

SHORE BANCSHARES INC  
Form 10-Q  
August 14, 2014

**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  
X ACT OF 1934**

For the Quarterly Period Ended June 30, 2014

**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)

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Maryland 52-1974638  
(State or Other Jurisdiction of (I.R.S. Employer  
Incorporation or Organization) Identification No.)

28969 Information Lane, Easton, Maryland 21601  
(Address of Principal Executive Offices) (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 R 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 R No £

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 company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer   
Non-accelerated filer  Smaller reporting company R  
(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 R

**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: 12,614,943 shares of common stock outstanding as of July 31, 2014.

**INDEX**

	<b>Page</b>
<u>Part I. Financial Information</u>	2
<u>Item 1. Financial Statements</u>	2
<u>Consolidated Balance Sheets - June 30, 2014 (unaudited) and December 31, 2013</u>	2
<u>Consolidated Statements of Operations - For the three and six months ended June 30, 2014 and 2013 (unaudited)</u>	3
<u>Consolidated Statements of Comprehensive Income (Loss) - For the three and six months ended June 30, 2014 and 2013 (unaudited)</u>	4
<u>Consolidated Statements of Changes in Stockholders' Equity - For the six months ended June 30, 2014 and 2013 (unaudited)</u>	5
<u>Consolidated Statements of Cash Flows - For the six months ended June 30, 2014 and 2013 (unaudited)</u>	6
<u>Notes to Consolidated Financial Statements (unaudited)</u>	7
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	25
<u>Item 3. Quantitative and Qualitative Disclosures about Market Risk</u>	37
<u>Item 4. Controls and Procedures</u>	37
<u>Part II. Other Information</u>	38
<u>Item 1. Legal Proceedings</u>	38
<u>Item 1A. Risk Factors</u>	38
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	38
<u>Item 3. Defaults Upon Senior Securities</u>	38
<u>Item 4. Mine Safety Disclosures</u>	38
<u>Item 5. Other Information</u>	38
<u>Item 6. Exhibits</u>	38
<u>Signatures</u>	38

Exhibit Index

1

**PART I – FINANCIAL INFORMATION**

## Item 1. Financial Statements.

## SHORE BANCSHARES, INC.

## CONSOLIDATED BALANCE SHEETS

(Dollars in thousands, except per share amounts)

	June 30, 2014 (Unaudited)	December 31, 2013
<b>ASSETS</b>		
Cash and due from banks	\$ 22,997	\$ 21,238
Interest-bearing deposits with other banks	69,717	109,384
Federal funds sold	1,656	468
Investment securities:		
Available for sale, at fair value	202,826	147,101
Held to maturity, at amortized cost – fair value of \$5,076 (2014) and \$5,062 (2013)	5,071	5,185
Loans held for sale	-	3,521
Loans	709,659	711,919
Less: allowance for credit losses	(9,076 )	(10,725 )
Loans, net	700,583	701,194
Premises and equipment, net	14,954	15,198
Goodwill	11,931	12,454
Other intangible assets, net	1,397	3,520
Other real estate owned, net	4,201	3,779
Other assets	29,520	31,082
<b>TOTAL ASSETS</b>	<b>\$ 1,064,853</b>	<b>\$ 1,054,124</b>
<b>LIABILITIES</b>		
Deposits:		
Noninterest-bearing	\$ 173,837	\$ 172,797
Interest-bearing	739,648	760,671
Total deposits	913,485	933,468
Short-term borrowings	7,801	10,140
Other liabilities	6,074	7,217

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TOTAL LIABILITIES	927,360	950,825
STOCKHOLDERS' EQUITY		
Common stock, par value \$.01 per share; shares authorized – 35,000,000; shares issued and outstanding – 12,614,943 (2014) and 8,471,289 (2013)	126	85
Additional paid in capital	63,497	32,207
Retained earnings	74,007	71,444
Accumulated other comprehensive loss	(137 )	(437 )
TOTAL STOCKHOLDERS' EQUITY	137,493	103,299
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 1,064,853	\$ 1,054,124

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 June 30,		For the Six Months Ended June 30,	
	2014	2013	2014	2013
<b>INTEREST INCOME</b>				
Interest and fees on loans	\$ 8,812	\$ 10,142	\$ 17,687	\$ 20,049
Interest and dividends on investment securities:				
Taxable	669	568	1,190	1,211
Tax-exempt	3	4	6	9
Interest on federal funds sold	-	1	-	3
Interest on deposits with other banks	39	40	95	90
Total interest income	9,523	10,755	18,978	21,362
<b>INTEREST EXPENSE</b>				
Interest on deposits	1,071	1,748	2,198	3,870
Interest on short-term borrowings	5	6	10	14
Total interest expense	1,076	1,754	2,208	3,884
<b>NET INTEREST INCOME</b>				
Provision for credit losses	8,447	9,001	16,770	17,478
	950	2,700	1,925	4,850
<b>NET INTEREST INCOME AFTER PROVISION FOR CREDIT LOSSES</b>				
	7,497	6,301	14,845	12,628
<b>NONINTEREST INCOME</b>				
Service charges on deposit accounts	602	600	1,160	1,172
Trust and investment fee income	455	393	886	783
Gains on sales of investment securities	-	913	-	913
Insurance agency commissions	2,536	2,633	5,613	5,446
Gain on sale of wholesale insurance subsidiary	114	-	114	-
Loss on termination of cash flow hedge	-	(1,306)	-	(1,306)
Other noninterest income	821	729	1,543	1,444
Total noninterest income	4,528	3,962	9,316	8,452
<b>NONINTEREST EXPENSE</b>				
Salaries and wages	4,292	4,307	8,606	8,590
Employee benefits	1,020	1,006	2,202	2,140
Occupancy expense	577	612	1,204	1,209
Furniture and equipment expense	243	243	516	493



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Data processing	739	706	1,499	1,409
Directors' fees	132	55	244	176
Amortization of other intangible assets	60	74	134	148
Insurance agency commissions expense	394	458	906	919
FDIC insurance premium expense	377	367	835	733
Write-downs of other real estate owned	101	56	176	728
Other noninterest expenses	1,982	1,875	3,710	3,705
Total noninterest expense	9,917	9,759	20,032	20,250
INCOME BEFORE INCOME TAXES	2,108	504	4,129	830
Income tax expense	803	143	1,566	247
NET INCOME	\$ 1,305	\$ 361	\$ 2,563	\$ 583
Basic net income per common share	\$ 0.13	\$ 0.04	\$ 0.28	\$ 0.07
Diluted net income per common share	\$ 0.13	\$ 0.04	\$ 0.28	\$ 0.07
Dividends paid per common share	\$ -	\$ -	\$ -	\$ -

See accompanying notes to Consolidated Financial Statements.

## SHORE BANCSHARES, INC.

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS) (Unaudited)

(Dollars in thousands)

	For the Three Months Ended June 30, 2014		For the Six Months Ended June 30, 2014	
	2013		2013	
Net income	\$ 1,305	\$ 361	\$ 2,563	\$ 583
Other comprehensive income				
Securities available for sale:				
Unrealized holding gains (losses) on available-for-sale securities	414	(2,560 )	503	(2,800 )
Tax effect	(167 )	1,034	(203 )	1,130
Reclassification of gains recognized in net income	-	(913 )	-	(913 )
Tax effect	-	368	-	368
Net of tax amount	247	(2,071 )	300	(2,215 )
Cash flow hedging activities:				
Unrealized holding gains on cash flow hedging activities	-	265	-	681
Tax effect	-	(106 )	-	(274 )
Reclassification of losses recognized in net income	-	1,306	-	1,306
Tax effect	-	(527 )	-	(527 )
Net of tax amount	-	938	-	1,186
Total other comprehensive income (loss)	247	(1,133 )	300	(1,029 )
Comprehensive income (loss)	\$ 1,552	\$ (772 )	\$ 2,863	\$ (446 )

See accompanying notes to Consolidated Financial Statements.

## SHORE BANCSHARES, INC.

## CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (Unaudited)

For the Six Months Ended June 30, 2014 and 2013

(Dollars in thousands, except per share amounts)

	Common Stock	Additional Paid in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
Balances, January 1, 2014	\$ 85	\$ 32,207	\$ 71,444	\$ (437	) \$ 103,299
Net income	-	-	2,563	-	2,563
Unrealized gains on available-for-sale securities, net of taxes	-	-	-	300	300
Issuance of common stock through public offering, net	41	31,241	-	-	31,282
Stock-based compensation	-	49	-	-	49
Balances, June 30, 2014	\$ 126	\$ 63,497	\$ 74,007	\$ (137	) \$ 137,493
Balances, January 1, 2013	\$ 85	\$ 32,155	\$ 81,078	\$ 708	\$ 114,026
Net income	-	-	583	-	583
Unrealized losses on available-for-sale securities, net of taxes	-	-	-	(2,215	) (2,215 )
Unrealized gains on cash flow hedging activities, net of taxes	-	-	-	1,186	1,186
Stock-based compensation	-	14	-	-	14
Balances, June 30, 2013	\$ 85	\$ 32,169	\$ 81,661	\$ (321	) \$ 113,594

See accompanying notes to Consolidated Financial Statements.

## SHORE BANCSHARES, INC.

## CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

(Dollars in thousands)

	For the Six Months Ended June 30,	
	2014	2013
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$ 2,563	\$ 583
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for credit losses	1,925	4,850
Depreciation and amortization	1,126	1,246
Discount accretion on debt securities	(25 )	(21 )
Stock-based compensation expense	49	40
Excess tax benefit from stock-based arrangements	-	(26 )
Deferred income tax expense (benefit)	1,241	(1,006 )
Gains on sales of investment securities	-	(913 )
(Gains) losses on sales of other real estate owned	(5 )	183
Write-downs of other real estate owned	176	728
Gain on sale of wholesale insurance subsidiary	(114 )	-
Loss on termination of cash flow hedge	-	1,306
Net changes in:		
Accrued interest receivable	(56 )	(55 )
Other assets	(182 )	3,493
Accrued interest payable	(27 )	(53 )
Other liabilities	(1,116 )	(256 )
Net cash provided by operating activities	5,555	10,099
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Proceeds from maturities and principal payments of investment securities available for sale	26,815	18,612
Proceeds from sales of investment securities available for sale	-	40,351
Purchases of investment securities available for sale	(82,395 )	(12,048 )
Proceeds from maturities and principal payments of investment securities held to maturity	108	61
Net change in loans	1,157	(4,680 )
Purchases of premises and equipment	(255 )	(203 )
Proceeds from sales of premises and equipment	-	4
Proceeds from sales of other real estate owned	456	2,838
Proceeds from sale of wholesale insurance subsidiary	2,878	-
Return of investment in unconsolidated subsidiary	-	85
Net cash (used in) provided by investing activities	(51,236 )	45,020
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		

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Net changes in:		
Noninterest-bearing deposits	1,041	4,570
Interest-bearing deposits	(21,023 )	(131,736 )
Short-term borrowings	(2,339 )	(3,666 )
Proceeds from issuance of common stock through public offering, net	31,282	-
Excess tax benefit from stock-based arrangements	-	26
Net cash provided by (used in) financing activities	8,961	(130,806 )
Net decrease in cash and cash equivalents	(36,720 )	(75,687 )
Cash and cash equivalents at beginning of period	131,090	200,193
Cash and cash equivalents at end of period	\$ 94,370	\$ 124,506
Supplemental cash flows information:		
Interest paid	\$ 2,235	\$ 3,937
Income taxes paid	\$ 85	\$ 157
Transfers from loans to other real estate owned	\$ 1,049	\$ 2,456
Transfers from loans held for sale to loans	\$ 3,521	\$ -

See accompanying notes to Consolidated Financial Statements.

Shore Bancshares, Inc.

Notes to Consolidated Financial Statements

For the Three and Six Months Ended June 30, 2014 and 2013

(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 June 30, 2014, the consolidated results of operations and comprehensive income (loss) for the three and six months ended June 30, 2014 and 2013, and changes in stockholders’ equity and cash flows for the six months ended June 30, 2014 and 2013, have been included. All such adjustments are of a normal recurring nature. The amounts as of December 31, 2013 were derived from the 2013 audited financial statements. The results of operations for the three and six months ended June 30, 2014 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, 2013. 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.

#### Recent Accounting Standards

*Accounting Standards Update (“ASU”) 2013-04, “Liabilities (Accounting Standards Codification (“ASC”) Topic 405) - Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation Is Fixed at the Reporting Date.”* ASU 2013-04 provides guidance for the recognition, measurement and disclosure of obligations resulting from joint and several liability arrangements for which the total amount of the obligation is fixed at the reporting date. This guidance requires an entity to measure the obligation as the sum of the amount the reporting entity agreed to pay on the basis of its arrangement among its co-obligors, and any additional amount the reporting entity expects to pay on behalf of its co-obligors. This guidance also requires an entity to disclose the nature and amount of the obligation as well as other information about those obligations. ASU 2013-04 became effective for the Company on January 1, 2014, and did not have a significant impact on the Company’s

financial statements.

*ASU 2014-04, "Receivables (ASC Topic 310) – Troubled Debt Restructurings by Creditors, Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure."* ASU 2014-04 clarifies when an in substance repossession or foreclosure occurs which is defined as when a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan such that the loan receivable should be derecognized and the real estate property recognized. The ASU requires that the real property be recognized upon obtaining legal title to the real estate collateral, or the borrower voluntarily conveying all interest in the real estate property to the lender to satisfy the loan through a deed in lieu of foreclosure or similar legal agreement. ASU 2014-04 is effective for the Company for interim and annual periods beginning after December 15, 2014 and is not expected to have a significant impact on the Company's financial statements.

#### Note 2 – Earnings Per Share

Basic earnings per common share is calculated by dividing net income available to common stockholders by the weighted average number of common shares outstanding during the period. Diluted earnings per common share is calculated by dividing net income available to common stockholders by the weighted average number of common shares outstanding during the period, adjusted for the dilutive effect of common stock equivalents (stock-based awards). The following table provides information relating to the calculation of earnings per common share:

7

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(In thousands, except per share data)	For the Three Months Ended		For the Six Months Ended	
	June 30, 2014	2013	June 30, 2014	2013
Net income	\$ 1,305	\$ 361	\$ 2,563	\$ 583
Weighted average shares outstanding - Basic	10,013	8,461	9,246	8,460
Dilutive effect of common stock equivalents	11	4	12	-
Weighted average shares outstanding - Diluted	10,024	8,465	9,258	8,460
Earnings per common share - Basic	\$ 0.13	\$ 0.04	\$ 0.28	\$ 0.07
Earnings per common share - Diluted	\$ 0.13	\$ 0.04	\$ 0.28	\$ 0.07

The increase in the weighted average shares outstanding for the three and six months ended June 30, 2014 when compared to the three and six months ended June 30, 2013 was due to the Company's public offer and sale of its common stock (the "stock sale") during the second quarter of 2014. As a result of the stock sale, the Company sold 4,140,000 shares of its common stock for a price of \$8.25 per share, which produced net proceeds of \$31.2 million.

There were no weighted average common stock equivalents excluded from the calculation of diluted earnings per share for the three and six months ended June 30, 2014, and for the three months ended June 30, 2013. There were 54 thousand weighted average common stock equivalents excluded from the calculation of diluted earnings per share for the six months ended June 30, 2013 because the effect of including them would have been antidilutive.

Note 3 – Investment Securities

The following table provides information on the amortized cost and estimated fair values of investment securities.

(Dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available-for-sale securities:				
June 30, 2014				
U.S. Treasury	\$ 5,276	\$ 8	\$ -	\$ 5,284
U.S. Government agencies	57,289	85	243	57,131
Mortgage-backed	139,872	640	720	139,792
Equity	617	2	-	619
Total	\$ 203,054	\$ 735	\$ 963	\$ 202,826
December 31, 2013				
U.S. Treasury	\$ 5,342	\$ 1	\$ -	\$ 5,343
U.S. Government agencies	60,754	62	372	60,444
Mortgage-backed	81,130	520	937	80,713



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Equity	609	-	8	601
Total	\$ 147,835	\$ 583	\$ 1,317	\$ 147,101
Held-to-maturity securities:				
June 30, 2014				
U.S. Government agencies	\$ 2,889	\$ -	\$ 151	\$ 2,738
States and political subdivisions	2,182	156	-	2,338
Total	\$ 5,071	\$ 156	\$ 151	\$ 5,076
December 31, 2013				
U.S. Government agencies	\$ 2,975	\$ -	\$ 222	\$ 2,753
States and political subdivisions	2,210	99	-	2,309
Total	\$ 5,185	\$ 99	\$ 222	\$ 5,062

The following tables provide information about gross unrealized losses and fair value by length of time that the individual securities have been in a continuous unrealized loss position at June 30, 2014 and December 31, 2013.

(Dollars in thousands)	Less than		More than		Total	
	12 Months		12 Months		Fair Value	Unrealized Losses
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses		
June 30, 2014						
Available-for-sale securities:						
U.S. Government agencies	\$19,606	\$ 30	\$9,963	\$ 213	\$29,569	\$ 243
Mortgage-backed	45,133	166	24,006	554	69,139	720
Total	\$64,739	\$ 196	\$33,969	\$ 767	\$98,708	\$ 963
Held-to-maturity securities:						
U.S. Government agencies	\$-	\$ -	\$2,738	\$ 151	\$2,738	\$ 151

(Dollars in thousands)	Less than		More than		Total	
	12 Months		12 Months		Fair Value	Unrealized Losses
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses		
December 31, 2013						
Available-for-sale securities:						
U.S. Government agencies	\$33,004	\$ 372	\$-	\$ -	\$33,004	\$ 372
Mortgage-backed	28,694	416	19,121	521	47,815	937
Equity	601	8	-	-	601	8
Total	\$62,299	\$ 796	\$19,121	\$ 521	\$81,420	\$ 1,317
Held-to-maturity securities:						
U.S. Government agencies	\$2,753	\$ 222	\$-	\$ -	\$2,753	\$ 222

All of the securities with unrealized losses in the portfolio have modest duration risk, low credit risk, and minimal losses 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 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 for debt securities, the Company considers the unrealized losses to be temporary.

The following table provides information on the amortized cost and estimated fair values of investment securities by maturity date at June 30, 2014.

Available for sale                      Held to maturity  
Amortized              Estimated    Amortized              Estimated  
(Dollars in thousands)