SHORE BANCSHARES INC
Form 10-Q
May 09, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended March 31, 2012

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	52-1974638
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
18 East Dover Street, 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 þ 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 þ 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. (Check one):

Large accelerated filer	¨	Accelerated filer	þ
Non-accelerated filer (Do not check if a smaller reporting company)	¨	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 þ

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: 8,457,359 shares of common stock outstanding as of April 30, 2012.

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements.

SHORE BANCSHARES, INC.

CONSOLIDATED BALANCE SHEETS

(Dollars in thousands, except per share amounts)

	March 31, 2012 (Unaudited)	December 31, 2011
ASSETS		
Cash and due from banks	$ 19,168	$ 22,986
Interest-bearing deposits with other banks	130,641	99,776
Federal funds sold	16,190	4,980
Investment securities:		
Available for sale, at fair value	121,093	129,780
Held to maturity, at amortized cost – fair value of $6,305 (2012) and $6,732 (2011)	6,056	6,480
Loans	819,015	841,050
Less: allowance for credit losses	(13,544)	(14,288)
Loans, net	805,471	826,762
Premises and equipment, net	15,243	14,662
Goodwill	12,454	12,454
Other intangible assets, net	4,082	4,208
Other real estate and other assets owned, net	11,418	9,385
Other assets	27,905	26,720
TOTAL ASSETS	$ 1,169,721	$ 1,158,193
LIABILITIES		
Deposits:		
Noninterest-bearing	$ 143,800	$ 133,801
Interest-bearing	884,271	876,118
Total deposits	1,028,071	1,009,919
Short-term borrowings	13,683	17,817
Other liabilities	8,928	8,753
Long-term debt	455	455
TOTAL LIABILITIES	1,051,137	1,036,944
STOCKHOLDERS' EQUITY		
Common stock, par value $.01 per share; shares authorized – 35,000,000; shares issued and outstanding – 8,457,359 (2012 and 2011)	85	85

Additional paid in capital	32,066	32,052
Retained earnings	87,680	90,801
Accumulated other comprehensive loss	(1,247)	(1,689)
TOTAL STOCKHOLDERS' EQUITY	118,584	121,249
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 1,169,721	$ 1,158,193

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,	
	2012	2011
INTEREST INCOME		
Interest and fees on loans	$ 11,011	$ 12,001
Interest and dividends on investment securities:		
Taxable	757	657
Tax-exempt	38	38
Interest on federal funds sold	2	16
Interest on deposits with other banks	48	6
Total interest income	11,856	12,718
INTEREST EXPENSE		
Interest on deposits	2,641	2,833
Interest on short-term borrowings	15	13
Interest on long-term debt	5	10
Total interest expense	2,661	2,856
NET INTEREST INCOME	9,195	9,862
Provision for credit losses	8,370	6,390
NET INTEREST INCOME AFTER PROVISION FOR CREDIT LOSSES	825	3,472
NONINTEREST INCOME		
Service charges on deposit accounts	648	704
Trust and investment fee income	423	376
Gains on sales of investment securities	-	79
Insurance agency commissions	2,689	2,510
Other noninterest income	814	726
Total noninterest income	4,574	4,395
NONINTEREST EXPENSE		
Salaries and wages	4,416	4,246
Employee benefits	1,170	1,153
Occupancy expense	687	596
Furniture and equipment expense	251	272
Data processing	666	851
Directors’ fees	109	107
Amortization of other intangible assets	126	129

Insurance agency commissions expense	385	375
FDIC insurance premium expense	273	460
Other noninterest expenses	2,415	1,702
Total noninterest expense	10,498	9,891
LOSS BEFORE INCOME TAX BENEFIT	(5,099)	(2,024)
Income tax benefit	(2,063)	(941)
NET LOSS	$ (3,036)	$ (1,083)
Basic net loss per common share	$ (0.36)	$ (0.13)
Diluted net loss per common share	$ (0.36)	$ (0.13)
Dividends paid per common share	$ 0.01	$ 0.06

See accompanying notes to Consolidated Financial Statements.

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SHORE BANCSHARES, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS (Unaudited)

(Dollars in thousands)

	For the Three Months Ended March 31,	
	2012	2011
Net loss	$ (3,036)	$ (1,083)
Other comprehensive income (loss):		
Securities available for sale:		
Unrealized holding gains (losses) on available-for-sale securities	381	(372)
Tax effect	(153)	150
Reclassification of gains recognized in net income	-	(79)
Tax effect	-	32
Net of tax amount	228	(269)
Cash flow hedging activities:		
Unrealized holding gains on cash flow hedging activities	359	377
Tax effect	(145)	(153)
Net of tax amount	214	224
Total other comprehensive income (loss)	442	(45)
Comprehensive loss	$ (2,594)	$ (1,128)

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, 2012 and 2011

(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, 2012	$ 85	$ -	$ 32,052	$ 90,801	$ (1,689)	$ 121,249
Comprehensive loss:						
Net loss	-	-	-	(3,036)	-	(3,036)
Unrealized gains on available-for-sale securities, net of taxes	-	-	-	-	228	228
Unrealized gains on cash flow hedging activities, net of taxes	-	-	-	-	214	214
Total comprehensive loss						(2,594)
Stock-based compensation	-	-	14	-	-	14
Cash dividends paid ($0.01 per share)	-	-	-	(85)	-	(85)
Balances, March 31, 2012	$ 85	$ -	$ 32,066	$ 87,680	$ (1,247)	$ 118,584
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

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, 2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$ (3,036)	$ (1,083)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Provision for credit losses	8,370	6,390
Depreciation and amortization	670	725
Discount accretion on debt securities	(21)	(25)
Stock-based compensation expense	97	69
Excess tax expense from stock-based arrangements	(83)	(21)
Deferred income tax benefit	(137)	(1,552)
Gains on sales of investment securities	-	(79)
Losses (gains) on disposals of premises and equipment	-	(3)
Losses on sales of other real estate owned	599	203
Net changes in:		
Accrued interest receivable	197	812
Other assets	(1,322)	140
Accrued interest payable	15	44
Other liabilities	160	(463)
Net cash provided by operating activities	5,509	5,157
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from maturities and principal payments of investment securities available for sale	14,913	14,979
Proceeds from sales of investment securities available for sale	-	12,061
Purchases of investment securities available for sale	(6,023)	(28,886)
Proceeds from maturities and principal payments of investment securities held to maturity	420	35
Net change in loans	9,368	5,713
Purchases of premises and equipment	(867)	(93)
Proceeds from sales of premises and equipment	-	4
Proceeds from sales of other real estate owned	921	527
Net cash provided by investing activities	18,732	4,340
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net change in noninterest-bearing deposits	9,999	(1,698)
Net change in interest-bearing deposits	8,153	8,668
Net change in short-term borrowings	(4,134)	(3,963)
Excess tax expense from stock-based arrangements	83	21

Common stock dividends paid	(85)	(507)
Net cash provided by financing activities	14,016	2,521
Net increase in cash and cash equivalents	38,257	12,018
Cash and cash equivalents at beginning of period	127,742	77,964
Cash and cash equivalents at end of period	$ 165,999	$ 89,982
Supplemental cash flows information:		
Interest paid	$ 2,646	$ 2,813
Income taxes paid	$ -	$ 817
Transfers from loans to other real estate owned	$ 3,553	$ 1,830

See accompanying notes to Consolidated Financial Statements.

Shore Bancshares, Inc.

Notes to Consolidated Financial Statements

For the Three Months Ended March 31, 2012 and 2011

(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, 2012, the consolidated results of operations and comprehensive income (loss) for the three months ended March 31, 2012 and 2011, and changes in stockholders' equity and cash flows for the three months ended March 31, 2012 and 2011, have been included. All such adjustments are of a normal recurring nature. The amounts as of December 31, 2011 were derived from the 2011 audited financial statements. The results of operations for the three months ended March 31, 2012 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, 2011. 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 Pronouncements

Accounting Standards Update ("ASU") 2011-03, "*Reconsideration of Effective Control for Repurchase Agreements.*" ASU 2011-03 affects all entities that enter into agreements to transfer financial assets that both entitle and obligate the transferor to repurchase or redeem the financial assets before their maturity. The amendments in ASU 2011-03 remove from the assessment of effective control the criterion relating to the transferor's ability to repurchase or redeem financial assets on substantially the agreed terms, even in the event of default by the transferee. ASU 2011-03 also eliminates the requirement to demonstrate that the transferor possesses adequate collateral to fund substantially all the cost of purchasing replacement financial assets. ASU 2011-03 became effective for the Company on January 1, 2012 and did not have a significant impact on the Company's financial statements.

ASU 2011-04, "Fair Value Measurement - Amendments to Achieve Common Fair Value Measurements and Disclosure Requirements in U.S. GAAP and IFRSs." ASU 2011-04 amends Topic 820, "Fair Value Measurements and Disclosures," to converge the fair value measurement guidance in U.S. Generally Accepted Accounting Principles and International Financial Reporting Standards. ASU 2011-04 clarifies the application of existing fair value measurement requirements, changes certain principles in Topic 820 and requires additional fair value disclosures. ASU 2011-04 became effective for the Company on January 1, 2012 and, aside from new disclosures included in Note 8 – Fair Value Measurements, did not have a significant impact on the Company's financial statements.

ASU 2011-08, "Intangibles - Goodwill and Other - Testing Goodwill for Impairment." ASU 2011-08 amends Topic 350, "Intangibles – Goodwill and Other," to give entities the option to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If, after assessing the totality of events or circumstances, an entity determines it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then performing the two-step impairment test is unnecessary. However, if an entity concludes otherwise, then it is required to perform the first step of the two-step impairment test by calculating the fair value of the reporting unit and comparing the fair value with the carrying amount of the reporting unit. ASU 2011-08 became effective for the Company on January 1, 2012 and did not have a significant impact on the Company's financial statements.

Note 2 – Earnings/(Loss) Per Share

Basic earnings/(loss) per common share is 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 is 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 common stock equivalents (stock-based awards and the 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:

	For the Three Months Ended March 31,	
(In thousands, except per share data)	2012	2011
Net loss available to common shareholders	$ (3,036)	$ (1,083)
Weighted average shares outstanding – Basic	8,457	8,443
Dilutive effect of common stock equivalents	-	-
Weighted average shares outstanding – Diluted	8,457	8,443
Loss per common share – Basic	$ (0.36)	$ (0.13)
Loss per common share – Diluted	$ (0.36)	$ (0.13)

The calculation of diluted earnings/(loss) per share for the three months ended March 31, 2012 excluded 17 thousand weighted average stock-based awards because the effect of including them would have been antidilutive. The calculation 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 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:				
March 31, 2012:				
Obligations of U.S. Government agencies and corporations	$ 29,901	$ 751	$ 7	$ 30,645
Mortgage-backed securities	87,931	1,943	30	89,844
Equity securities	581	23	-	604
Total	$ 118,413	$ 2,717	$ 37	$ 121,093
December 31, 2011:				
Obligations of U.S. Government agencies and corporations	$ 41,360	$ 803	$ 15	$ 42,148
Mortgage-backed securities	85,545	1,587	99	87,033
Equity securities	577	22	-	599
Total	$ 127,482	$ 2,412	$ 114	$ 129,780
Held-to-maturity securities:				
March 31, 2012:				
Obligations of states and political subdivisions	$ 6,056	$ 249	$ -	$ 6,305
December 31, 2011:				
Obligations of states and political subdivisions	$ 6,480	$ 252	$ -	$ 6,732

The following table provides information about 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, 2012.

	Less than 12 Months		More than 12 Months		Total	
(Dollars in thousands)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Available-for-sale securities:						
U.S. Gov’t. agencies and corporations	$4,110	$ 7	$-	$ -	$4,110	$ 7
Mortgage-backed securities	2,978	22	3,749	8	6,727	30
Total	$7,088	$ 29	$3,749	$ 8	$10,837	$ 37

Total available-for-sale securities have a fair value of approximately $121.1 million. Of these securities, approximately $10.8 million have unrealized losses when compared to their amortized cost. All of the securities with the unrealized losses in the available-for-sale portfolio have modest duration risk, low credit risk, and minimal losses (approximately 0.03%) 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. There were no unrealized losses in the held-to-maturity securities portfolio at March 31, 2012.

The following table provides information on the amortized cost and estimated fair values of investment securities by maturity date at March 31, 2012.

	Available for sale		Held to maturity	
	Amortized	Estimated	Amortized	Estimated
(Dollars in thousands)	Cost	Fair Value	Cost	Fair Value
Due in one year or less	$7,002	$7,071	$2,277	$ 2,304
Due after one year through five years	10,301	10,338	2,057	2,112
Due after five years through ten years	5,371	5,549	712	793
Due after ten years	95,158	97,531	1,010	1,096
	117,832	120,489	6,056	6,305
Equity securities	581	604	-	-
Total	$118,413	$121,093	$6,056	$ 6,305

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

Note 4 – Loans and allowance for credit losses

The Company makes residential mortgage, commercial and consumer loans to customers primarily in Talbot County, Queen Anne’s County, Kent County, Caroline County and Dorchester County in Maryland and in Kent County, Delaware. The following table provides information about the principal classes of the loan portfolio at March 31, 2012 and December 31, 2011.

(Dollars in thousands)	March 31, 2012	December 31, 2011
Construction	$ 114,390	$ 119,883
Residential real estate	309,234	321,604
Commercial real estate	315,565	315,439
Commercial	64,347	69,485
Consumer	15,479	14,639
Total loans	819,015	841,050
Allowance for credit losses	(13,544)	(14,288)
Total loans, net	$ 805,471	$ 826,762

Loans include deferred costs net of deferred fees of $182 thousand at March 31, 2012 and $188 thousand at December 31, 2011.

Loans are stated at their principal amount outstanding net of any deferred fees and costs. Interest income on loans is accrued at the contractual rate based on the principal amount outstanding. Fees charged and costs capitalized for originating loans are being amortized substantially on the interest method over the term of the loan. A loan is placed on nonaccrual when it is specifically determined to be impaired or when principal or interest is delinquent for 90 days or more, unless the loan is well secured and in the process of collection. Any unpaid interest previously accrued on those loans is reversed from income. Interest payments received on nonaccrual loans are applied as a reduction of the loan principal balance unless collectability of the principal amount is reasonably assured, in which case interest is recognized on a cash basis. Loans are returned to accrual status when all principal and interest amounts contractually due are brought current and future payments are reasonably assured.

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 (i.e., placing impaired loans on nonaccrual status). Generally, interest income is not recognized on specific impaired loans unless the likelihood of further loss is remote. The allowance for credit losses includes specific reserves related to impaired loans. 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 formula portion of 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 for credit losses is made until such time that a charge-off is made. Impaired nonaccrual loans decreased $2.0 million to $49.4 million at the end of March 2012 from $51.4 million at the end of December 2011. At March 31, 2012, impaired nonaccrual loans had been reduced by partial charge-offs totaling $17.9 million, or 26.6% of the aggregate unpaid principal balance. In addition, $1.7 million in specific reserves were established against $6.9 million of impaired nonaccrual loans. At December 31, 2011, impaired nonaccrual loans had been reduced by partial charge-offs totaling $13.5 million, or 20.8% of the aggregate unpaid principal balance. In addition, $1.5 million in specific reserves were established against $4.7 million of impaired nonaccrual loans.

A loan is considered a troubled debt restructuring if a concession is granted due to deterioration in a borrower’s financial condition. At March 31, 2012 and December 31, 2011, the Company had impaired accruing troubled debt restructurings of $30.0 million and $25.2 million, respectively.

Gross interest income of $632 thousand for the first three months of 2012, $2.6 million for fiscal year 2011 and $720 thousand for the first three months of 2011 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 2012 or 2011.

The following tables provide information on impaired loans by loan class as of March 31, 2012 and December 31, 2011.

(Dollars in thousands)	Unpaid principal balance	Recorded investment with no allowance	Recorded investment with an allowance	Related allowance	Average recorded investment
March 31, 2012					
Impaired nonaccrual loans:					
Construction	$ 21,170	$ 12,450	$ 308	$ 132	$ 16,635
Residential real estate	27,693	17,076	4,634	878	18,626
Commercial real estate	15,541 &				