



GOOD THINGS
HAPPEN WHEN
YOU'RE IN IT
TOGETHER



SHORE BANCSHARES, INC.
2013 ANNUAL REPORT



WHERE YOU'LL FIND US
AS WE LOOK AHEAD
DEFINING OUR FUTURE

SELECTED FINANCIAL DATA

(Dollars in thousands, except per share data)	Years Ended December 31,				
	2013	2012	2011	2010	2009
RESULTS OF OPERATIONS:					
Interest income	\$ 41,351	\$ 45,901	\$ 50,852	\$ 55,461	\$ 58,789
Interest expense	<u>6,475</u>	<u>10,562</u>	<u>11,088</u>	<u>12,822</u>	<u>17,411</u>
Net interest income	34,876	35,339	39,764	42,639	41,378
Provision for credit losses	<u>27,784</u>	<u>27,745</u>	<u>19,470</u>	<u>21,119</u>	<u>8,986</u>
Net interest income after provision for credit losses	7,092	7,594	20,294	21,520	32,39
Noninterest income	17,459	15,758	17,318	18,041	19,541
Noninterest expense	<u>40,686</u>	<u>39,555</u>	<u>39,167</u>	<u>41,720</u>	<u>40,248</u>
(Loss) income before income taxes	(16,135)	(16,203)	(1,555)	(2,159)	11,685
Income tax (benefit) expense	<u>6,501</u>	<u>(6,565)</u>	<u>(658)</u>	<u>(492)</u>	<u>4,412</u>
Net (loss) income	(9,634)	(9,638)	(897)	(1,667)	7,273
Preferred stock dividends and discount accretion	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>1,876</u>
Net (loss) income available to common shareholders	<u>\$(9,634)</u>	<u>\$(9,638)</u>	<u>\$ (897)</u>	<u>\$(1,667)</u>	<u>\$ 5,397</u>
PER COMMON SHARE DATA:					
Net (loss) income – basic	\$ (1.14)	\$ (1.14)	\$ (0.11)	\$(0.20)	\$ 0.64
Net (loss) income – diluted	(1.14)	(1.14)	(0.11)	(0.20)	0.64
Dividends paid	<u>—</u>	0.01	0.09	0.24	0.64
Book value (at year end)	12.19	13.48	14.34	14.51	15.18
Tangible book value (at year end) ¹	10.31	11.56	12.37	12.32	12.64
FINANCIAL CONDITION (at year end):					
Loans	\$ 711,919	\$ 785,082	\$ 841,050	\$ 895,404	\$ 916,557
Assets	1,054,124	1,185,807	1,158,193	1,130,311	1,156,516
Deposits	933,468	1,049,273	1,009,919	979,516	990,937
Long-term debt	<u>—</u>	<u>—</u>	455	932	1,429
Stockholders' equity	103,299	114,026	121,249	122,513	127,810
PERFORMANCE RATIOS (for the year):					
Return on average total assets	(0.89)%	(0.82)%	(0.08)%	(0.15)%	0.48%
Return on average stockholders' equity	(8.64)	(8.07)	(0.74)	(1.33)	4.00
Net interest margin	3.48	3.23	3.74	4.02	3.90
Efficiency ratio ²	77.59	77.17	68.35	68.75	66.07
Dividend payout ratio	<u>—</u>	(0.88)	(81.82)	(120.00)	100.00
Average stockholders' equity to average total assets	10.31	10.18	10.66	11.05	11.96

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

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

DEAR SHAREHOLDERS:

We are pleased to have 2013 end on a positive note. Shore Bancshares Inc., reported a net income of \$1.2 million or \$0.14 per diluted common share, compared to a net loss of \$11.4 million or (\$1.35) per diluted common share for the third quarter of 2013. The primary reason for the improved results was due to a decline in the credit provision for credit losses which is a direct result of the bulk sale of non-performing loans in the third quarter.

On October 28, 2013, Shore Bancshares Inc., the wholly owned subsidiary of The Talbot Bank of Easton made the decision to sell a significant number of its non-performing loans to curtail credit losses and provide an opportunity for future earnings and growth. A significant portion of our non-performing loans were real estate development loans that had been restructured due to the current market conditions. Also in the loan sale was a variety of real estate that was acquired through the foreclosure process and held on The Talbot Bank's balance sheet. By selling the non-performing assets we improved our risk profile; we are now in a position to change the trajectory of our future by aggressively pursuing opportunities that will enhance revenue.

In reflection, 2013 was a transformation year for Shore Bancshares, Inc., beginning with executive leadership changes. In January of 2013, Mr. George Rapp joined the company as Chief Financial Officer of Shore Bancshares, Inc. Mr. Rapp has extensive financial banking experience and has held numerous positions as an executive leader at various companies. Mr. Patrick Bilbrough was promoted to Chief Executive Officer at the Talbot Bank, succeeding Mr. Buck Duncan who retired in January of 2013. In June of 2013, Mr. Lloyd "Scott" L. Beatty, Jr. was promoted to Chief Executive Officer of Shore Bancshares, Inc., succeeding Mr. Moorhead Vermilye who retired as Chief Executive Officer of Shore Bancshares, Inc. Later in June of 2013, Donna Stevens was promoted to Senior Vice President, Chief Operations Officer at Shore Bancshares, Inc., after serving as Senior Vice President of Operations and Compliance at CNB.

The economic crisis over the past five years presented significant challenges for our companies. Businesses on the Delmarva have not rebounded as well as in other regions. Real estate activity and prices continue to remain sluggish with few signs of improvement. The latent effects of the economy and the real estate market have altered our strategy.

STRATEGIC MOVES IN 2013

In the first quarter of 2013 we partnered with a marketing agency to aid us in conducting a series of focus groups to help us better understand our customers and prospects of Shore Bancshares and its business entities. The research concluded that respondents felt it was important to have a provider that meets all of their service needs, is local in the community, and can offer "big bank" products and services under one roof. As a result of our research findings, in July we launched a new brand campaign "good things are happening here™" to leverage our company culture and commitment to our local communities and to promote the broad range of innovative banking, insurance, and wealth management solutions available throughout our community of companies.



To further support the marketing campaign and future direction of our company we launched a series of quarterly meetings in the second quarter of 2013 for our top leadership staff to focus on core strategic objectives to develop a unified approach to enhance business development, and build a strong sales and marketing culture.

During the third quarter of 2013, our banks switched to a new debit card platform to add an additional layer of security in monitoring fraudulent activity. The new platform includes adaptive software that will enable us to contact our customers to confirm when a transaction appears to be outside of a customer's normal spending patterns.

Our benefits insurance division of the Avon Dixon Agency is responding to the changes surrounding the Affordable Care Act by offering free webinars and seminars to help business clients who are forced to balance the shift in health care benefits and the potential costs that may be incurred as the law is implemented.

Wye Financial and Trust continues to support Shore Bancshares in competing with larger financial services by providing brokerage, wealth management, and trust services for our banks and insurance companies as well as independent clients, thereby building deeper relationships with our customers.

In the fourth quarter of 2013, the loan operations departments of Talbot Bank and CNB were merged into a central location to leverage the resources and talents of our staff, create efficiencies, and support the future loan growth of our banks.

In the last year, we have implemented many new initiatives and internal process improvements, and we have promoted and hired staff to help us navigate through the challenges of 2013. With many of these issues now behind us we will focus our resources on the most promising markets, diversified lending, and product, employee, and business development. At Shore Bancshares we are committed to meet the overall strategic mission of our company; to be the dominant financial institution on the Delmarva Peninsula.

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

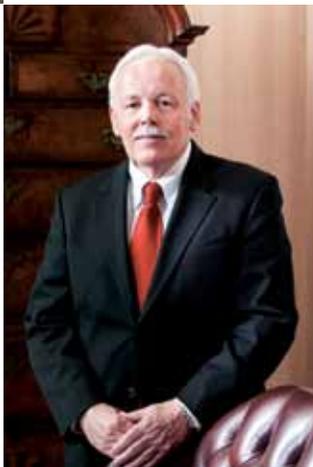
Sincerely,

A handwritten signature in black ink that reads "Lloyd L. Beatty, Jr." The signature is written in a cursive style.

Lloyd "Scott" L. Beatty, Jr.

A handwritten signature in black ink that reads "Christopher F. Spurry". The signature is written in a cursive style.

Christopher F. Spurry



DEFINING OUR FUTURE

AS WE LOOK AHEAD

WHERE YOU'LL FIND US

GOOD PEOPLE MAKE GOOD THINGS HAPPEN



SCOTT BEATTY

GEORGE RAPP

SHORE BANCSHARES Today in a marketplace of continual innovation and change, a company needs strong strategic leadership to survive. Shore Bancshares Executive Leaders, Lloyd L. “Scott” Beatty, Jr., President and Chief Executive Officer and George S. Rapp, Chief Financial Officer are investing the time and energy to make positive changes in 2014.

In 2013, the leadership team at Shore Bancshares, Inc. launched quarterly officer and manager meetings to build employee relationships across all of its companies. “The platform of these meetings focuses on the ‘big picture’ our road map to success,” says Mr. Rapp. “By bringing our employees together, they all hear the same message”.

Like most companies, employees spend a considerable amount of time communicating through e-mail and telephone

without ever meeting face to face. “The quarterly meetings not only provide a consistent message about financial performance, strategic objectives, and the status of projects, they bring something more; the opportunity for employees to share information with their co-workers,” comments Mr. Beatty.

Throughout 2014 the companies will continue to meet quarterly to share information about their lines of business and discuss the successes and modifications we need to increase profitability. “We believe that every day affords the opportunity to become better than what we were yesterday,” says Mr. Beatty.

The Shore Bancshares story may have begun over a decade ago, but the spirit, principles and core values that have driven our success so far will guide us into the future and to continue to help make many good things happen for our stockholders, customers and employees.



BETH SPURRY

WYE FINANCIAL & TRUST As a division of CNB, Wye Financial & Trust’s history reaches back to 1876 when Centreville National Bank opened its doors to business. In 2002 CNB created Wye Financial Services which evolved to become Wye Financial & Trust in 2005.

Personal, relationship-based customer service is at the core of Wye Financial & Trust’s philosophy and distinguishes our small and independent wealth management team. Our business is built on a commitment to providing high quality advice, delivered by a professionally credentialed staff with access to world-class portfolio managers. At Wye Financial & Trust we adapt our wealth management services to meet the individual needs of our clients, whether they be individuals, families, or institutions. Our services include but are not limited to: comprehensive planning, wealth management, fiduciary and trust services. These services are important to our banking and insurance customers, and support the growth strategies of the entire Shore Bancshares company. By working with internal partners across all the affiliates, Wye Financial & Trust can help grow and build deeper life-long relationships with our customers.

We live and work in the communities that we serve. The staff of Wye Financial & Trust believes in giving back to our neighbors. We have consistently provided support through charitable giving and volunteer hours to numerous organizations and events on the Eastern Shore.

“We put the customer at the center of all of our work by providing the wealth management and financial planning services they need in the ways that are most helpful to them,” comments Beth Spurry, Senior Vice President. “We continually look for ways to grow the value of our company to benefit our customers, our affiliates, our shareholders and our community.”

CNB We are optimistic about the future of our bank and have put ourselves in a “ready to go” position as the right opportunities present themselves. “Community banks have held to their deep local roots by offering trademark customer service, lower fees than the big banks and more lending flexibility,” says Win Trice, President and Chief Executive Officer of CNB. CNB rates as one of the healthiest banks on the Delmarva Peninsula, allowing us the flexibility to offer more lending solutions than our nearby competitors.

CNB has a talented business development and lending team in place who have built strong relationships with our customers. We work closely with our affiliate companies to utilize company resources to enhance our performance to benefit our customers and shareholders. Attracting new customers and deepening relationships with our existing customers is critical to our success. By introducing our customers to services offered by other affiliate companies, in insurance and wealth management, we are building a process that will yield high rewards in the coming year. Personal customer service is the norm for doing business and practiced daily in all of our 11 branches. CNB volunteers provided 8,155 hours of community service in 2013; the highest number of hours on record over preceding years. All that we have achieved so far has been through the teamwork and strength of our employees.

TALBOT BANK We are now in a strong position to aggressively pursue lending opportunities that will support the growth of the communities in which we live and work. As a local community bank, we are linked to the people and businesses that we serve. We continually strive to invest in our community whether it is through charitable giving or volunteer service hours provided by our employees. Talbot Bank had the honor of being named ‘Best Bank of the Eastern Shore’ by the *What’s Up Eastern Shore* magazine reader’s poll. The award recognized Talbot Bank as the best for bank services that the Shore has to offer. “We have been a partner, neighbor and friend to our community for over 125 years,” comments Pat Bilbrough, President and Chief Executive Officer of Talbot Bank. “We strive to serve our customers well and to make a real difference in their lives.”

We believe that being a local bank is much more than opening a branch on every corner. It’s the critical role we take in channeling loans to our depositor’s neighborhoods, thereby helping to keep our communities vibrant and growing. Larger regional banks may take deposits in one state and lend in others. As a local bank, we focus our attention on the needs of local businesses and our officers as well as executive management are accessible to our customers.

“Talbot Bank is in a great position to gain market share in the coming year,” says Pat Bilbrough. “We are ready to put 2013 behind us and focus on future success.”



WIN TRICE
PAT BILBROUGH



AVON-DIXON Since 1850, The Avon-Dixon Agency has enjoyed a long history operating as an independent, full-service insurance agency with multiple divisions in Maryland, including Jack Martin & Associates, Freestate and Son, and Elliott Wilson Insurance. The many lines of personal, business and benefit insurance products offered by Avon-Dixon provide unique solutions to match each client’s individual needs. The insurance specialists at Avon-Dixon serve customers throughout the United States.

Avon-Dixon is a strong, customer-focused insurance agency that responds to ever changing personal and business environments affected by legislation and laws, the most notable of which is currently the Affordable Care Act (ACA). The benefits division is actively reaching out to educate clients and the public through public service announcements, email campaigns, webinars and individual meetings to help them understand how the ACA will impact them.

Employees at Avon-Dixon believe that civic involvement means serving and getting to know the communities in which they live. Participation in various types of local activities and organizations provides a foundation

for caring and helping their customers no matter where that customer lives. This expands the impact of Avon-Dixon beyond the local community outward to the entire region. “At Avon-Dixon, we remain dedicated to helping people manage the risks of everyday life,” say Rich Trippe, President. “Avon-Dixon can help make good things happen whether a customer is just starting out in life or in business, is already established or is planning for the future.”

RICH TRIPPE

AS WE LOOK AHEAD

WHERE YOU’LL FIND US

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BLENDA W. ARMISTEAD
Investor

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President and Chief Executive Officer
Shore Bancshares, Inc.

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Certified Public Accountant
Anthony, Judge & Ware, LLC

NEIL R. LECOMPTÉ
Certified Public Accountant
Office of Neil R. LeCompte

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President and Chief Executive Officer, JASCO

DAVID J. BATES
Investor

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President, Spurry and Associates, Inc.

F. WINFIELD TRICE, JR.
President and Chief Executive Officer, CNB

W. MOORHEAD VERMILYE
Senior Business Development Officer
Talbot Bank

JOHN H. WILSON
President, Coastal South of MD, Inc.

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Shore Bancshares, Inc.

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Vice President and Chief Financial Officer

W. David Morse
Secretary and Legal Counsel

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Vice President, Internal Audit

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Chief Operations Officer

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Pamela J. Dill
Vice President and Chief Human Relations Officer

Debra H. Rich
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OF EASTON, MARYLAND

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Kathleen Kurtz
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Chief Credit Officer

Edward C. Allen
Vice President and Chief Financial Officer

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WILLIAM L. LANE JR., Chairman
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Executive Vice President

Mark M. Freestate
Executive Vice President

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President

Lloyd L. "Scott" Beatty, Jr.
Secretary

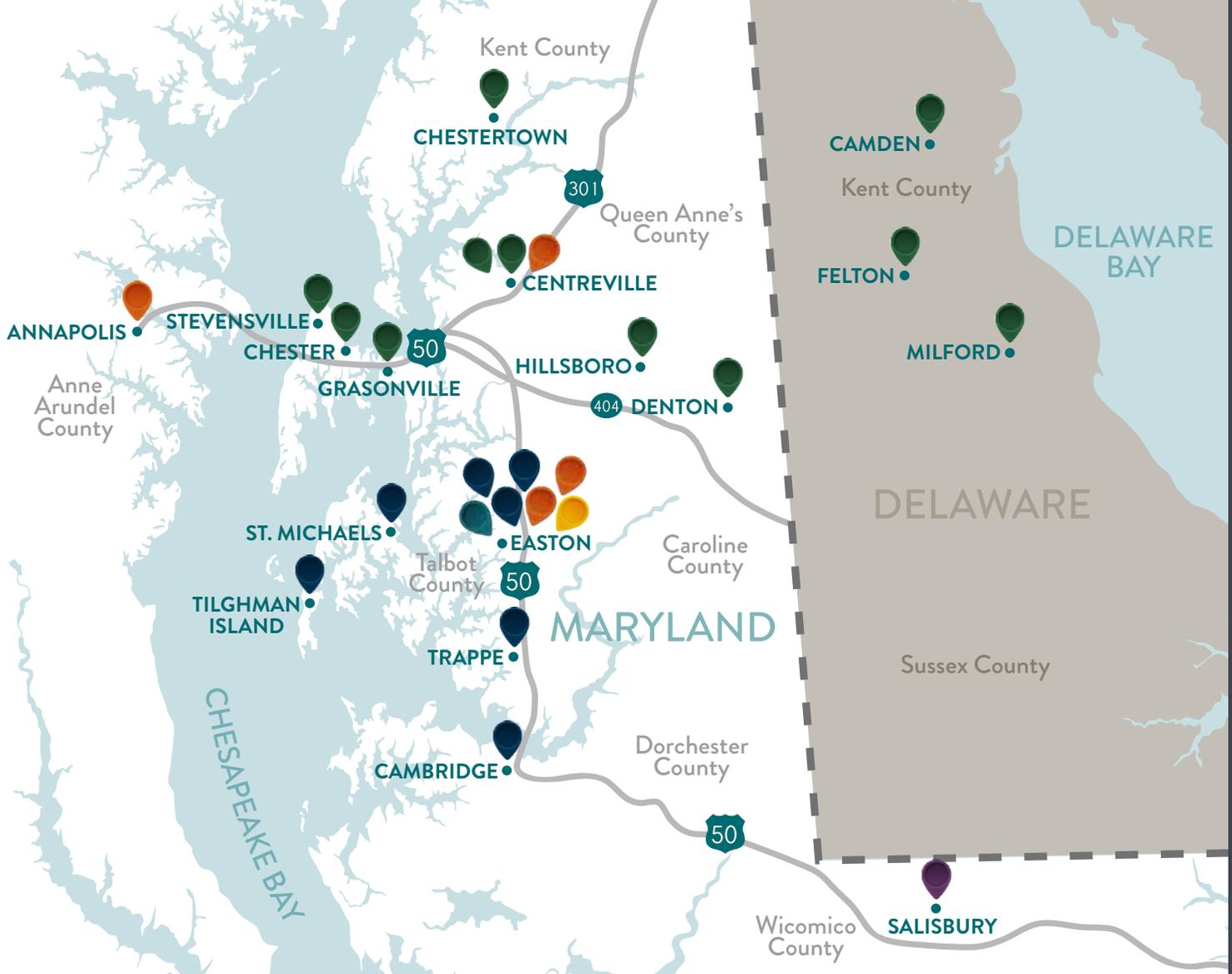
Brenda Dickerson
Executive Vice President

INVESTMENTS

WYE FINANCIAL & TRUST

Officer

Elizabeth Spurry
Senior Vice President



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NASDAQ:SHBI

SHORE BANCSHARES, INC.

Good things are happening here.™

shorebancshares.com NASDAQ:SHBI

COMMUNITY *of* COMPANIES

