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SHORE BANCSHARES INC  
Form 10-Q/A  
October 26, 2004

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

FORM 10-Q/A  
AMENDMENT NO. 1

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

For the Quarterly Period Ended June 30, 2004

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  
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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) 822-1400  
-----

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 period that the  
Registrant was required to file such reports), and (2) has been subject to such  
filing requirements for the past 90 days Yes X No  
-----

Indicate by checkmark whether the registrant is an accelerated filer (as defined  
in Rule 12b-2 of the Exchange Act). Yes X No  
-----

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of

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common stock, as of the latest practicable date:  
As of September 30, 2004, registrant had 5,513,619 issued and outstanding  
-----  
shares of common stock.  
-----

### EXPLANATORY NOTE

This Amendment No. 1 on Form 10-Q/A amends the Quarterly Report on Form 10-Q for the quarter ended June 30, 2004 to reflect purchase accounting adjustments relating to the goodwill and deferred tax assets recognized in the acquisition of Midstate Bancorp on April 1, 2004. The amounts reported in the unaudited Condensed Consolidated Balance Sheet for June 30, 2004 for "Goodwill" and "Other assets" have been adjusted. To preserve the nature and character of the disclosures set forth in Item 1 of Part 1 as originally filed, this Amendment No. 1 speaks as of the date of the original filing and the registrant has not updated the disclosures to speak as of a later date. All information contained in this Amendment No. 1 is subject to updating and supplementing as provided in the registrant's reports filed with the Securities and Exchange Commission subsequent to the date of the original filing of the Quarterly Report on Form 10-Q. Pursuant to Exchange Act Rule 12b-15, new certifications are supplied as Exhibits 31.1, 31.2, and 32.1.

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Part I

Item 1. Financial Statements

SHORE BANCSHARES, INC.  
CONDENSED CONSOLIDATED BALANCE SHEETS  
(Dollars in Thousands)

	June 30, 2004
ASSETS:	
-----	-----
Cash and due from banks	(unaudited) \$ 22,779
Interest bearing deposits with other banks	5,977
Federal funds sold	32,429
Investment securities:	
Held-to-maturity, at amortized cost (fair value of \$15,229, \$15,585, respectively)	15,351
Available for sale, at fair value	122,389
Loans, less allowance for credit losses (\$4,331, \$4,060, respectively)	547,165
Insurance premiums receivable	642
Premise and equipment, net	12,430
Accrued interest receivable on loans and investment securities	3,042
Investment in unconsolidated subsidiary	843
Goodwill	8,626
Other intangible assets	2,411
Other assets	5,892
	-----
TOTAL ASSETS	\$779,976 =====
LIABILITIES:	
-----	
Deposits:	
Noninterest bearing demand	\$ 94,937
NOW and Super NOW	113,565
Certificates of deposit \$100,000 or more	90,295
Other time and savings	354,497
	-----
Total Deposits	653,294
Short term borrowings	28,726
Long term debt	5,000
Other liabilities	4,098
	-----
TOTAL LIABILITIES	691,118 -----
STOCKHOLDERS' EQUITY:	
-----	
Common stock, par value \$.01; authorized 35,000,000 shares; issued and outstanding:	
June 30, 2004	5,512,309
December 31, 2003	5,400,793
Additional paid in capital	55 27,950

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Retained earnings	62,084
Accumulated other comprehensive income (loss)	(1,231)
	-----
TOTAL STOCKHOLDERS' EQUITY	88,858
	-----
TOTAL LIABILITIES & STOCKHOLDERS' EQUITY	\$779,976
	=====

See accompanying notes to Condensed Consolidated Financial Statements.

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

	Three months ended June 30,	
	2004	2003
	----	----
INTEREST INCOME		
Loans, including fees	\$8,013	\$ 7,362
Interest and dividends on investment securities:		
Taxable	1,099	1,015
Tax-exempt	150	142
Other interest income	83	123
	-----	-----
Total interest income	9,345	8,642
	-----	-----
INTEREST EXPENSE		
Certificates of deposit, \$100,000 or more	584	627
Other deposits	1,569	1,787
Other interest	105	114
	-----	-----
Total interest expense	2,258	2,528
	-----	-----
NET INTEREST INCOME	7,087	6,114
PROVISION FOR CREDIT LOSSES	100	70
	-----	-----
NET INTEREST INCOME AFTER PROVISION FOR CREDIT LOSSES	6,987	6,044
	-----	-----
NONINTEREST INCOME		
Service charges on deposit accounts	658	495
Gain (loss) on sale of securities	(2)	81
Insurance agency commissions	1,499	1,520
Other noninterest income	497	388
	-----	-----
Total noninterest income	2,652	2,484

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NONINTEREST EXPENSE		
Salaries and employee benefits	3,530	3,025
Expenses of premises and equipment	574	482
Other noninterest expense	1,482	1,227
	-----	-----
Total noninterest expense	5,586	4,734
	-----	-----
INCOME BEFORE TAXES ON INCOME	4,053	3,794
Federal and State income taxes	1,453	1,338
	-----	-----
NET INCOME	\$2,600	\$2,456
	=====	=====
Basic earnings per common share	\$.47	\$.46
Diluted earnings per common share	\$.47	\$.45
Dividends declared per common share	\$.18	\$.17

See accompanying notes to Condensed Consolidated Financial Statements.

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SHORE BANCSHARES, INC.  
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (continued)  
(Dollars in thousands)

	Common Stock	Additional Paid in Capital	Retained Earnings
	-----	-----	-----
Balances, January 1, 2004	\$ 54	\$ 24,231	\$ 58,932
Comprehensive income:			
Net income	-	-	5,116
Other comprehensive income, net of tax:			
Unrealized loss on available for sale securities	-	-	-
Total comprehensive income			
Shares issued	1	3,719	-
Cash dividends paid \$0.36 per share	-	-	(1,964)

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	-----	-----	-----
Balances, June 30, 2004	\$ 55 =====	\$ 27,950 =====	\$ 62,084 =====
Balances, January 1, 2003	\$ 54	\$ 23,837	\$ 52,985
Comprehensive income:			
Net income	-	-	4,977
Other comprehensive income, net of tax:			
Unrealized loss on available for sale securities	-	-	-
Total comprehensive income			
Shares issued	-	71	-
Cash dividends paid \$0.32 per share	-	-	(1,720)
	-----	-----	-----
Balances, June 30, 2003	\$ 54 =====	\$ 23,908 =====	\$ 56,242 =====

See accompanying Notes to Condensed Consolidated Financial Statements

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

For the Six  
2004

CASH FLOWS FROM OPERATING ACTIVITIES:

Net Income	\$ 5,116
Adjustments to reconcile net income to net cash provided by operating activities:	
Depreciation and amortization	717
Discount accretion on debt securities	(51)
Provision for credit losses, net	(119)
Gain on sale of securities	(14)
Loss on other real estate owned	-
Equity in earnings of unconsolidated subsidiary	(20)
Net changes in:	
Insurance premiums receivable	202
Accrued interest receivable	232
Other assets	(689)
Accrued interest payable on deposits	25

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Accrued expenses	274
Net cash provided by operating activities	5,673
CASH FLOWS FROM INVESTING ACTIVITIES:	
Proceeds from maturities and principal payments of securities available for sale	39,360
Proceeds from sale of investment securities available for sale	7,867
Purchase of securities available for sale	(17,682)
Proceeds from maturities and principal payments of securities held to maturity	1,287
Purchase of securities held to maturity	(1,340)
Net increase in loans	(38,303)
Proceeds from sale of loans	-
Purchase of premises and equipment	(697)
Purchase of other real estate owned	(60)
Proceeds from sale of other real estate owned	-
Proceeds from sale of investment in unconsolidated subsidiary	380
Acquisition, net of stock issued	(235)
Net cash used in investing activities	(9,423)
CASH FLOWS FROM FINANCING ACTIVITIES:	
Net increase in demand, NOW, money market and savings deposits	872
Net increase (decrease) in certificates of deposit	11,017
Net increase in securities sold under agreement to repurchase	7,768
Proceeds from issuance of common stock	511
Dividends paid	(1,964)
Net cash provided by financing activities	18,204
NET INCREASE IN CASH AND CASH EQUIVALENTS	14,454
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	46,731
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 61,185

See accompanying notes to Condensed Consolidated Financial Statements

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Shore Bancshares, Inc.  
Notes to Condensed Consolidated Financial Statements  
(Unaudited)

- The consolidated financial statements include the accounts of Shore Bancshares, Inc. (the "Company") 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 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 financial position at June 30, 2004, the results of operations for the three- and six-month periods ended June 30, 2004 and 2003, and cash flows for the six-month period ended June 30, 2004 and 2003, have been included.

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The amounts as of December 31, 2003 were derived from audited financial statements. All such adjustments are of a normal recurring nature. The results of operations for the three- and six-month periods ended June 30, 2004 are not necessarily indicative of the results to be expected for the full year. The consolidated financial statements and related notes contained herein should be read in conjunction with the audited consolidated financial statements and related notes included in the Company's Annual Report on Form 10-K, as amended by Amendment No. 1 on Form 10-K/A, for the year ended December 31, 2003.

- 2) Year to date basic earnings per share is derived by dividing net income available to common stockholders by the weighted average number of common shares outstanding during the period of 5,451,928 shares for 2004 and 5,373,484 shares for 2003. The diluted earnings per share calculation is derived by dividing net income by the weighted average number of shares outstanding, adjusted for the dilutive effect of outstanding options and warrants. Considering the effect of these common stock equivalents, the adjusted average shares for the six months ended June 30, 2004 and 2003 were 5,497,949 and 5,463,656, respectively. As of June 30, 2004, there were 4,000 shares excluded from the diluted net income per share computation because the exercise price of related options exceeded the average market price of those shares and, therefore, their effect would be anti-dilutive. No shares were excluded from the diluted net income per share computation as of June 30, 2003.
  
- 3) Under the provisions of Statements of Financial Accounting Standards (SFAS) Nos. 114 and 118, "Accounting by Creditors for Impairment of a Loan", 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 contracted terms. 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. Interest income generally is not recognized on specific impaired loans unless the likelihood of further loss is remote. Interest payments received on such loans are applied as a reduction of the loans principal balance. Interest income on other nonaccrual loans is recognized only to the extent of interest payments received.

Information with respect to impaired loans and the related valuation allowance is shown below:

(Dollars in thousands)	June 30 2004
<hr style="border-top: 1px dashed black;"/>	
Impaired loans with valuation allowance	\$ 529
Impaired loans with no valuation allowance	740
Total impaired loans	----- \$1,269 =====
Allowance for credit losses applicable to impaired loans	\$ 318
Allowance for credit losses applicable to other than impaired loans	4,013
Total allowance for credit losses	----- \$4,331 =====
Interest income on impaired loans recorded on the cash basis	\$ 7 =====



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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 upon historical loss ratios and are included in the allowance for credit losses.

- 4) In the normal course of business, to meet the financial needs of its customers, the Company's bank subsidiaries are parties to financial instruments with off-balance sheet risk. These financial instruments include commitments to extend credit and standby letters of credit. At June 30, 2004, total commitments to extend credit were approximately \$110,036,000. Outstanding letters of

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credit were approximately \$5,779,000 at June 30, 2004.

- 5) The Company has adopted the disclosure-only provisions of SFAS No. 123, "Accounting for Stock-based Compensation" and SFAS No. 148 "Accounting for Stock-Based Compensation - Transition and Disclosure", but applies APB Opinion No. 25 and related interpretations in accounting for its plans. No compensation expense related to the plans was recorded during the three-month periods ended June 30, 2004 and 2003. If the Company had elected to recognize compensation cost based on fair value at the vesting dates for awards under the plans consistent with the method prescribed by SFAS No. 123, net income and earnings per share would have been changed to the pro forma amounts as follows:

	Six-month period ended June 2004	2003
	----	----
Net income:		
As reported	\$5,116	\$4,116
Less pro forma stock-based compensation expense determined under the fair value method, net of related tax effects	(11)	(11)
Pro forma net income	\$5,105	\$4,105
	=====	=====
Basic net income per share:		
As reported	\$0.94	\$0.94
Pro forma	0.94	0.94
Diluted earnings per share		
As reported	0.93	0.93
Pro forma	0.93	0.93
	Three-month period ended June 2004	2003
	----	----
Net income:		
As reported	2,600	2,600
Less pro forma stock-based compensation expense determined under the fair value		

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method, net of related tax effects	(5)	-----
Pro forma net income	\$2,595	=====
Basic net income per share:		
As reported	\$0.47	\$
Pro forma	0.47	
Diluted earnings per share		
As reported	0.47	\$
Pro forma	0.47	

The pro forma amounts are not representative of the effects on reported net income for future periods.

- 6) The Company operates two primary businesses: 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 the Company's 14-branch network. Community banking activities include small business services, retail brokerage, 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.

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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 line of business for the six months ended June 30, is included in the following table:

(In thousands)	Community banking	Insurance products and services	Parent Company (a)
2004			
Net Interest income	\$ 13,508	\$ -	\$ 1
Provision for credit losses	205	-	-
Net interest income after provision	13,303	-	1
Noninterest income	1,956	3,537	1,132
Noninterest expense	8,011	2,766	1,117
Income before taxes	7,248	771	16
Income tax expense	2,608	305	6

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Net income	\$ 4,640	\$466	\$ 10
Intersegment revenue(expense)	\$ (978)	\$ (102)	\$ 1,080
Average assets	\$755,625	\$6,830	\$3,289
2003			
Net Interest income	\$ 12,087	\$ (14)	\$ 12
Provision for credit losses	160	-	-
Net interest income after provision	11,927	(14)	12
Noninterest income	1,966	3,377	736
Noninterest expense	7,021	2,540	650
Income before taxes	6,872	823	98
Income tax expense	2,452	325	39
Net income	\$ 4,420	\$ 498	59
Intersegment revenue(expense)	\$ (642)	\$ (14)	\$ 656
Average assets	\$647,825	\$ 6,387	\$ 539

- (a) Amount included in Parent Company in 2004 relate to services provided to subsidiaries by the holding company and rental income.
- 7) On April 1, 2004, the Company completed its merger with Midstate Bancorp, Inc., a Delaware bank holding company ("Midstate Bancorp"). Pursuant to the merger agreement, each share of common stock of Midstate Bancorp was converted into the right to receive (i) \$31.00 in cash, plus (ii) 0.8732 shares of the common stock of the Corporation, with cash being paid in lieu of fractional shares at the rate of \$33.83 per share. The Company paid \$2,953,710 in cash and issued 82,786 shares of common stock to stockholders of Midstate Bancorp in connection with the merger. The Company recorded approximately \$2,636,000 of goodwill and \$968,000 of other intangible assets as a result of the acquisition.

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Part II

Item 6. Exhibits and Reports on Form 8-K.

a) Exhibits:

3.1 Shore Bancshares, Inc. Amended and Restated Articles of Incorporation (incorporated by reference to Exhibit 3.1 on Form 8-K filed by Shore Bancshares, Inc. on December 14, 2000).

3.2 Shore Bancshares, Inc. Amended and Restated By-Laws (incorporated by reference to Exhibit 3.2 on Form 8-K filed by Shore Bancshares, Inc. on December 14, 2000).

10.1 Form of Employment Agreement with W. Moorhead Vermilye (incorporated

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- by reference to Appendix XIII of Exhibit 2.1 on Form 8-K filed by Shore Bancshares, Inc. on July 31, 2000).
- 10.2 Form of Employment Agreement with Daniel T. Cannon (incorporated by reference to Appendix XIII of Exhibit 2.1 on Form 8-K filed by Shore Bancshares, Inc. on July 31, 2000).
- 10.3 Form of Employment Agreement between The Avon-Dixon Agency, LLC and Kevin P. LaTulip (incorporated by reference to Exhibit 10.3 of the Company's Annual Report on Form 10-K for the year ended December 31, 2002).
- 10.4 Form of Supplemental Retirement Plan Agreement and Life Insurance Endorsement Method Split Dollar Plan Agreement between The Centreville National Bank of Maryland and Daniel T. Cannon (incorporated by reference to Exhibit 10.4 of the Company's Quarterly Report on Form 10-Q for the period ended June 30, 2003).
- 10.5 Form of Life Insurance Endorsement Method Split Dollar Plan Agreement between The Centreville National Bank of Maryland and Daniel T. Cannon (incorporated by reference to Exhibit 10.5 of the Company's Quarterly Report on Form 10-Q for the period ended June 30, 2003).
- 10.6 Employment Agreement between The Avon-Dixon Agency, LLC and Steven Fulwood.\*
- 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).
- 32.1 Certifications of the CEO and the PAO pursuant to 18 U.S.C. ss. 1350 (furnished herewith)
- 99.1 Shore Bancshares, Inc. 1998 Employee Stock Purchase Plan, as amended and restated (incorporated by reference to Appendix A of the Company's Definitive Proxy Statement on Schedule 14A for the 2003 Annual Meeting of Stockholders, filed on March 31, 2003).
- 99.2 1998 Stock Option Plan (incorporated by reference from the Shore Bancshares, Inc. Registration Statement on Form S-8 filed on September 25, 1998 (Registration No. 333-64319)).
- 99.3 Talbot Bancshares, Inc. Employee Stock Option Plan (incorporated by reference from the Shore Bancshares, Inc. Registration Statement on Form S-8 filed on May 4, 2001 (Registration No. 333-60214)).

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\* Previously filed with the Quarterly Report on Form 10-Q to which this Amendment No. 1 on Form 10-Q/A relates.

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b) Reports on Form 8-K.

On April 2, 2004, the Company filed a Current Report on Form 8-K in which it announced in Item 5 the completion of its merger with Midstate Bancorp, Inc.

On May 7, 2004, the Company filed a Current Report on Form 8-K in

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which it furnished in Item 12 the unaudited results of operations for the quarter ended March 31, 2004.

### Signatures

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

Shore Bancshares, Inc.

Date: October 26, 2004

By: /s/ W. Moorhead Vermilye

-----  
W. Moorhead Vermilye  
President and Chief Executive Officer

Date: October 26, 2004

By: /s/ Susan E. Leaverton

-----  
Susan E. Leaverton, CPA  
Treasurer and Principal Accounting Officer

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### EXHIBIT INDEX

Exhibit	Description
-----	-----
3.1	Shore Bancshares, Inc. Amended and Restated Articles of Incorporation (incorporated by reference to Exhibit 3.1 on Form 8-K filed by Shore Bancshares, Inc. on December 14, 2000).
3.2	Shore Bancshares, Inc. Amended and Restated By-Laws (incorporated by reference to Exhibit 3.2 on Form 8-K filed by Shore Bancshares, Inc. on December 14, 2000).
10.1	Form of Employment Agreement with W. Moorhead Vermilye (incorporated by reference to Appendix XIII of Exhibit 2.1 on Form 8-K filed by Shore Bancshares, Inc. on July 31, 2000).
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10.5	Form of Life Insurance Endorsement Method Split Dollar Plan Agreement between The Centreville National Bank of Maryland and Daniel T. Cannon (incorporated by reference to Exhibit 10.5 of the Company's Quarterly

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Report on Form 10-Q for the period ended June 30, 2003).

- 10.6 Employment Agreement between The Avon-Dixon Agency, LLC and Steven Fulwood.\*
- 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).
- 32.1 Certifications of the CEO and the PAO pursuant to 18 U.S.C. ss. 1350 (furnished herewith)
- 99.1 Shore Bancshares, Inc. 1998 Employee Stock Purchase Plan, as amended and restated (incorporated by reference to Appendix A of the Company's Definitive Proxy Statement on Schedule 14A for the 2003 Annual Meeting of Stockholders, filed on March 31, 2003).
- 99.2 1998 Stock Option Plan (incorporated by reference from the Shore Bancshares, Inc. Registration Statement on Form S-8 filed on September 25, 1998 (Registration No. 333-64319)).
- 99.3 Talbot Bancshares, Inc. Employee Stock Option Plan (incorporated by reference from the Shore Bancshares, Inc. Registration Statement on Form S-8 filed on May 4, 2001 (Registration No. 333-60214)).

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\* Previously filed with the Quarterly Report on Form 10-Q to which this Amendment No. 1 on Form 10-Q/A relates.