.

Risk-based capital standards have been supplemented with requirements for a minimum Tier 1 capital to average assets ratio (leverage ratio). In addition, regulatory agencies consider the published capital levels as minimum levels and may require a financial institution to maintain capital at higher levels. The Company's capital ratios continued to be well in excess of regulatory minimums.

A comparison of the Company's capital ratios as of March 31, 2011 and December 31, 2010 to the minimum regulatory requirements is presented below:

	March 31, 2011		December 31, 2010		Minimum Regulatory Requirements	
Tier 1 risk-based capital ratio	11.79	%	11.81	%	4.00	%
Total risk-based capital ratio	13.05	%	13.07	%	8.00	%
Leverage ratio	9.38	%	9.53	%	4.00	%

Item 3. Quantitative and Qualitative Disclosures about Market Risk.

Our primary market risk is to interest rate fluctuation and management has procedures in place to evaluate and mitigate this risk. This risk and these procedures are discussed in Item 7 of Part II of the Annual Report of Shore Bancshares, Inc. on Form 10-K for the year ended December 31, 2010 under the caption "Market Risk Management". Management believes that there have been no material changes in our market risks, the procedures used to evaluate and mitigate these risks, or our actual and simulated sensitivity positions since December 31, 2010.

Item 4. Controls and Procedures.

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in the reports that Shore Bancshares, Inc. files under the Securities Exchange Act of 1934 with the SEC, such as this Quarterly Report, is recorded, processed, summarized and reported within the time periods specified in those rules and forms, and that such information is accumulated and communicated to management, including Shore Bancshares, Inc.'s Chief Executive Officer ("CEO") and the Principal Accounting Officer ("PAO"), as appropriate, to allow for timely decisions regarding required disclosure. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate.

An evaluation of the effectiveness of these disclosure controls as of March 31, 2011 was carried out under the supervision and with the participation of management, including the CEO and the PAO. Based on that evaluation, the Company's management, including the CEO and the PAO, has concluded that our disclosure controls and procedures are, in fact, effective at the reasonable assurance level.

There was no change in our internal control over financial reporting during the first quarter of 2011 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II – OTHER INFORMATION

Item 1A. Risk Factors.

The risks and uncertainties to which our financial condition and operations are subject are discussed in detail in Item 1A of Part I of the Annual Report of Shore Bancshares, Inc. on Form 10-K for the year ended December 31, 2010. Management does not believe that any material changes in our risk factors have occurred since they were last disclosed.

Item 6. Exhibits.

The exhibits filed or furnished with this quarterly report are shown on the Exhibit List that follows the signatures to this report, which list is incorporated herein by reference.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

SHORE BANCSHARES, INC.

Date: May 9, 2011

By: /s/ W. Moorhead Vermilye
W. Moorhead Vermilye
Chief Executive Officer

Date: May 9, 2011

By: /s/ Susan E. Leaverton
Susan E. Leaverton, CPA
Treasurer/Principal Accounting Officer

EXHIBIT INDEX

Exhibit Number	Description
31.1	Certifications of the CEO pursuant to Section 302 of the Sarbanes-Oxley Act (filed herewith).
31.2	Certifications of the PAO pursuant to Section 302 of the Sarbanes-Oxley Act (filed herewith).
32	Certification pursuant to Section 906 of the Sarbanes-Oxley Act (furnished herewith).

32
