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 September 30, 2019

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.)
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)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock	SHBI	NASDAQ

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 every Interactive Data File required to be submitted 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 such files). Yes ☑ 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	☑
			Emerging growth company	☐

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

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: 12,687,972 shares of common stock outstanding as of October 31, 2019.

INDEX

PART I – FINANCIAL INFORMATION

Item 1. Financial Statements.

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

	September 30, 2019 (Unaudited)	December 31, 2018
ASSETS		
Cash and due from banks	$ 22,777	$ 16,294
Interest-bearing deposits with other banks	80,596	50,931
Cash and cash equivalents	103,373	67,225
Investment securities:		
Available-for-sale, at fair value	138,911	154,432
Held to maturity, at amortized cost - fair value of $9,715 (2019) and $6,000 (2018)	9,780	6,043
Equity securities, at fair value	1,339	1,269
Restricted securities	4,655	6,476
Loans	1,235,035	1,195,355
Less: allowance for credit losses	(10,438)	(10,343)
Loans, net	1,224,597	1,185,012
Premises and equipment, net	23,871	22,711
Goodwill	17,518	17,518
Other intangible assets, net	2,396	2,857
Other real estate owned, net	74	1,222
Right-of-use assets	4,908	—
Other assets	30,257	17,678
Assets of discontinued operations	—	633
TOTAL ASSETS	$ 1,561,679	$ 1,483,076
LIABILITIES		
Deposits:		
Noninterest-bearing	$ 362,557	$ 330,466
Interest-bearing	962,934	881,875
Total deposits	1,325,491	1,212,341
Short-term borrowings	17,263	60,812
Long-term borrowings	15,000	15,000
Lease liabilities	4,923	—
Other liabilities	5,039	8,415
Liabilities of discontinued operations	—	3,323
TOTAL LIABILITIES	1,367,716	1,299,891
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY		
Common stock, par value $.01 per share; shares authorized - 35,000,000; shares issued and outstanding - 12,742,372 (2019) and 12,749,497 (2018)	127	127
Additional paid in capital	64,879	65,434
Retained earnings	128,924	120,574
Accumulated other comprehensive income (loss)	33	(2,950)
TOTAL STOCKHOLDERS' EQUITY	193,963	183,185
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 1,561,679	$ 1,483,076

See accompanying notes to Consolidated Financial Statements.

Table of Contents

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

	For Three Months Ended September 30, 2019	For Three Months Ended September 30, 2018	For Nine Months Ended September 30, 2019	For Nine Months Ended September 30, 2018
INTEREST INCOME				
Interest and fees on loans	**$ 14,100**	$ 13,205	**$ 41,348**	$ 37,880
Interest and dividends on investment securities:				
Taxable	**870**	947	**2,755**	2,950
Interest on deposits with other banks	**223**	84	**499**	183
Total interest income	**15,193**	14,236	**44,602**	41,013
INTEREST EXPENSE				
Interest on deposits	**2,288**	826	**6,439**	1,954
Interest on short-term borrowings	**117**	463	**475**	1,150
Interest on long-term borrowings	**108**	—	**321**	—
Total interest expense	**2,513**	1,289	**7,235**	3,104
NET INTEREST INCOME	**12,680**	12,947	**37,367**	37,909
Provision for credit losses	**200**	307	**500**	1,214
NET INTEREST INCOME AFTER PROVISION FOR CREDIT LOSSES	**12,480**	12,640	**36,867**	36,695
NONINTEREST INCOME				
Service charges on deposit accounts	**990**	982	**2,952**	2,834
Trust and investment fee income	**383**	383	**1,140**	1,197
Other noninterest income	**1,156**	1,100	**3,234**	2,870
Total noninterest income	**2,529**	2,465	**7,326**	6,901
NONINTEREST EXPENSE				
Salaries and wages	**3,853**	4,209	**11,411**	12,536
Employee benefits	**1,299**	983	**3,621**	3,204
Occupancy expense	**697**	646	**2,056**	1,973
Furniture and equipment expense	**263**	212	**821**	714
Data processing	**972**	930	**2,801**	2,487
Directors' fees	**140**	145	**342**	411
Amortization of other intangible assets	**144**	270	**461**	597
FDIC insurance premium expense	**—**	193	**386**	612
Other real estate owned expenses, net	**133**	166	**426**	125
Legal and professional fees	**495**	443	**1,655**	1,378
Other noninterest expenses	**1,388**	1,113	**3,732**	3,578
Total noninterest expense	**9,384**	9,310	**27,712**	27,615
INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	**5,625**	5,795	**16,481**	15,981
Income tax expense	**1,411**	1,539	**4,211**	4,071
Income from continuing operations	**4,214**	4,256	**12,270**	11,910
(Loss) income from discontinued operations before income taxes	**(10)**	269	**(113)**	1,317
Income tax (benefit) expense	**(2)**	71	**(27)**	324
(Loss) income from discontinued operations	**(8)**	198	**(86)**	993
NET INCOME	**$ 4,206**	$ 4,454	**$ 12,184**	$ 12,903
Earnings per common share - Basic				
Income from continuing operations	**$ 0.33**	$ 0.33	**$ 0.96**	$ 0.93
(Loss) income from discontinued operations	**—**	0.02	**(0.01)**	0.08
Net income	**$ 0.33**	$ 0.35	**$ 0.95**	$ 1.01
Earnings per common share - Diluted				
Income from continuing operations	**$ 0.33**	$ 0.33	**$ 0.96**	$ 0.93
(Loss) income from discontinued operations	**—**	0.02	**(0.01)**	0.08
Net income	**$ 0.33**	$ 0.35	**$ 0.95**	$ 1.01
Dividends paid per common share	**0.10**	0.08	**$ 0.30**	$ 0.23

See accompanying notes to Consolidated Financial Statements.

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

	For Three Months Ended September 30,		For Nine Months Ended September 30,	
	2019	2018	**2019**	2018
Net income	**$ 4,206**	$ 4,454	**$ 12,184**	$ 12,903
Other comprehensive income (loss):				
Investment securities:				
Unrealized holding gains (losses) on available-for-sale-securities	**303**	(420)	**4,083**	(3,836)
Tax effect	**(83)**	116	**(1,116)**	1,058
Amortization of unrealized loss on securities transferred from available-for-sale to held-to-maturity	**8**	7	**22**	22
Tax effect	**(2)**	(2)	**(6)**	(7)
Total other comprehensive income (loss)	**226**	(299)	**2,983**	(2,763)
Comprehensive income	**$ 4,432**	$ 4,155	**$ 15,167**	$ 10,140

See accompanying notes to Consolidated Financial Statements.

Table of Contents

SHORE BANCSHARES, INC.
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (Unaudited)
For the Three and Nine months Ended September 30, 2019 and 2018
(Dollars in thousands)

	Common Stock	Additional Paid in Capital	Retained Earnings	Accumulated Other Comprehensive Income(Loss)	Total Stockholders' Equity
Balances, January 1, 2019	$ 127	$ 65,434	$ 120,574	$ (2,950)	$ 183,185
Net Income	—	—	3,754	—	3,754
Other comprehensive income	—	—	—	1,446	1,446
Stock-based compensation	—	63	—	—	63
Exercise of options and vesting of restricted stock, net of shares surrendered	1	(89)	—	—	(88)
Cash dividends declared	—	—	(1,278)	—	(1,278)
Balances, March 31, 2019	$ 128	$ 65,408	$ 123,050	$ (1,504)	$ 187,082
Net Income	—	—	4,224	—	4,224
Other comprehensive income	—	—	—	1,311	1,311
Stock-based compensation	—	(32)	—	—	(32)
Cash dividends declared	—	—	(1,278)	—	(1,278)
Balances, June 30, 2019	$ 128	$ 65,376	$ 125,996	$ (193)	$ 191,307
Net Income	—	—	4,206	—	4,206
Other comprehensive income	—	—	—	226	226
Retirement of common stock	(1)	(558)	—	—	(559)
Stock-based compensation	—	61	—	—	61
Cash dividends declared	—	—	(1,278)	—	(1,278)
Balances, September 30, 2019	$ 127	$ 64,879	$ 128,924	$ 33	$ 193,963

	Common Stock	Additional Paid in Capital	Retained Earnings	Accumulated Other Comprehensive Income(Loss)	Total Stockholders' Equity
Balances, January 1, 2018	$ 127	$ 65,256	$ 99,662	$ (1,309)	$ 163,736
Net Income	—	—	4,058	—	4,058
Other comprehensive (loss)	—	—	—	(2,069)	(2,069)
Stock-based compensation	—	143	—	—	143
Cash dividends declared	—	—	(891)	—	(891)
Balances, March 31, 2018	$ 127	$ 65,399	$ 102,829	$ (3,378)	$ 164,977
Cumulative effect adjustment (ASU 2016-01)	—	—	(6)	6	—
Net Income	—	—	4,391	—	4,391
Other comprehensive (loss)	—	—	—	(395)	(395)
Stock-based compensation	—	163	—	—	163
Cash dividends declared	—	—	(1,021)	—	(1,021)
Balances, June 30, 2018	$ 127	$ 65,562	$ 106,193	$ (3,767)	$ 168,115
Net Income	—	—	4,454	—	4,454
Other comprehensive (loss)	—	—	—	(299)	(299)
Stock-based compensation	—	168	—	—	168
Cash dividends declared	—	—	(1,019)	—	(1,019)
Balances, September 30, 2018	$ 127	$ 65,730	$ 109,628	$ (4,066)	$ 171,419

See accompanying notes to Consolidated Financial Statements.

Table of Contents

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

	For Nine Months Ended September 30,	
	2019	2018
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net Income	**$ 12,184**	$ 12,903
Adjustments to reconcile net income to net cash provided by operating activities:		
Net accretion of acquisition accounting estimates	**(414)**	(517)
Provision for credit losses	**500**	1,214
Depreciation and amortization	**1,779**	1,664
Net amortization of securities	**396**	498
Stock-based compensation expense	**92**	474
Deferred income tax expense	**266**	566
Losses on sales and valuation adjustments on other real estate owned	**417**	73
Fair value adjustment on equity securities	**(47)**	20
Net changes in:		
Accrued interest receivable	**(162)**	(99)
Other assets	**1,267**	(5,401)
Accrued interest payable	**(154)**	331
Other liabilities	**(6,865)**	305
Net cash provided by operating activities	**9,259**	12,031
CASH FLOWS FROM INVESTING ACTIVITES:		
Proceeds from maturities and principal payments of investment securities available for sale	**19,211**	24,292
Proceeds from maturities and principal payments of investment securities held to maturity	**281**	228
Purchases of securities held to maturity	**(4,000)**	—
Purchases of equity securities	**(23)**	(11)
Net change in loans	**(39,817)**	(87,470)
Purchases of premises and equipment	**(1,995)**	(1,026)
Proceeds from sales of other real estate owned	**731**	280
Net redemption of restricted securities	**1,821**	—
Purchases of bank owned life insurance	**(14,586)**	—
Net cash (used in) investing activities	**(38,377)**	(63,707)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net changes in:		
Noninterest-bearing deposits	**32,091**	3,444
Interest-bearing deposits	**81,205**	(24,189)
Short-term borrowings	**(43,549)**	92,309
Common stock dividends paid	**(3,834)**	(2,931)
Retirement of common stock	**(559)**	—
Repurchase of shares for tax withholding on exercised options and vested restricted stock	**(88)**	—
Net cash provided by financing activities	**65,266**	68,633
Net increase in cash and cash equivalents	**36,148**	16,957
Cash and cash equivalents at beginning of period	**67,225**	31,820
Cash and cash equivalents at end of period	**$ 103,373**	$ 48,777
Supplemental cash flows information:		
Interest paid	**$ 7,521**	$ 2,973
Income taxes paid	**$ 10,812**	$ 4,025
Lease liabilities arising from right-of-use assets	**$ (5,243)**	$ —
Transfers from loans to other real estate owned	**$ —**	$ 77
Unrealized gain (loss) on securities available for sale	**$ (4,083)**	$ (3,836)
Amortization of unrealized loss on securities transferred from available for sale to held to maturity	**$ 22**	$ 22

See accompanying notes to Consolidated Financial Statements.

Shore Bancshares, Inc.
Notes to Consolidated Financial Statements
For the Three and Nine Months Ended September 30, 2019 and 2018
(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 September 30, 2019, the consolidated results of income and comprehensive income for the three and nine months ended September 30, 2019 and 2018, changes in stockholders’ equity for the three and nine months ended September 30, 2019 and cash flows for the nine months ended September 30, 2019 and 2018, have been included. All such adjustments are of a normal recurring nature. The amounts as of December 31, 2018 were derived from the 2018 audited financial statements. The results of operations for the three and nine months ended September 30, 2019 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, 2018. For purposes of comparability, certain immaterial 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 subsidiary.

Recent Accounting Standards

ASU No. 2016-13 - In June 2016, the FASB issued ASU No. 2016-13, “Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.” The amendments in this ASU, among other things, require the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to better inform their credit loss estimates. Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to reflect the full amount of expected credit losses. In addition, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. At the FASB’s October 16, 2019 meeting, the Board affirmed its decision to amend the effective date of this ASU for many companies. Public business entities that are SEC filers, excluding those meeting the smaller reporting company definition, will retain the initial required implementation date of fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. All other entities will be required to apply the guidance for fiscal years, and interim periods within those years, beginning after December 15, 2022. At this time, the Company has established a project management team which meets periodically to discuss and assign roles and responsibilities, key tasks to complete, and a general timeline to be followed for implementation. The team has been working with an advisory consultant and has purchased a vendor model for implementation. Historical data has been collected and uploaded to the new model and the team is in the process of finalizing the methodologies that will be utilized. The team is currently running a parallel simulation to its current incurred loss impairment model. The Company is continuing to evaluate the extent of the potential impact of this standard and continues to keep current on evolving interpretations and industry practices via webcasts, publications, conferences, and peer bank meetings.

ASU No. 2017-04 – In January 2017, the FASB issued ASU No. 2017-04, “Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment”. The amendments in this ASU simplify how an entity is required to test goodwill for impairment by eliminating Step 2 from the goodwill impairment test. Step 2 measures a goodwill impairment loss by comparing the implied fair value of a reporting unit’s goodwill with the carrying amount of that goodwill. Instead, under the amendments in this ASU, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity still has the option to perform the qualitative assessment for a reporting unit to determine if the quantitative impairment test is necessary. Public business entities that are U.S.

Securities and Exchange Commission (SEC) filers should adopt the amendments in this ASU for annual or interim goodwill impairment tests in fiscal years beginning after December 15, 2019. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The guidance is not expected to have a significant impact on the Company's financial positions, results of operations or disclosures.

ASU No. 2018-13 – In August 2018, the FASB issued ASU 2018-13, "Fair Value Measurement (Topic 820): Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement." The amendments modify the disclosure requirements in Topic 820 to add disclosures regarding changes in unrealized gains and losses, the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements and the narrative description of measurement uncertainty. Certain disclosure requirements in Topic 820 are also removed or modified. The amendments are effective for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. Certain of the amendments are to be applied prospectively while others are to be applied retrospectively. Early adoption is permitted. As ASU No. 2018-13 only revises disclosure requirements, it will not have a material impact on the Company's Consolidated Financial Statements.

ASU No. 2019-04 – In April 2019, the FASB issued ASU 2019-04, "Codification Improvements to Topic 326, Financial Instruments-Credit Losses, Topic 815, Derivatives and Hedging, and Topic 825, Financial Instruments." This ASU clarifies and improves areas of guidance related to the recently issued standards on credit losses, hedging, and recognition and measurement including improvements resulting from various TRG Meetings. The amendments are effective for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. Early adoption is permitted. The Company is currently assessing the impact that ASU 2019-04 will have on its consolidated financial statements.

ASU No. 2019-05 - In May 2019, the FASB issued ASU 2019-05, "Financial Instruments—Credit Losses (Topic 326): Targeted Transition Relief." The amendments in this ASU provide entities that have certain instruments within the scope of Subtopic 326-20 with an option to irrevocably elect the fair value option in Subtopic 825-10, applied on an instrument-by-instrument basis for eligible instruments, upon the adoption of Topic 326. The fair value option election does not apply to held-to-maturity debt securities. An entity that elects the fair value option should subsequently measure those instruments at fair value with changes in fair value flowing through earnings. The amendments are effective for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. The amendments should be applied on a modified-retrospective basis by means of a cumulative-effect adjustment to the opening balance of retained earnings balance in the balance sheet. Early adoption is permitted. The Company is currently assessing the impact that ASU 2019-04 will have on its consolidated financial statements.

Note 2 – Sale of Subsidiary

Avon-Dixon Agency Sale

On December 31, 2018, the Company completed the sale of the specific assets and activities related to its insurance agency, Avon-Dixon Agency, LLC ("Avon-Dixon") to Avon-Dixon, an Alera Group Agency, LLC ("Alera"). Also, on this date the Company discontinued the operations of its premium finance company, Mubell Finance, LLC ("Mubell"). Together, Avon-Dixon and Mubell companies are referred to as the "Insurance Subsidiaries". The Insurance Subsidiaries represented the Company's insurance products and services segment, the activities of which related to originating, servicing and underwriting retail insurance policies. Assets sold to Alera included various intangible assets and a 40% interest in segregated portfolio of Eastern Re. LTD., a specialty reinsurance company. Mubell, along with certain other assets and liabilities that will be sold or settled separately within one year, is classified as discontinued operations in the accompanying Consolidated Balance Sheets and Consolidated Statements of Income.

The specific assets acquired by Alera include, among other things, the insurance origination offices, insurance expirations, workforce and system procedures, trade names and goodwill. Alera has assumed certain obligations and liabilities of the Company under the acquired leases, and with respect to the employment of transferred employees. The Company received a $25.2 million cash payment, upon the closing of the transaction.

The following table summarizes the calculation of the net gain on disposal of discontinued operations.

($ in thousands)	Year Ended December 31, 2018
Proceeds from the transaction	$ 29,276
Compensation expense related to the transaction	2,588
Broker fees	935
Other transaction costs	594
Net cash proceeds	25,159
Net assets sold	(12,423)
Net gain on disposal	**$ 12,736**

The following tables present the financial information of discontinued operations as of the dates and for the periods indicated:

($ in thousands)	September 30, 2019	December 31, 2018
ASSETS		
Goodwill	**$** —	$ 8
Other assets	—	625
Assets of discontinued operations	**$** —	$ 633
LIABILITIES		
Accrued expenses and other liabilities	**$** —	$ 3,323
Liabilities of discontinued operations	**$** —	$ 3,323

($ in thousands)	For Three Months Ended September 30, 2019	2018	For Nine Months Ended September 30, 2019	2018
Noninterest income				
Insurance agency commissions	**$ —**	$ 2,170	**$ —**	$ 7,015
All other income	**—**	76	**15**	264
Total noninterest income	**—**	2,246	**15**	7,279
Noninterest expense				
Salaries and wages	**—**	1,307	**28**	3,836
Employee benefits	**—**	288	**7**	953
Occupancy expense	**—**	121	**14**	330
Furniture and equipment	**—**	38	**1**	98
Amortization of intangible assets	**—**	12	**—**	35
Legal and professional fees	**2**	20	**73**	54
Other noninterest expenses	**8**	191	**5**	656
Total noninterest expense	**10**	1,977	**128**	5,962
(Loss) income from discontinued operations before income taxes	**(10)**	269	**(113)**	1,317
Income tax (benefit) expense	**(2)**	71	**(27)**	324
(Loss) income from discontinued operations	**$ (8)**	$ 198	**$ (86)**	$ 993

Note 3 – 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 potential common stock equivalents (stock-based awards). The following table provides information relating to the calculation of earnings per common share:

(In thousands, except per share data)	For the Three Months Ended September 30, 2019	2018	For the Nine Months Ended September 30, 2019	2018
Net income from continuing operations	**$ 4,214**	$ 4,256	**$ 12,270**	$ 11,910
Net (loss) income from discontinued operations	**(8)**	198	**(86)**	993
Net Income	**$ 4,206**	$ 4,454	**$ 12,184**	$ 12,903
Weighted average shares outstanding - Basic	**12,764**	12,748	**12,771**	12,736
Dilutive effect of common stock equivalents-options	**5**	13	**5**	13
Weighted average shares outstanding - Diluted	**12,769**	12,761	**12,776**	12,749
Basic earnings per common share				
Income from continuing operations	**$ 0.33**	$ 0.33	**$ 0.96**	$ 0.93
(Loss) income from discontinued operations	**—**	0.02	**(0.01)**	0.08
Net income	**$ 0.33**	$ 0.35	**$ 0.95**	$ 1.01
Diluted earnings per common share				
Income from continuing operations	**$ 0.33**	$ 0.33	**$ 0.96**	$ 0.93
(Loss) income from discontinued operations	**—**	0.02	**(0.01)**	0.08
Net income	**$ 0.33**	$ 0.35	**$ 0.95**	$ 1.01

There were no weighted average common stock equivalents excluded from the calculation of diluted earnings per share for the three and nine months ended September 30, 2019 and 2018.

Note 4 – Investment Securities

The following tables provide information on the amortized cost and estimated fair values of debt securities.

(Dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available-for-sale securities:				
September 30, 2019				
U.S. Government agencies	**$ 33,917**	**$ 3**	**$ 81**	**$ 33,839**
Mortgage-backed	**104,926**	**458**	**312**	**105,072**
Total	**$ 138,843**	**$ 461**	**$ 393**	**$ 138,911**
December 31, 2018				
U.S. Government agencies	$ 34,285	$ 2	$ 651	$ 33,636
Mortgage-backed	124,162	115	3,481	120,796
Total	$ 158,447	$ 117	$ 4,132	$ 154,432
Held-to-maturity securities:				
September 30, 2019				
U.S. Government agencies	**$ 1,380**	**$ 12**	**$ —**	**$ 1,392**
States and political subdivisions	**1,400**	**1**	**—**	**1,401**
Other Debt securities	**7,000**	**—**	**78**	**6,922**
Total	**$ 9,780**	**$ 13**	**$ 78**	**$ 9,715**
December 31, 2018				
U.S. Government agencies	$ 1,642	$ —	$ 25	$ 1,617
States and political subdivisions	1,401	14	—	1,415
Other Debt securities	3,000	—	32	2,968
Total	$ 6,043	$ 14	$ 57	$ 6,000

The Company adopted ASU 2016-01 effective January 1, 2018 and equity securities with an aggregate fair value of $1.3 million at September 30, 2019 and December 31, 2018 are presented separately on the balance sheet. The fair value adjustment recorded through earnings totaled $47 thousand for the nine months ended September 30, 2019 and $(20) thousand for the nine months ended September 30, 2018, respectively.

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 September 30, 2019 and December 31, 2018.

	Less than 12 Months		More than 12 Months		Total	
(Dollars in thousands)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
September 30, 2019						
Available-for-sale securities:						
U.S. Government agencies	**$ 8,985**	**$ 15**	**$ 24,854**	**$ 66**	**$ 33,839**	**$ 81**
Mortgage-backed	**17,476**	**48**	**23,296**	**264**	**40,772**	**312**
Total	**$ 26,461**	**$ 63**	**$ 48,150**	**$ 330**	**$ 74,611**	**$ 393**
Held-to-maturity securities:						
Other debt securities	**6,922**	**78**	**—**	**—**	**6,922**	**78**
Total	**$ 6,922**	**$ 78**	**$ —**	**$ —**	**$ 6,922**	**$ 78**

(Dollars in thousands)	Less than 12 Months Fair Value	Less than 12 Months Unrealized Losses	More than 12 Months Fair Value	More than 12 Months Unrealized Losses	Total Fair Value	Total Unrealized Losses
December 31, 2018						
Available-for-sale securities:						
U.S. Government agencies	$ 1,079	$ 10	$ 32,362	$ 641	$ 33,441	$ 651
Mortgage-backed	13,981	261	99,904	3,220	113,885	3,481
Total	$ 15,060	$ 271	$ 132,266	$ 3,861	$ 147,326	$ 4,132
Held-to-maturity securities:						
U.S. Government agencies	—	—	1,617	25	1,617	25
Other debt securities	2,968	32	—	—	2,968	32
Total	$ 2,968	$ 32	$ 1,617	$ 25	$ 4,585	$ 57

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. There were thirty-nine available-for-sale securities and four held-to-maturity securities in an unrealized loss position at September 30, 2019.

The following table provides information on the amortized cost and estimated fair values of investment securities by maturity date at September 30, 2019.

(Dollars in thousands)	**Available for sale Amortized Cost**	**Available for sale Fair Value**	**Held to maturity Amortized Cost**	**Held to maturity Fair Value**
Due in one year or less	$ 5,999	$ 5,994	$ 1,000	$ 1,000
Due after one year through five years	28,660	28,581	400	401
Due after five years through ten years	56,236	56,373	7,000	6,922
Due after ten years	47,948	47,963	1,380	1,392
Total	$ 138,843	$ 138,911	$ 9,780	$ 9,715

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

Note 5 – 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, Dorchester County, Baltimore County and Howard County in Maryland, Kent County, Delaware and Accomack County, Virginia. The following table provides information about the principal classes of the loan portfolio at September 30, 2019 and December 31, 2018.

(Dollars in thousands)	**September 30, 2019**	December 31, 2018
Construction	**$ 116,368**	$ 127,572
Residential real estate	**442,324**	429,560
Commercial real estate	**558,741**	523,427
Commercial	**105,583**	107,522
Consumer	**12,019**	7,274
Total loans	**1,235,035**	1,195,355
Allowance for credit losses	**(10,438)**	(10,343)
Total loans, net	**$ 1,224,597**	$ 1,185,012

Loans are stated at their principal amount outstanding net of any purchase premiums/discounts, deferred fees and costs. Loans included deferred costs, net of deferred fees, of $1.5 million and discounts on acquired loans of $1.1 million at September 30, 2019. Loans included deferred costs, net of deferred fees, of $789 thousand and discounts on acquired loans of $1.4 million at December 31, 2018. At September 30, 2019 and December 31, 2018, included in total loans were $83.1. million and $92.8 million in loans, respectively, acquired as part of the NWBI branch acquisition. 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 (i.e., interest income is no longer accrued) 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 when due. 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. Once the amount of impairment has been determined, the uncollectible portion is charged off. Loan payments received on nonaccrual impaired loans are generally applied to the outstanding principal balance. In certain circumstances, income may be recognized on a cash basis. Generally, interest income is not recognized on impaired loans unless the likelihood of further loss is remote. The allowance for credit losses may include specific reserves related to impaired loans. Specific reserves remain until charge offs are made. 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. See additional discussion under the caption "Critical Accounting Policies" in Management's Discussion and Analysis of Financial Condition and Results of Operations.

A loan is considered a troubled debt restructuring ("TDR") if a borrower is experiencing financial difficulties and a creditor has granted a concession. Concessions may include interest rate reductions or below market interest rates, principal forgiveness, restructuring amortization schedules and other actions intended to minimize potential losses. Loans are identified to be restructured when signs of impairment arise such as borrower interest rate reduction request, slowness to pay, or when an inability to repay becomes evident. The terms being offered are evaluated to determine if they are more liberal than those that would be indicated by policy or industry standards for similar, untroubled credits. In those situations where the terms or the interest rates are considered to be more favorable than industry standards or the current underwriting guidelines of the Company's banking subsidiary, Shore United Bank (the "Bank"), the loan is classified as a TDR. All loans designated as TDRs are considered impaired loans and may be on either accrual or nonaccrual status. In instances where the loan has been placed on nonaccrual status, six consecutive months of timely payments are required prior to returning the loan to accrual status.

All loans classified as TDRs which are restructured and accrue interest under revised terms require a full and comprehensive review of the borrower's financial condition, capacity for repayment, realistic assessment of collateral values, and the assessment of risk entered into any workout agreement. Current financial information on the borrower, guarantor, and underlying collateral is analyzed to determine if it supports the ultimate collection of principal and interest. For commercial loans, the cash flows are analyzed, both for the underlying project and globally. For consumer loans, updated salary, credit history and cash flow information is obtained. Current market conditions are also considered. Following a full analysis, the determination of the appropriate loan structure is made.

In the normal course of banking business, risks related to specific loan categories are as follows:

Construction loans – Construction loans are offered primarily to builders and individuals to finance the construction of single-family dwellings. In addition, the Bank periodically finances the construction of commercial projects. Credit risk factors include the borrower's ability to successfully complete the construction on time and within budget, changing market conditions which could affect the value and marketability of projects, changes in the borrower's ability or willingness to repay the loan and potentially rising interest rates which can impact both the borrower's ability to repay and the collateral value.

Residential real estate – Residential real estate loans are typically made to consumers and are secured by residential real estate. Credit risk arises from the borrower's continuing financial stability, which can be adversely impacted by job loss, divorce, illness, or personal bankruptcy, among other factors. Also impacting credit risk would be a shortfall in the value of the residential real estate in relation to the outstanding loan balance in the event of a default or subsequent liquidation of the real estate collateral.

Commercial real estate – Commercial real estate loans consist of both loans secured by owner occupied properties and nonowner occupied properties where an established banking relationship exists and involves investment properties for warehouse, retail, and office space with a history of occupancy and cash flow. These loans are subject to adverse changes in the local economy and commercial real estate markets. Credit risk associated with owner occupied properties arises from the borrower's financial stability and the ability of the borrower and the business to repay the loan. Nonowner occupied properties carry the risk of a tenant's deteriorating credit strength, lease expirations in soft markets and sustained vacancies which can adversely impact cash flow.

Commercial – Commercial loans are secured or unsecured loans for business purposes. Loans are typically secured by accounts receivable, inventory, equipment and/or other assets of the business. Credit risk arises from the successful operation of the business which may be affected by competition, rising interest rates, regulatory changes and adverse conditions in the local and regional economy.

Consumer – Consumer loans include home equity loans and lines, installment loans and personal lines of credit. Credit risk is similar to residential real estate loans above as it is subject to the borrower's continuing financial stability and the value of the collateral securing the loan.

The following tables include impairment information relating to loans and the allowance for credit losses as of September 30, 2019 and December 31, 2018.

(Dollars in thousands)	Construction	Residential real estate	Commercial real estate	Commercial	Consumer	Total
September 30, 2019						
Loans individually evaluated for impairment	**$ 43**	**$ 6,712**	**$ 13,639**	**$ 436**	**$ —**	**$ 20,830**
Loans collectively evaluated for impairment	**116,325**	**435,612**	**545,102**	**105,147**	**12,019**	**1,214,205**
Total loans	**$ 116,368**	**$ 442,324**	**$ 558,741**	**$ 105,583**	**$ 12,019**	**$ 1,235,035**
Allowance for credit losses allocated to:						
Loans individually evaluated for impairment	**$ —**	**$ 441**	**$ 452**	**$ 62**	**$ —**	**$ 955**
Loans collectively evaluated for impairment	**1,541**	**2,240**	**3,396**	**1,954**	**352**	**9,483**
Total allowance	**$ 1,541**	**$ 2,681**	**$ 3,848**	**$ 2,016**	**$ 352**	**$ 10,438**

(Dollars in thousands)	Construction	Residential real estate	Commercial real estate	Commercial	Consumer	Total
December 31, 2018						
Loans individually evaluated for impairment	$ 2,893	$ 8,553	$ 13,532	$ 340	$ —	$ 25,318
Loans collectively evaluated for impairment	124,679	421,007	509,895	107,182	7,274	1,170,037
Total loans	$ 127,572	$ 429,560	$ 523,427	$ 107,522	$ 7,274	$ 1,195,355
Allowance for credit losses allocated to:						
Loans individually evaluated for impairment	$ 320	$ 301	$ 104	$ 36	$ —	$ 761
Loans collectively evaluated for impairment	2,342	2,052	2,973	1,913	302	9,582
Total allowance	$ 2,662	$ 2,353	$ 3,077	$ 1,949	$ 302	$ 10,343

The following tables provide information on impaired loans and any related allowance by loan class as of September 30, 2019 and December 31, 2018. The difference between the unpaid principal balance and the recorded investment is the amount of partial charge-offs that have been taken and interest paid on nonaccrual loans that has been applied to principal.

					September 30, 2019		
(Dollars in thousands)	Unpaid principal balance	Recorded investment with no allowance	Recorded investment with an allowance	Related allowance	Quarter-to-date average recorded investment	Average recorded investment	Interest recorded investment
September 30, 2019							
Impaired nonaccrual loans:							
Construction	$ —	—	—	—	—	1,435	—
Residential real estate	2,366	489	1,570	256	2,642	2,904	—
Commercial real estate	10,834	8,901	1,262	430	10,221	9,717	—
Commercial	425	—	308	4	310	316	—
Consumer	—	—	—	—	—	—	—
Total	$ 13,625	$ 9,390	$ 3,140	$ 690	$ 13,173	$ 14,372	$ —
Impaired accruing TDRs:							
Construction	$ 43	$ 43	$ —	$ —	$ 44	$ 47	$ 9
Residential real estate	4,069	1,260	2,809	185	4,052	4,193	130
Commercial real estate	3,476	2,795	681	22	3,479	3,515	93
Commercial	—	—	—	—	—	—	—
Consumer	—	—	—	—	—	—	—
Total	$ 7,588	$ 4,098	$ 3,490	$ 207	$ 7,575	$ 7,755	$ 232
Other Impaired accruing loans:							
Construction	$ —	$ —	$ —	$ —	$ —	$ —	$ —
Residential real estate	584	584	—	—	—	—	—
Commercial real estate	—	—	—	—	—	—	—
Commercial	128	—	128	58	—	—	—
Consumer	—	—	—	—	—	—	—
Total	$ 712	$ 584	$ 128	$ 58	$ —	$ —	$ —
Total impaired loans:							
Construction	$ 43	$ 43	$ —	$ —	$ 44	$ 1,482	$ 9
Residential real estate	6,435	1,749	4,379	441	6,694	7,097	130
Commercial real estate	14,310	11,696	1,943	452	13,700	13,232	93
Commercial	425	—	308	4	310	316	—
Consumer	—	—	—	—	—	—	—
Total	$ 21,213	$ 13,488	$ 6,630	$ 897	$ 20,748	$ 22,127	$ 232

(Dollars in thousands)	Unpaid principal balance	Recorded investment with no allowance	Recorded investment with an allowance	Related allowance	September 30, 2018 Quarter-to-date average recorded investment	Average recorded investment	Interest income recognized
December 31, 2018							
Impaired nonaccrual loans:							
Construction	$ 3,219	$ 127	$ 2,715	$ 320	$ 3,043	$ 3,006	$ —
Residential real estate	4,281	2,605	1,494	118	1,710	1,573	—
Commercial real estate	10,029	9,307	67	67	1,742	1,438	—
Commercial	445	—	340	36	327	338	—
Consumer	—	—	—	—	—	—	—
Total	$ 17,974	$ 12,039	$ 4,616	$ 541	$ 6,822	$ 6,355	$ —
Impaired accruing TDRs:							
Construction	$ 51	$ 51	$ —	$ —	$ 145	$ 1,138	$ 13
Residential real estate	4,454	1,440	3,014	183	4,709	4,613	46
Commercial real estate	4,158	1,286	2,872	37	4,307	4,499	41
Commercial	—	—	—	—	—	—	—
Consumer	—	—	—	—	—	—	—
Total	$ 8,663	$ 2,777	$ 5,886	$ 220	$ 9,161	$ 10,250	$ 100
Total impaired loans:							
Construction	$ 3,270	$ 178	$ 2,715	$ 320	$ 3,188	$ 4,144	$ 13
Residential real estate	8,735	4,045	4,508	301	6,419	6,186	46
Commercial real estate	14,187	10,593	2,939	104	6,049	5,937	41
Commercial	445	—	340	36	327	338	—
Consumer	—	—	—	—	—	—	—
Total	$ 26,637	$ 14,816	$ 10,502	$ 761	$ 15,983	$ 16,605	$ 100

The following tables provide a roll-forward for TDRs as of September 30, 2019 and September 30, 2018.

(Dollars in thousands)	1/1/2019 TDR Balance	New TDRs	Disbursements (Payments)	Charge-offs	Reclassifications/ Transfer In/(Out)	Payoffs	9/30/2019 TDR Balance	Related Allowance
For nine months ended September 30, 2019								
Accruing TDRs								
Construction	**$ 51**	**$ —**	**$ (8)**	**$ —**	**$ —**	**$ —**	**$ 43**	**$ —**
Residential real estate	**4,454**	**41**	**(73)**	**—**	**—**	**(353)**	**4,069**	**185**
Commercial real estate	**4,158**	**—**	**(682)**	**—**	**—**	**—**	**3,476**	**22**
Commercial	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**
Consumer	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**
Total	**$ 8,663**	**$ 41**	**$ (763)**	**$ —**	**$ —**	**$ (353)**	**$ 7,588**	**$ 207**
Nonaccrual TDRs								
Construction	**$ 2,798**	**$ —**	**$ (1,379)**	**$ (3)**	**$ —**	**$ —**	**$ 1,416**	**$ 133**
Residential real estate	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**
Commercial real estate	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**
Commercial	**320**	**—**	**(12)**	**—**	**—**	**—**	**308**	**4**
Consumer	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**
Total	**$ 3,118**	**$ —**	**$ (1,391)**	**$ (3)**	**$ —**	**$ —**	**$ 1,724**	**$ 137**
Total	**$ 11,781**	**$ 41**	**$ (2,154)**	**$ (3)**	**$ —**	**$ (353)**	**$ 9,312**	**$ 344**

(Dollars in thousands)	1/1/2018 TDR Balance	New TDRs	Disbursements (Payments)	Charge-offs	Reclassifications/ Transfer In/(Out)	Payoffs	9/30/2018 TDR Balance	Related Allowance
For nine months ended September 30, 2018								
Accruing TDRs								
Construction	$ 3,972	$ —	$ (225)	$ (379)	$ (696)	$ (2,600)	$ 72	$ 19
Residential real estate	4,536	—	(63)	—	542	(351)	4,664	194
Commercial real estate	4,818	—	(402)	—	—	(219)	4,197	32
Commercial	—	—	—	—	—	—	—	—
Consumer	—	—	—	—	—	—	—	—
Total	$ 13,326	$ —	$ (690)	$ (379)	$ (154)	$ (3,170)	$ 8,933	$ 245
Nonaccrual TDRs								
Construction	$ 2,878	$ —	$ (73)	$ —	$ 83	$ —	$ 2,888	$ 356
Residential real estate	—	—	—	(80)	80	—	—	—
Commercial real estate	83	—	—	—	(83)	—	—	—
Commercial	337	—	(13)	—	—	—	324	20
Consumer	—	—	—	—	—	—	—	—
Total	$ 3,298	$ —	$ (86)	$ (80)	$ 80	$ —	$ 3,212	$ 376
Total	$ 16,624	$ —	$ (776)	$ (459)	$ (74)	$ (3,170)	$ 12,145	$ 621

The following tables provide information on loans that were modified and considered TDRs during the nine months ended September 30, 2019 and September 30, 2018.

(Dollars in thousands)	Number of contracts	Premodification outstanding recorded investment	Postmodification outstanding recorded investment	Related allowance
TDRs:				
For nine months ended September 30, 2019				
Construction	**—**	**$ —**	**$ —**	**$ —**
Residential real estate	**1**	**75**	**41**	**—**
Commercial real estate	**—**	**—**	**—**	**—**
Commercial	**—**	**—**	**—**	**—**
Consumer	**—**	**—**	**—**	**—**
Total	**1**	**$ 75**	**$ 41**	**$ —**
For nine months ended September 30, 2018				
Construction	—	$ —	$ —	$ —
Residential real estate	—	—	—	—
Commercial real estate	—	—	—	—
Commercial	—	—	—	—
Consumer	—	—	—	—
Total	—	$ —	$ —	$ —

The following tables provide information on TDRs that defaulted within twelve months of restructuring during the nine months ended September 30, 2019 and September 30, 2018. There were no defaults during the nine months ended September 30, 2019 and two defaults totaling $533 for the nine months ended September 30, 2018. Generally, a loan is considered in default when principal or interest is past due 90 days or more, the loan is placed on nonaccrual, the loan is charged off, or there is a transfer to OREO or repossessed assets.

(Dollars in thousands)	Number of contracts	Recorded investment	Related allowance
TDRs that subsequently defaulted:			
For nine months ended September 30, 2019			
Construction	—	**$ —**	**$ —**
Residential real estate	—	—	—
Commercial real estate	—	—	—
Commercial	—	—	—
Consumer	—	—	—
Total	—	**$ —**	**$ —**
For nine months ended September 30, 2018			
Construction	1	$ 379	$ —
Residential real estate	1	154	—
Commercial real estate	—	—	—
Commercial	—	—	—
Consumer	—	—	—
Total	2	$ 533	$ —

Management uses risk ratings as part of its monitoring of the credit quality in the Company's loan portfolio. Loans that are identified as special mention, substandard or doubtful are adversely rated. These loans and the pass/watch loans are assigned higher qualitative factors than favorably rated loans in the calculation of the formula portion of the allowance for credit losses. At September 30, 2019, there were no nonaccrual loans classified as special mention or doubtful and $12.5 million of nonaccrual loans were classified as substandard. Similarly, at December 31, 2018, there were no nonaccrual loans classified as special mention or doubtful and $16.7 million of nonaccrual loans were classified as substandard.

The following tables provide information on loan risk ratings as of September 30, 2019 and December 31, 2018.

(Dollars in thousands)	Pass/Performing	Pass/Watch	Special Mention	Substandard	Doubtful	Total
September 30, 2019						
Construction	**$ 100,669**	**$ 13,560**	**$ 2,139**	**$ —**	**$ —**	**$ 116,368**
Residential real estate	**405,154**	**28,927**	**5,408**	**2,835**	**—**	**442,324**
Commercial real estate	**427,825**	**110,846**	**4,999**	**15,071**	**—**	**558,741**
Commercial	**85,507**	**19,725**	**10**	**341**	**—**	**105,583**
Consumer	**11,619**	**397**	**—**	**3**	**—**	**12,019**
Total	**$ 1,030,774**	**$ 173,455**	**$ 12,556**	**$ 18,250**	**$ —**	**$ 1,235,035**

(Dollars in thousands)	Pass/Performing	Pass/Watch	Special Mention	Substandard	Doubtful	Total
December 31, 2018						
Construction	$ 93,977	$ 30,735	$ —	$ 2,860	$ —	$ 127,572
Residential real estate	386,553	33,739	3,769	5,499	—	429,560
Commercial real estate	389,219	113,873	4,515	15,820	—	523,427
Commercial	90,777	15,727	642	376	—	107,522
Consumer	6,805	466	—	3	—	7,274
Total	$ 967,331	$ 194,540	$ 8,926	$ 24,558	$ —	$ 1,195,355

The following tables provide information on the aging of the loan portfolio as of September 30, 2019 and December 31, 2018.

(Dollars in thousands)	Current	Accruing 30-59 days past due	Accruing 60-89 days past due	Accruing Greater than 90 days	Accruing Total past due	Nonaccrual	Total
September 30, 2019							
Construction	**$ 116,111**	**$ —**	**$ 257**	**$ —**	**$ 257**	**$ —**	**$ 116,368**
Residential real estate	**433,458**	**5,195**	**1,028**	**584**	**6,807**	**2,059**	**442,324**
Commercial real estate	**546,492**	**1,894**	**192**	**—**	**2,086**	**10,163**	**558,741**
Commercial	**104,809**	**337**	**1**	**128**	**466**	**308**	**105,583**
Consumer	**11,985**	**18**	**16**	**—**	**34**	**—**	**12,019**
Total	**$ 1,212,855**	**$ 7,444**	**$ 1,494**	**$ 712**	**$ 9,650**	**$ 12,530**	**$ 1,235,035**
Percent of total loans	**98.2 %**	**0.6 %**	**0.1 %**	**0.1 %**	**0.8 %**	**1.0 %**	**100.0 %**

(Dollars in thousands)	Current	Accruing 30-59 days past due	Accruing 60-89 days past due	Accruing Greater than 90 days	Accruing Total past due	Nonaccrual	Total
December 31, 2018							
Construction	$ 124,535	$ 195	$ —	$ —	$ 195	$ 2,842	$ 127,572
Residential real estate	423,732	1,384	206	139	1,729	4,099	429,560
Commercial real estate	512,252	253	1,548	—	1,801	9,374	523,427
Commercial	107,089	83	10	—	93	340	107,522
Consumer	7,238	30	6	—	36	—	7,274
Total	$ 1,174,846	$ 1,945	$ 1,770	$ 139	$ 3,854	$ 16,655	$ 1,195,355
Percent of total loans	98.3 %	0.2 %	0.1 %	— %	0.3 %	1.4 %	100.0 %

The following tables provide a summary of the activity in the allowance for credit losses allocated by loan class for the three and nine months ended September 30, 2019 and September 30, 2018. Allocation of a portion of the allowance to one loan class does not preclude its availability to absorb losses in other loan classes.

(Dollars in thousands)	Construction	Residential real estate	Commercial real estate	Commercial	Consumer	Total
For three months ended September 30, 2019						
Allowance for credit losses:						
Beginning Balance	**$ 2,443**	**$ 2,155**	**$ 3,367**	**$ 2,057**	**$ 283**	**$ 10,305**
Charge-offs	**—**	**(86)**	**—**	**(98)**	**—**	**(184)**
Recoveries	**1**	**12**	**7**	**96**	**1**	**117**
Net charge-offs	**1**	**(74)**	**7**	**(2)**	**1**	**(67)**
Provision	**(903)**	**600**	**474**	**(39)**	**68**	**200**
Ending Balance	**$ 1,541**	**$ 2,681**	**$ 3,848**	**$ 2,016**	**$ 352**	**$ 10,438**

(Dollars in thousands)	Construction	Residential real estate	Commercial real estate	Commercial	Consumer	Total
For three months ended September 30, 2018						
Allowance for credit losses:						
Beginning Balance	$ 2,593	$ 2,150	$ 2,845	$ 2,210	$ 323	$ 10,121
Charge-offs	—	(109)	—	(137)	—	(246)
Recoveries	3	5	5	122	11	146
Net charge-offs	3	(104)	5	(15)	11	(100)
Provision	188	95	87	15	(78)	307
Ending Balance	$ 2,784	$ 2,141	$ 2,937	$ 2,210	$ 256	$ 10,328

(Dollars in thousands)	Construction	Residential real estate	Commercial real estate	Commercial	Consumer	Total
For nine months ended September 30, 2019						
Allowance for credit losses:						
Beginning Balance	**$ 2,662**	**$ 2,353**	**$ 3,077**	**$ 1,949**	**$ 302**	**$ 10,343**
Charge-offs	**(3)**	**(509)**	**—**	**(260)**	**(29)**	**(801)**
Recoveries	**8**	**23**	**114**	**248**	**3**	**396**
Net charge-offs	**5**	**(486)**	**114**	**(12)**	**(26)**	**(405)**
Provision	**(1,126)**	**814**	**657**	**79**	**76**	**500**
Ending Balance	**$ 1,541**	**$ 2,681**	**$ 3,848**	**$ 2,016**	**$ 352**	**$ 10,438**

(Dollars in thousands)	Construction	Residential real estate	Commercial real estate	Commercial	Consumer	Total
For nine months ended September 30, 2018						
Allowance for credit losses:						
Beginning Balance	$ 2,460	$ 2,284	$ 2,594	$ 2,241	$ 202	$ 9,781
Charge-offs	(379)	(288)	—	(263)	(24)	(954)
Recoveries	18	91	23	144	11	287
Net charge-offs	(361)	(197)	23	(119)	(13)	(667)
Provision	685	54	320	88	67	1,214
Ending Balance	$ 2,784	$ 2,141	$ 2,937	$ 2,210	$ 256	$ 10,328

Foreclosure Proceedings

Consumer mortgage loans collateralized by residential real estate property that were in the process of foreclosure totaled $66 thousand as of September 30, 2019 and $949 thousand as of December 31, 2018, respectively. There were no residential real estate properties included in the balance of other real estate owned at September 30, 2019 and December 31, 2018.

All accruing TDRs were in compliance with their modified terms. Both performing and non-performing TDRs had no further commitments associated with them as of September 30, 2019 and December 31, 2018.

Note 6 – Leases

On January 1, 2019, the Company adopted ASU No. 2016-02 *"Leases (Topic 842)"* and all subsequent ASUs that modified Topic 842. The Company elected the prospective application approach provided by ASU 2018-11 and did not adjust prior periods for ASC 842. The Company also elected certain practical expedients within the standard and consistent with such elections did not reassess whether any expired or existing contracts are or contain leases, did not reassess the lease classification for any expired or existing leases, and did not reassess any initial direct costs for existing leases. As stated in the Company's 2018 Form 10-K, the implementation of the new standard resulted in recognition of right-of-use assets and lease liabilities totaling $3.8 million at the date of adoption, which are primarily related to the Company's lease of premises used in operations. Since adoption of the leasing standard in January 2019, the Company recognized additional right-of-use assets and lease liabilities of $1.4 million, primarily related to the lease of additional premises used in operations.

Lease liabilities represent the Company's obligation to make lease payments and are presented at each reporting date as the net present value of the remaining contractual cash flows. Cash flows are discounted at the Company's incremental borrowing rate in effect at the commencement date of the lease. Right-of-use assets represent the Company's right to use the underlying asset for the lease term and are calculated as the sum of the lease liability and if applicable, prepaid rent, initial direct costs and any incentives received from the lessor.

The Company's long-term lease agreements are classified as operating leases. Certain of these leases offer the option to extend the lease term and the Company has included such extensions in its calculation of the lease liabilities to the extent the options are reasonably certain of being exercised. The lease agreements do not provide for residual value guarantees and have no restrictions or covenants that would impact dividends or require incurring additional financial obligations.

The following tables present information about the Company's leases:

(Dollars in thousands)		September 30, 2019
Lease liabilities	$	4,923
Right-of-use assets	$	4,908
Weighted average remaining lease term		11.87 years
Weighted average discount rate		3.12 %

Lease cost (in thousands)		For the three months ended September 30, 2019		For the nine months ended September 30, 2019
Operating lease cost	$	173	$	440
Short-term lease cost		—		—
Total lease cost	$	173	$	440
Cash paid for amounts included in the measurement of lease liabilities	$	163	$	419

A maturity analysis of operating lease liabilities and reconciliation of the undiscounted cash flows to the total of operating lease liabilities is as follows:

Lease payments due (in thousands)		As of September 30, 2019
Three months ending December 31, 2019	$	168
Twelve months ending December 31, 2020		604
Twelve months ending December 31, 2021		545
Twelve months ending December 31, 2022		541
Twelve months ending December 31, 2023		521
Twelve months ending December 31, 2024		473
Thereafter		3,258
Total undiscounted cash flows	$	6,110
Discount		1,187
Lease liabilities	$	4,923

Note 7 – Goodwill and Other Intangibles

The following table provides information on the significant components of goodwill and other acquired intangible assets at September 30, 2019 and December 31, 2018.

September 30, 2019

(Dollars in thousands)	Gross Carrying Amount	Accumulated Impairment Charges	Accumulated Amortization	Net Carrying Amount	Weighted Average Remaining Life (in years)
Goodwill	**$ 19,728**	**$ (1,543)**	**$ (667)**	**$ 17,518**	**—**
Other intangible assets					
Amortizable					
Core deposit intangible	**$ 3,954**	**$ —**	**$ (1,558)**	**$ 2,396**	**6.1**
Total other intangible assets	**$ 3,954**	**$ —**	**$ (1,558)**	**$ 2,396**	

December 31, 2018

(Dollars in thousands)	Gross Carrying Amount	Accumulated Impairment Charges	Accumulated Amortization	Net Carrying Amount	Weighted Average Remaining Life (in years)
Goodwill	$ 19,728	$ (1,543)	$ (667)	$ 17,518	—
Other intangible assets					
Amortizable					
Core deposit intangible	$ 3,954	$ —	$ (1,097)	$ 2,857	7.2
Total other intangible assets	$ 3,954	$ —	$ (1,097)	$ 2,857	

The aggregate amortization expense included in continuing operations was $461 thousand for the nine months ended September 30, 2019 and $597 thousand for the nine months ended September 30, 2018.

At September 30, 2019, estimated future remaining amortization for amortizing intangibles within the years ending December 31, is as follows:

(Dollars in thousands)	Amortization Expense
2019	$ 144
2020	533
2021	461
2022	389
2023	317
2024	246
Thereafter	306
Total amortizing intangible assets	$ 2,396

Note 8 – Other Assets

The Company had the following other assets at September 30, 2019 and December 31, 2018 excluding discontinued operations.

(Dollars in thousands)	September 30, 2019	December 31, 2018
Accrued interest receivable	**3,507**	3,345
Deferred income taxes	**2,795**	4,182
Prepaid expenses	**1,483**	1,067
Cash surrender value on life insurance	**18,440**	3,726
Income taxes receivable	**518**	—
Other assets	**3,514**	5,358
Total	**$ 30,257**	$ 17,678

The following table provides information on significant components of the Company's deferred tax assets and liabilities as of September 30, 2019 and December 31, 2018.

(Dollars in thousands)	September 30, 2019	December 31, 2018
Deferred tax assets:		
Allowance for credit losses	**$ 2,850**	$ 2,797
Reserve for off-balance sheet commitments	**81**	81
Net operating loss carry forward	**37**	—
Write-downs of other real estate owned	**(3)**	273
Nonaccrual loan interest	**354**	260
Unrealized losses on available-for-sale securities	—	1,105
Unrealized losses on available-for-sale securities transferred to held to maturity	**6**	12
Other	**480**	524
Total deferred tax assets	**3,805**	5,052
Deferred tax liabilities:		
Depreciation	**187**	238
Amortization on loans FMV adjustment	**48**	60
Acquisition accounting adjustments	**448**	247
Deferred capital gain on branch sale	**195**	200
Unrealized gains on available-for-sale securities	**10**	—
Other	**122**	125
Total deferred tax liabilities	**1,010**	870
Net deferred tax assets	**$ 2,795**	$ 4,182

Note 9 – Other Liabilities

The Company had the following other liabilities at September 30, 2019 and December 31, 2018 excluding discontinued operations.

(Dollars in thousands)	September 30, 2019	December 31, 2018
Accrued interest payable	**$ 450**	$ 604
Other accounts payable	**211**	3,213
Deferred compensation liability	**1,074**	1,040
Income taxes payable	—	3,454
Other liabilities	**3,304**	104
Total	**$ 5,039**	$ 8,415

Table of Contents

Note 10 - Stock-Based Compensation

At the 2016 annual meeting, stockholders approved the Shore Bancshares, Inc. 2016 Stock and Incentive Plan ("2016 Equity Plan"), replacing the Shore Bancshares, Inc. 2006 Stock and Incentive Plan ("2006 Equity Plan"), which expired on that date. The Company may issue shares of common stock or grant other equity-based awards pursuant to the 2016 Equity Plan. Stock-based awards granted to date generally are time-based, vest in equal installments on each anniversary of the grant date and range over a one- to five-year period of time, and, in the case of stock options, expire 10 years from the grant date. As part of the 2016 Equity Plan, a performance equity incentive award program, known as the "Long-term incentive plan" allows participating officers of the Company to earn incentive awards of performance share/restricted stock units if certain pre-determined targets are achieved at the end of a three-year performance cycle. Stock-based compensation expense based on the grant date fair value is recognized ratably over the requisite service period for all awards and reflects forfeitures as they occur. The 2016 Equity Plan originally reserved 750,000 shares of common stock for grant, and 636,465 shares remained available for grant at September 30, 2019.

The following tables provide information on stock-based compensation expense for the three and nine months ended September 30, 2019 and 2018.

	For Three Months Ended September 30,		For Nine Months Ended September 30,	
(Dollars in thousands)	**2019**	2018	**2019**	2018
Stock-based compensation expense	**$ 61**	$ 168	**$ 92**	$ 474
Excess tax benefits related to stock-based compensation	**2**	11	**5**	146

	As of September 30,	
(Dollars in thousands)	**2019**	2018
Unrecognized stock-based compensation expense	**$ 90**	$ 530
Weighted average period unrecognized expense is expected to be recognized	**0.5 years**	0.8 years

The following table summarizes restricted stock award activity for the Company under the 2016 Equity Plan for the nine months ended September 30, 2019 and 2018.

	Nine Months Ended September 30, 2019	
	Number of Shares	Weighted Average Grant Date Fair Value
Nonvested at beginning of period	—	**$ —**
Granted	**15,702**	**15.36**
Vested	—	—
Cancelled	—	—
Nonvested at end of period	**15,702**	**$ 15.36**

The fair value of restricted stock awards that vested during the first nine months of 2019 and 2018 was $0 and $520 thousand, respectively.

Restricted stock units (RSUs) are similar to restricted stock, except the recipient does not receive the stock immediately, but instead receives it upon the terms and conditions of the Company's long-term incentive plans which are subject to performance milestones achieved at the end of a three-year period. Each RSU cliff vests at the end of the three-year period and entitles the recipient to receive one share of common stock on a specified issuance date. The recipient does not have any stockholder rights, including voting rights, with respect to the shares underlying awarded RSUs until the recipient becomes the holder of those shares.

In the second quarter of 2019, the Long-Term Incentive Plan culminating December 31, 2020 was terminated by the Board's Compensation Committee and all outstanding RSUs were forfeited as presented in the table below. To replace this compensation incentive plan, the Compensation Committee elected to institute individual Supplemental Executive Retirement Plans ("SERPs") which will be executed in the beginning of 2020, with the exception of three SERPs which began on July 19, 2019 for Lloyd L. Beatty, Jr., President and Chief Executive Officer, Edward C. Allen, Executive Vice President and Chief Financial Officer and Donna J. Stevens, Executive Vice President and Chief Operating Officer. These individuals also forfeited their RSUs in the LTI culminating December 31, 2019.

During 2017, the Company entered into a long-term incentive plan agreement with officers of the Company and its subsidiaries to award RSUs based on a performance metric to be achieved as of December 31, 2019. Assuming the performance metric is achieved, these awards will cliff vest on this date, in which the final number of common shares to be issued will be determined. The range of RSUs which could potentially be awarded at the end of the performance cycle is between 6,178 shares and 24,726 shares, assuming a certain performance metric is met. The table below presents management's evaluation of the probable number of common stock awards to be issued at the end of the performance cycle.

During 2016, the Company entered into a long-term incentive plan agreement with officers of the Company and its subsidiaries to award RSUs based on a performance metric to be achieved as of December 31, 2018. Based on the results for the year ended December 31, 2018, 15,577 shares were vested.

The following table summarizes restricted stock units activity based on management's evaluation of the probable number of common stock awards to be issued at the end of the performance cycle for the Company under the 2016 Equity Plan for the nine months ended September 30, 2019.

	Nine Months Ended September 30, 2019	
	Number of Shares	Weighted Average Grant Date Fair Value
Outstanding at beginning of period	**38,562**	**$ 14.69**
Granted	—	—
Vested	**(15,577)**	**11.68**
Forfeited	**(16,807)**	**16.78**
Outstanding at end of period	**6,178**	**$ 16.57**

The fair value of restricted stock units that vested during the first nine months of 2019 and 2018 was $241 thousand and $383 thousand.

The following table summarizes stock option activity for the Company under the 2016 Equity Plan for the nine months ended September 30, 2019 and 2018.

	Nine Months Ended September 30, 2019	
	Number of Shares	Weighted Average Grant Date Exercise Price
Outstanding at beginning of period	**27,249**	**$ 9.68**
Granted	—	—
Exercised	**(15,578)**	**10.01**
Expired/Cancelled	—	—
Outstanding at end of period	**11,671**	**$ 9.25**
Exercisable at end of period	**11,671**	**$ 9.25**

There were no stock options granted during the three and nine months ended September 30, 2019 and September 30, 2018. The Company estimates the fair value of 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 contract 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.

At the end of the third quarter of 2019, the aggregate intrinsic value of the options outstanding under the 2016 Equity Plan was $72 thousand based on the $15.41 market value per share of the Company's common stock at September 30, 2019. Similarly, the aggregate intrinsic value of the options exercisable was $72 thousand at September 30, 2019. The intrinsic value on options exercised during the nine months ended September 30, 2019 was $72 thousand based on the $14.66 market value per share of the Company's common stock at January 15, 2019. The intrinsic value on options exercised in 2018 was $365 thousand based on the $17.92 market value per share of the Company's common stock at January 31, 2018. At September 30, 2019, the weighted average remaining contract life of options outstanding and exercisable was 5.0 years.

Note 11 – Accumulated Other Comprehensive Income

The Company records unrealized holding gains (losses), net of tax, on investment securities available for sale as accumulated other comprehensive income (loss), a separate component of stockholders' equity. The following table provides information on the changes in the components of accumulated other comprehensive income (loss) for the nine months ended September 30, 2019 and 2018.

(Dollars in thousands)	Unrealized gains (losses) on available for sale securities	Unrealized gains (losses) on securities transferred from Available-for-sale to Held-to-maturity	Accumulated other comprehensive income (loss)
Balance, December 31, 2018	**$ (2,918)**	**$ (32)**	**$ (2,950)**
Other comprehensive income	**2,967**	**16**	**2,983**
Balance, September 30, 2019	**$ 49**	**$ (16)**	**$ 33**
Balance, December 31, 2017	$ (1,255)	$ (54)	$ (1,309)
Cumulative effect adjustment (ASU 2016-01)	6	—	6
Other comprehensive income (loss)	(2,778)	15	(2,763)
Balances, September 30, 2018	$ (4,027)	$ (39)	$ (4,066)

Note 12 – Fair Value Measurements

Accounting guidance under GAAP 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. This accounting guidance 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 uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. Securities available for sale 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, loans held for sale and other real estate owned (foreclosed assets). These nonrecurring fair value adjustments typically involve application of lower of cost or market accounting or write-downs of individual assets.

Under fair value accounting guidance, 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.

Below is a discussion on the Company's assets measured at fair value on a recurring basis.

Investment Securities Available for Sale

Fair value measurement for investment securities available for sale is based on quoted prices from an independent pricing service. The fair value measurements consider observable data that may include present value of future cash flows, prepayment assumptions, credit loss assumptions and other factors. The Company classifies its investments in U.S. Treasury securities, if any, as Level 1 in the fair value hierarchy, and it classifies its investments in U.S. Government agencies securities and mortgage-backed securities issued or guaranteed by U.S. Government sponsored entities as Level 2.

Equity Securities

Fair value measurement for equity securities is based on quoted market prices retrieved by the Company via on-line resources. Although these securities have readily available fair market values, the Company determined that they should be classified as level 2 investments in the fair value hierarchy due to not being considered traded in a highly active market.

The tables below present the recorded amount of assets measured at fair value on a recurring basis at September 30, 2019 and December 31, 2018. No assets were transferred from one hierarchy level to another during the first nine months of 2019 or 2018.

(Dollars in thousands)	Fair Value	Quoted Prices (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
September 30, 2019				
Securities available for sale:				
U.S. Government agencies	**$ 33,839**	**$ —**	**$ 33,839**	**$ —**
Mortgage-backed	**105,072**	**—**	**105,072**	**—**
	138,911	**—**	**138,911**	**—**
Equity	**1,339**	**—**	**1,339**	**—**
Total	**$ 140,250**	**$ —**	**$ 140,250**	**$ —**

(Dollars in thousands)	Fair Value	Quoted Prices (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2018				
Securities available for sale:				
U.S. Government agencies	$ 33,636	$ —	$ 33,636	$ —
Mortgage-backed	120,796	—	120,796	—
	154,432	—	154,432	—
Equity	1,269	—	1,269	—
Total	$ 155,701	$ —	$ 155,701	$ —

Below is a discussion on the Company's assets measured at fair value on a nonrecurring basis.

Impaired Loans

Loans are considered impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts according to the contractual terms of the loan agreement when due. Loan impairment is measured using the present value of expected cash flows, the loan's observable market price or the fair value of the collateral (less selling costs) if the loans are collateral dependent and these are considered Level 3 in the fair value hierarchy. Collateral may be real estate and/or business assets including equipment, inventory and/or accounts receivable. The value of business equipment, inventory and accounts receivable, discounted on management's review and analysis. Appraised and reported values may be discounted based on management's historical knowledge, changes in market conditions from the time of valuation, and/or management's expertise and knowledge of the client and the client's business. Impaired loans are reviewed and evaluated on at least a quarterly basis for additional impairment and adjusted accordingly, based on the factors identified above. Valuation techniques are consistent with those techniques applied in prior periods.

Other Real Estate Owned (Foreclosed Assets)

Foreclosed assets are adjusted for fair value upon transfer of loans to foreclosed assets establishing a new cost basis. Subsequently, foreclosed assets are carried at the lower of carrying value or fair value. The estimated fair value for foreclosed assets included in Level 3 are determined by independent market based appraisals and other available market information, less costs to sell, that may be reduced further based on market expectations or an executed sales agreement. If the fair value of the collateral deteriorates subsequent to the initial recognition, the Company records the foreclosed asset as a non-recurring Level 3 adjustment. Valuation techniques are consistent with those techniques applied in prior periods.

The tables below present the recorded amount of assets measured at fair value on a nonrecurring basis at September 30, 2019 and December 31, 2018.

	Quantitative Information about Level 3 Fair Value Measurements			
(Dollars in thousands)	Fair Value	Valuation Technique	Unobservable Input	Range
September 30, 2019				
Nonrecurring measurements:				
Impaired loans	$ **1,777**	Appraisal of collateral	(1) Appraisal adjustments	(2) 0% - 17%
			Liquidation expense	(2) 0% - 10%
Impaired loans	$ **3,956**	Discounted cash flow analysis	(1) Discount rate	4% - 7.25%
Other real estate owned	$ **74**	Appraisal of collateral	(1) Appraisal adjustments	(2) 15% - 40%
			Liquidation expense	(2) 5% - 10%

	Quantitative Information about Level 3 Fair Value Measurements			
(Dollars in thousands)	Fair Value	Valuation Technique	Unobservable Input	Range
December 31, 2018				
Nonrecurring measurements:				
Impaired loans	$ 3,839	Appraisal of collateral	(1) Appraisal adjustments	(2) 0% - 17%
			Liquidation expense	(2) 0% - 10%
Impaired loans	$ 5,902	Discounted cash flow analysis	(1) Discount rate	4% - 7.25%
Other real estate owned	$ 1,222	Appraisal of collateral	(1) Appraisal adjustments	(2) 15% - 40%
			Liquidation expense	(2) 5% - 10%

(1) Fair value is generally determined through independent appraisals of the underlying collateral (impaired loans and OREO) or discounted cash flow analyses (impaired loans), which generally include various level III inputs which are not identifiable.

(2) Appraisals may be adjusted by management for qualitative factors such as economic conditions and estimated liquidation expenses. The range and weighted average of liquidation expenses and other appraisal adjustments are presented as a percent of the appraisal.

The carrying amounts and estimated fair values of the Company's financial instruments not carried at fair value on the Company's Consolidated Balance Sheets are presented in the following table. Fair values for September 30, 2019 and December 31, 2018 were estimated using an exit price notion.

	September 30, 2019		December 31, 2018	
(Dollars in thousands)	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets				
Level 1 inputs				
Cash and cash equivalents	**$ 103,373**	**$ 103,373**	$ 67,225	$ 67,225
Level 2 inputs				
Investment securities held to maturity	**$ 9,780**	**$ 9,715**	$ 6,043	$ 6,000
Restricted securities	**4,655**	**4,655**	6,476	6,476
Cash surrender value on life insurance	**18,440**	**18,440**	3,726	3,726
Level 3 inputs				
Loans, net	**$ 1,224,597**	**$ 1,227,196**	$ 1,185,012	$ 1,150,418
Financial liabilities				
Level 2 inputs				
Deposits:				
Noninterest-bearing demand	**$ 362,557**	**$ 362,557**	$ 330,466	$ 330,466
Checking plus interest	**288,521**	**288,521**	239,809	239,809
Money market	**248,114**	**248,114**	232,613	232,613
Savings	**141,498**	**141,498**	148,723	148,723
Club	**1,502**	**1,502**	387	387
Brokered Deposits	**12,070**	**12,067**	22,084	22,075
Certificates of deposit, $100,000 or more	**123,142**	**123,655**	97,905	96,435
Other time	**148,087**	**147,684**	140,354	136,292
Short-term borrowings	**17,263**	**17,263**	60,812	60,812
Long-term borrowings	**15,000**	**14,999**	15,000	15,012

Note 13 – Financial Instruments with Off-Balance Sheet Risk

In the normal course of business, to meet the financial needs of its customers, the Bank is a party to 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 Bank 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.

The following table provides information on commitments outstanding at September 30, 2019 and December 31, 2018.

(Dollars in thousands)	**September 30, 2019**	December 31, 2018
Commitments to extend credit	**$ 232,355**	$ 210,463
Letters of credit	**7,112**	6,917
Total	**$ 239,467**	$ 217,380

Note 14 – Revenue Recognition

On January 1, 2018, the Company adopted ASU No. 2014-09 *"Revenue from Contracts with Customers" (Topic 606)* and all subsequent ASUs that modified Topic 606. The implementation of the new standard did not have a material impact on the measurement or recognition of revenue; as such, a cumulative effect adjustment to opening retained earnings was not deemed necessary. Results for reporting periods beginning after January 1, 2018 are presented under Topic 606, while prior period amounts were not adjusted and continue to be reported in accordance with our historic accounting under Topic 605.

Topic 606 does not apply to revenue associated with financial instruments, including revenue from loans and securities. Topic 606 is applicable to noninterest revenue streams such as trust and asset management income, deposit related fees, interchange fees and merchant income. However, the recognition of these revenue streams did not change significantly upon adoption of Topic 606. Substantially all of the Company's revenue is generated from contracts with customers. Noninterest revenue streams in-scope of Topic 606 are discussed below.

Service Charges on Deposit Accounts
Service charges on deposit accounts consist of account analysis fees (i.e., net fees earned on analyzed business and public checking accounts), monthly service fees, check orders, and other deposit account related fees. The Company's performance obligation for account analysis fees and monthly service fees is generally satisfied, and the related revenue recognized, over the period in which the service is provided.

Check orders and other deposit account related fees are largely transactional based, and therefore, the Company's performance obligation is satisfied, and related revenue recognized, at a point in time. Payment for service charges on deposit accounts is primarily received immediately or at the end of the month through a direct charge to customers' accounts.

Trust and Investment Fee Income
Trust and investment fee income are primarily comprised of fees earned from the management and administration of trusts and other customer assets. The Company's performance obligation is generally satisfied over time and the resulting fees are recognized monthly, based upon the month-end market value of the assets under management and the applicable fee rate. Payment is generally received a few days after month end through a direct charge to customers' accounts. The Company does not earn performance-based incentives.

Optional services such as real estate sales and tax return preparation services are also available to existing trust and asset management customers. The Company's performance obligation for these transactional-based services is generally satisfied, and related revenue recognized, at a point in time (i.e., as incurred). Payment is received shortly after services are rendered.

Other Noninterest Income
Other noninterest income consists of: fees, exchange, other service charges, safety deposit box rental fees, and other miscellaneous revenue streams. Fees and other service charges are primarily comprised of debit and credit card income, ATM fees, merchant services income, and other service charges. Debit and credit card income is primarily comprised of interchange fees earned whenever the Company's debit and credit cards are processed through card payment networks such as Visa. ATM fees are primarily generated when a Company cardholder uses a non-Company ATM or a non-Company cardholder uses a Company ATM. Merchant services income mainly represents fees charged to merchants to process their debit and credit card transactions, in addition to account management fees. Other service charges include revenue from processing wire transfers, bill pay service, cashier's checks, and other services. The Company's performance obligation for fees, exchange, and other service charges are largely satisfied, and related revenue recognized, when the services are rendered or upon completion. Payment is typically received immediately or in the following month. Safe deposit box rental fees are charged to the customer on an annual basis and recognized upon receipt of payment. The

Company determined that rentals and renewals of safe deposit boxes will be recognized on a monthly basis consistent with the duration of the performance obligation.

The following presents noninterest income from continuing operations, segregated by revenue streams in-scope and out-of-scope of Topic 606, for the three and nine months ended September 30, 2019 and 2018.

(Dollars in thousands)	For Three Months Ended September 30, **2019**	For Three Months Ended September 30, 2018	For Nine Months Ended September 30, **2019**	For Nine Months Ended September 30, 2018
Noninterest Income				
In-scope of Topic 606:				
Service charges on deposit accounts	**$ 990**	$ 982	**$ 2,952**	$ 2,834
Trust and investment fee income	**383**	383	**1,140**	1,197
Other noninterest income	**1,018**	1,076	**3,005**	2,802
Noninterest Income (in-scope of Topic 606)	**2,391**	2,441	**7,097**	6,833
Noninterest Income (out-of-scope of Topic 606)	**138**	24	**229**	68
Total Noninterest Income	**$ 2,529**	$ 2,465	**$ 7,326**	$ 6,901

Contract Balances

A contract asset balance occurs when an entity performs a service for a customer before the customer pays consideration (resulting in a contract receivable) or before payment is due (resulting in a contract asset). A contract liability balance is an entity's obligation to transfer a service to a customer for which the entity has already received payment (or payment is due) from the customer. The Company's noninterest revenue streams are largely based on transactional activity, or standard month-end revenue accruals such as asset management fees based on month-end market values. Consideration is often received immediately or shortly after the Company satisfies its performance obligation and revenue is recognized. The Company does not typically enter into long-term revenue contracts with customers, and therefore, does not experience significant contract balances. As of September 30, 2019 and December 31, 2018, the Company did not have any significant contract balances.

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 about 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 and Item 1A of Part I of the Annual Report of Shore Bancshares, Inc. on Form 10-K for the year ended December 31, 2018 (the "2018 Annual 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 elsewhere in this report, as well as the audited consolidated financial statements and related notes included in the 2018 Annual Report.

Shore Bancshares, Inc. is the largest independent financial holding company headquartered on the Eastern Shore of Maryland. It is the parent company of Shore United Bank. The Bank operates 21 full service branches in Baltimore County, Howard County, Kent County, Queen Anne's County, Talbot County, Caroline County and Dorchester County in Maryland, Kent County, Delaware and Accomack County, Virginia. The Company engages in the trust services business through the trust department at Shore United Bank under the trade name Wye Financial & Trust.

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.shorebancshares.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

The Company's consolidated financial statements are prepared in accordance with GAAP and follow general practices within the industries in which it operates. Application of these principles requires management to make estimates, assumptions, and judgments that affect the amounts reported in the financial statements and accompanying notes. These estimates, assumptions, and judgments are based on information available as of the date of the financial statements; accordingly, as this information changes, the financial statements could reflect different estimates, assumptions, and judgments. Certain policies inherently have a greater reliance on the use of estimates, assumptions, and judgments and as such have a greater possibility of producing results that could be materially different than originally reported. Estimates, assumptions, and judgments are necessary when assets and liabilities are required to be recorded at fair value, when a decline in the value of an asset not carried on the financial statements at fair value warrants an impairment write-down or valuation reserve to be established, or when an asset or liability needs to be recorded contingent upon a future event. Carrying assets and liabilities at fair value inherently results in more financial statement volatility.

The fair values and the information used to record valuation adjustments for certain assets and liabilities are based on quoted market prices, collateral value or are provided by other third-party sources, when available.

The most significant accounting policies that the Company follows are presented in Note 1 of the 2018 Annual Report. These policies, along with the disclosures presented in the notes to the financial statements and in this discussion, provide information on how significant assets and liabilities are valued in the financial statements and how those values are determined. Based on the valuation techniques used and the sensitivity of financial statement amounts to the methods, assumptions, and estimates underlying those amounts, management has determined that the accounting policies with respect to the allowance for credit losses, goodwill and other intangible assets, deferred tax assets, and fair value are critical accounting policies. These policies are considered critical because they relate to accounting areas that require the most subjective or complex judgments, and, as such, could be most subject to revision as new information becomes available.

The allowance for credit losses represents management's estimate of credit losses inherent in the loan portfolio as of the balance sheet date. Determining the amount of the allowance for credit losses is considered a critical accounting estimate because it requires significant judgment and the use of estimates related to the amount and timing of expected future cash flows on impaired loans, estimated losses on pools of homogeneous loans based on historical loss experience, and consideration of current economic trends and conditions, all of which may be susceptible to significant change. The loan portfolio also represents the largest asset type on the consolidated balance sheets. Note 1 of the 2018 Annual Report describes the methodology used to determine the allowance for credit losses. A discussion of the factors driving changes in the amount of the allowance for credit losses is included in the Asset Quality - Provision for Credit Losses and Risk Management section below.

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 are required to be recorded at fair value at inception. Determining fair value is subjective, requiring the use of estimates, assumptions and management judgment. Goodwill and other intangible assets with indefinite lives are tested at least annually for impairment, usually during the first 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. At the present time the Company only has one reporting unit, the Bank. If the fair value of the Bank is less than book value, an expense may be required to write down the related goodwill or purchased intangibles to record an impairment loss.

Deferred tax assets and liabilities are determined by applying the applicable federal and state income tax rates to cumulative temporary differences. These temporary differences represent differences between financial statement carrying amounts and the corresponding tax bases of certain assets and liabilities. Deferred taxes result from such temporary differences. A valuation allowance, if needed, reduces deferred tax assets to the expected amount most likely to be realized. Realization of deferred tax assets is dependent on the generation of a sufficient level of future taxable income, recoverable taxes paid in prior years and tax planning strategies. The Company evaluates all positive and negative evidence before determining if a valuation allowance is deemed necessary regarding the realization of deferred tax assets.

The Company measures certain financial assets and liabilities at fair value, with the measurements made on a recurring or nonrecurring basis. Significant financial instruments measured at fair value on a recurring basis are investment securities. Impaired loans and other real estate owned are significant financial instruments measured at fair value on a nonrecurring basis. Fair value is defined 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. In determining fair value, the Company is required to maximize the use of observable inputs and minimize the use of unobservable inputs, reducing subjectivity.

OVERVIEW

The Company reported net income of $4.2 million for the third and second quarters of 2019, or diluted income per common share of $0.33, compared to net income of $4.5 million, or diluted income per common share of $0.35, for the third quarter of 2018. Net income from continuing operations for the third and second quarter of 2019 was $4.2 million or $0.33 per diluted common share, compared to net income from continuing operations of $4.3 million or $0.33 per diluted common share for the third quarter of 2018. When comparing net income from continuing operations for the third quarter of 2019 to the third quarter of 2018, the slightly lower net income was primarily due to an increase in interest expense on deposits, partially, offset by increases in interest income and noninterest income, coupled with a decrease in the provision for credit losses. When comparing net income from continuing operations for the third quarter of 2019 to the second quarter of 2019, the stable results were primarily attributable to an increase in net interest income, offset by a decrease in noninterest income and higher noninterest expenses.

For the first nine months of 2019, the Company reported net income of $12.2 million, or diluted income per common share of $0.95, compared to net income of $12.9 million, or diluted income per common share of $1.01, for the first nine months of 2018. Net income from continuing operations for the first nine months of 2019 was $12.3 million, or 0.96 per diluted common share, compared to net income from continuing operations of $11.9 million or $0.93 per diluted common share for the first nine months of 2018. When comparing net income from continuing operations for the first nine months of 2019 to the first nine months of 2018, the improved results were due to higher noninterest income coupled with a reduction in the provision for credit losses, partially offset by an increase in interest expense and to a lesser degree, noninterest expense.

RESULTS OF OPERATIONS

Net Interest Income

Tax-equivalent net interest income is net interest income adjusted for the tax-favored status of income from certain loans and investments. As shown in the table below, tax-equivalent net interest income was $12.7 million for the third quarter of 2019 and $13.0 million for the third quarter of 2018. Tax-equivalent net interest income was $12.3 million for the second quarter of 2019. The decrease in net interest income for the third quarter of 2019 when compared to the third quarter of 2018 was primarily due to an increase in interest expense, primarily interest on deposits of $1.5 million, or 177.0%. The increase in interest expense for the third quarter of 2019 was partially offset by higher interest income and fees on loans of $895 thousand, or 6.8%. Net interest income increased for the third quarter of 2019 when compared to the second quarter of 2019 due to higher interest income and fees on loans of $351 thousand, or 2.6% and interest on deposits with other banks of $110 thousand, or 97.3%. Net interest margin is tax-equivalent net interest income (annualized) divided by average earning assets. The net interest margin for the third quarter of 2019 was 3.52%, which is a decrease of 24 basis points (bps) when compared to 3.76% for the third quarter of 2018 and a decrease of 2bps when compared to 3.54% for the second quarter of 2019.

Interest Income

On a tax-equivalent basis, interest income increased $974 thousand, or 6.8%, for the third quarter of 2019 when compared to the third quarter of 2018. The increase was due to a $895 thousand, or 6.8%, increase in interest income and fees on loans, primarily the result of the increase in the average balance of loans of $60.9 million, or 5.2%. The average yield on loans increased 7bps from the comparable quarter in 2018. Interest on interest-bearing deposits with other banks increased $139 thousand, or 165.5% due to increased average balances as well as an increase in the average yield on these deposits of 22bps. Interest on investment securities decreased $77 thousand, or 8.1%, due to a decrease in the average balance of investment securities of $23.2 million, or 13.0% which was used to fund loan growth between the comparable quarters.

On a tax-equivalent basis, interest income increased $448 thousand, or 3.0%, for the third quarter of 2019 when compared to the second quarter of 2019. The increase was primarily due to an increase in interest income and fees on loans of $355 thousand, or 2.6%, primarily the result of an increase in the average balance on loans of $14.2 million, or 1.2%. Also, attributing to the higher interest income was interest-bearing deposits with other banks which increased $110 thousand, or 97.3%, which was impacted by higher average balances of $23.2 million, or 126.8%. Partially offsetting these increases in interest income was reduced income on taxable investment securities of $17 thousand, or 1.9%, which was impacted by lower average balances of $4.6 million, or 2.8%.

Interest Expense

Interest expense increased $1.2 million, or 95.0%, when comparing the third quarter of 2019 to the third quarter of 2018. The increase in interest expense was due to an increase in the rates paid on interest-bearing deposits of 62bps and a $61.7 million increase in average balances, which resulted in $1.5 million of additional interest expense. The addition of long-term borrowings resulted in additional interest expense of $108 thousand, partially offset by a decrease in the average balance of short-term borrowings of $70.2 million, or 79.8%. The average balance of interest-bearing deposits increased $61.7 million, or 7.1%, which was a positive transition from higher rates paid on short-term borrowings and a more sustainable approach for funding long-term loan growth. The average balance of noninterest-bearing deposits increased $25.5 million, or 7.8% between the comparable quarters.

Interest expense increased $57 thousand, or 2.3%, when comparing the third quarter of 2019 to the second quarter of 2019. The increase in interest expense was due to an increase in the average balance of interest-bearing deposits of $30.8 million, or 3.4%. This increase provided the opportunity for the Company to pay-down short-term borrowings resulting in a decrease in the average balance of $3.8 million, or 17.8%. The average balance of noninterest-bearing deposits increased $15.3 million, or 4.5% when compared to the second quarter of 2019.

The following tables presents the distribution of the average consolidated balance sheets, interest income/expense, and annualized yields earned and rates paid for the three months ended September 30, 2019 and 2018.

	For Three Months Ended September 30, 2019			For Three Months Ended September 30, 2018		
(Dollars in thousands)	**Average Balance**	**Income(1)/ Expense**	**Yield/ Rate**	Average Balance	Income(1)/ Expense	Yield/ Rate
Earning assets						
Loans (2), (3)	**$ 1,235,374**	**$ 14,144**	**4.54 %**	$ 1,174,513	$ 13,233	4.47 %
Investment securities:						
Taxable	**155,324**	**870**	**2.24**	178,572	947	2.12
Interest-bearing deposits	**41,554**	**223**	**2.13**	17,488	84	1.91
Total earning assets	**1,432,252**	**15,237**	**4.22 %**	1,370,573	14,264	4.13 %
Cash and due from banks	**18,127**			17,790		
Other assets	**73,823**			79,065		
Allowance for credit losses	**(10,412)**			(10,354)		
Total assets	**$ 1,513,790**			$ 1,457,074		
Interest-bearing liabilities						
Demand deposits	**$ 252,386**	**447**	**0.70 %**	$ 221,905	178	0.32 %
Money market and savings deposits	**389,268**	**657**	**0.67**	373,357	132	0.14
Brokered Deposits	**14,568**	**84**	**2.29**	25,507	138	2.01
Certificates of deposit $100,000 or more	**119,200**	**537**	**1.78**	97,563	170	0.69
Other time deposits	**149,708**	**563**	**1.49**	145,130	208	0.57
Interest-bearing deposits	**925,130**	**2,288**	**0.98**	863,462	826	0.36
Short-term borrowings	**17,729**	**117**	**2.64**	87,925	463	2.09
Long-term debt	**15,000**	**108**	**2.86**	—	—	—
Total interest-bearing liabilities	**957,859**	**2,513**	**1.04 %**	951,387	1,289	0.52 %
Noninterest-bearing deposits	**354,927**			329,383		
Other liabilities	**7,884**			6,005		
Stockholders' equity	**193,120**			170,299		
Total liabilities and stockholders' equity	**$ 1,513,790**			$ 1,457,074		
Net interest spread		**$ 12,724**	**3.18 %**		$ 12,975	3.61 %
Net interest margin			**3.52 %**			3.76 %
Tax-equivalent adjustment						
Loans		**$ 44**			$ 28	
Total		**$ 44**			$ 28	

(1) All amounts are reported on a tax-equivalent basis computed using the statutory federal income tax rate of 21.0%, exclusive of nondeductible interest expense.
(2) Average loan balances include nonaccrual loans.
(3) Interest income on loans includes amortized loan fees, net of costs, and accretion of discounts on acquired loans, which are included in the yield calculations.

Net Interest Income

Tax-equivalent net interest income decreased $507 thousand, or 1.3%, during the nine months ended September 30, 2019 compared to the nine months ended September 30, 2018. The decrease in net interest income was primarily due to an increase in interest expense on interest-bearing deposits of $4.5 million, or 229.5%, partially offset by an increase in interest income from earning assets of $3.6 million, or 8.8%. This resulted in a net interest margin of 3.56% for the nine months ended September 30, 2019 compared to 3.79% for the nine months ended September 30, 2018.

Interest Income

On a tax-equivalent basis, interest income increased $3.6 million, or 8.8%, for the nine months ended September 30, 2019 when compared to the nine months ended September 30, 2018. The increase was primarily due to a $3.5 million, or 9.2%, increase in interest income and fees on loans. The average balance on loans increased $78.7 million, or 6.9%, while the yield on these loans expanded 10bps. In addition, interest income from interest-bearing deposits with other banks increased

$316 thousand, or 172.7%, due to a higher average balance of $15.7 million, or 116.2% and a 48bps increase in yield on these deposits. This was partially offset by a decrease in interest income on investment securities of $195 thousand, or 6.6%, primarily due to a decrease in the average balance of these investments of $26.9 million, or 14.4%, which was used to fund loan growth between the comparable periods.

Interest Expense

Interest expense increased $4.1 million, or 133.1%, when comparing the nine months ended September 30, 2019 to the nine months ended September 30, 2018. The increase in interest expense was due to the increase in the average balance of interest-bearing deposits of $49.7 million, or 5.8%, and the average rate paid on these deposits of 66bps. This added $4.5 million in additional interest expense when comparing the first nine months of 2019 to the first nine months of 2018. The addition of long-term borrowings of $15.0 million was offset by a decrease in the average balance of short-term borrowings of $54.9 million, or 69.6% which decreased the dependence on outside funding sources which carry a higher rate than core deposits.

The following tables present the distribution of the average consolidated balance sheets, interest income/expense, and annualized yields earned and rates paid for the nine months ended September 30, 2019 and 2018.

	For Nine Months Ended September 30, 2019			For Nine Months Ended September 30, 2018		
(Dollars in thousands)	**Average Balance**	**Income(1)/ Expense**	**Yield/ Rate**	Average Balance	Income(1)/ Expense	Yield/ Rate
Earning assets						
Loans (2), (3)	**$ 1,219,623**	**$ 41,467**	**4.55 %**	$ 1,140,925	$ 37,964	4.45 %
Investment securities:						
Taxable	**160,035**	**2,755**	**2.30**	186,936	2,950	2.10
Interest-bearing deposits	**29,279**	**499**	**2.28**	13,542	183	1.80
Total earning assets	**1,408,937**	**44,721**	**4.24 %**	1,341,403	41,097	4.10 %
Cash and due from banks	**17,520**			17,031		
Other assets	**64,775**			78,243		
Allowance for credit losses	**(10,419)**			(10,173)		
Total assets	**$ 1,480,813**			$ 1,426,504		
Interest-bearing liabilities						
Demand deposits	**$ 242,364**	**1,188**	**0.66 %**	$ 214,317	411	0.26 %
Money market and savings deposits	**386,113**	**2,267**	**0.79**	378,404	376	0.13
Brokered Deposits	**19,144**	**344**	**2.40**	12,157	190	2.09
Certificates of deposit $100,000 or more	**108,504**	**1,251**	**1.54**	98,772	425	0.58
Other time deposits	**145,381**	**1,389**	**1.28**	148,107	552	0.50
Interest-bearing deposits	**901,506**	**6,439**	**0.96**	851,757	1,954	0.30
Short-term borrowings	**24,034**	**475**	**2.64**	78,945	1,150	1.95
Long-term debt	**15,000**	**321**	**2.86**	—	—	—
Total interest-bearing liabilities	**940,540**	**7,235**	**1.03 %**	930,702	3,104	0.44 %
Noninterest-bearing deposits	**341,966**			322,748		
Other liabilities	**9,213**			5,766		
Stockholders' equity	**189,094**			167,288		
Total liabilities and stockholders' equity	**$ 1,480,813**			$ 1,426,504		
Net interest spread		**$ 37,486**	**3.21 %**		$ 37,993	3.66 %
Net interest margin			**3.56 %**			3.79 %
Tax-equivalent adjustment						
Loans		**$ 119**			$ 84	
Total		**$ 119**			$ 84	

(1) All amounts are reported on a tax-equivalent basis computed using the statutory federal income tax rate of 21.0%, exclusive of nondeductible interest expense.

(2) Average loan balances include nonaccrual loans.

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

Noninterest Income

Total noninterest income from continuing operations for the third quarter of 2019 increased $64 thousand, or 2.6%, when compared to the third quarter of 2018. The increase from the third quarter of 2018 was mainly due to increases in other fees on bank services and loan fee income of $56 thousand. Noninterest income from continuing operations decreased $80 thousand, or 3.1%, when compared to the second quarter of 2019 mainly due to lower loan fee income and service charges on deposit accounts.

Total noninterest income from continuing operations for the nine months ended September 30, 2019 increased $425 thousand, or 6.2%, when compared to the same period in 2018. The increase in noninterest income primarily consisted of increases in other fees on bank services of $375 thousand and service charges on deposit accounts of $118 thousand, partially offset by a decrease in trust and investment income of $57 thousand.

Noninterest Expense

Total noninterest expense from continuing operations for the third quarter of 2019 increased $74 thousand, or less than 1%, when compared to the third quarter of 2018. The increase in noninterest expense for the third quarter of 2019 compared to the third quarter of 2018 was primarily due to higher employee benefit costs of $316 thousand and other expenses which included advertising, education and recruiting of $275 thousand, which were largely offset by decreases in salaries and wages of $356 thousand and a decrease in the FDIC insurance premium expense due to an FDIC assessment credit for banks under $10 billion. The decrease in salaries and wages was due to the termination of the 2020 Long-Term Incentive Plan and the absence of the former president of the Bank's salary. The increase in total noninterest expenses from continuing operations when compared to the second quarter of 2019 was primarily due to higher employee benefits, which included the funding of a new supplemental executive retirement plan, a write-down on an other real estate owned property and other loan expenses, partially offset by the FDIC assessment credit.

Total noninterest expense from continuing operations for the nine months ended September 30, 2019 increased $97 thousand, or less than 1%, when compared to the same period in 2018. Despite the minimal increase in total noninterest expenses from continuing operations, several expense line items experienced significant variances. The significant increases in noninterest expenses were the following: Employee benefits of $417 thousand, primarily due to a newly implemented supplemental executive retirement plan and higher health insurance accrual, data processing fees of $314 thousand, partially due to a Microsoft software renewal, other real estate owned expenses, net of $301 thousand, legal and professional fees of $277 thousand, which was due to increases in third party loan reviews and a one-time board consultant fee, and furniture and fixtures of $107 thousand. The significant decreases in noninterest expense were the following: Salaries and wages of $1.1 million, FDIC insurance premium expense of $226 thousand and $69 thousand in directors' fees.

Provision for Credit Losses

The provision for credit losses was $200 thousand for the third and second quarters of 2019 and $307 thousand for the third quarter of 2018. The lower level of provision for credit losses when comparing the third quarter of 2019 to the third quarter of 2018 was due primarily to lower loan growth in the third quarter of 2019. The provision for credit losses remained flat between the third and second quarter of 2019 due to stagnant loan growth. Net charge-offs were $67 thousand for the third quarter of 2019, $100 thousand for the third quarter of 2018 and $313 thousand for the second quarter of 2019. The relatively stable net-charge offs between the third quarter of 2019 and the third quarter of 2018 was due to minimal issues with problem credits. The decrease in net charge-offs in the third quarter of 2019 when compared to the second quarter of 2019 was primarily due to the sale of real estate securing specific loans at a foreclosure auction, which resulted in additional charge-offs during the second quarter of 2019. Total nonperforming assets at September 30, 2019 increased $3.1 million when compared to September 30, 2018, which was due to a nonaccrual loan added late in the fourth quarter of 2018, in which the Company does not anticipate any further losses. Total nonperforming assets when compared to the second quarter of 2019 decreased $2.2 million, due to decreases in nonaccrual loans of $2.1 million and other real estate owned of $450 thousand, partially offset by an increase in loans 90 days past due and still accruing of $273 thousand. The ratio of annualized net charge-offs to average loans was 0.02% for the third quarter of 2019, 0.03% for the third quarter of 2018 and 0.10% for the second quarter of 2019.

The provision for credit losses for the nine months ended September 30, 2019 and 2018 was $500 thousand and $1.2 million, respectively, while net charge-offs were $405 thousand and $667 thousand, respectively. The decrease in provision for credit losses was the result of improved overall credit quality exclusive of one large nonaccrual loan with an outstanding loan balance of $7.5 million added late in the fourth quarter of 2018. The Company does not currently expect to incure any further losses on this loan. Additionally, the decrease in provision for credit losses for the first nine months of 2019 when compared to the first nine months of 2018 was impacted by lower loan growth and lower net charge-offs in 2019. The ratio of annualized net charge-offs to average loans was 0.04% for the first nine months of September 30, 2019 and 0.08% for the same period in 2018.

Income Taxes

The Company reported income tax expense from continuing operations of $1.4 million for the third quarter of 2019, $1.5 million for the third quarter of 2018 and $1.5 million for the second quarter of 2019. Income tax expense decreased when compared to the third quarter of 2018 due to slightly lower pre-tax earnings. Income tax expense remained relatively flat when compared to the second quarter of 2019 due to a comparable level of pre-tax earnings. The effective tax rate on continuing operations was 25.1% for the third quarter of 2019, 26.6% for the third quarter of 2018 and 26.0% for the second quarter of 2019. The effective tax rates for the nine months ended 2019 and 2018 were 25.6% and 25.5%, respectively. Income taxes from continuing operations for the nine months ended September 30, 2019 increased $140 thousand or 3.4%, due to an increase in pre-tax earnings.

ANALYSIS OF FINANCIAL CONDITION

Loans

Loans totaled $1.235 billion at September 30, 2019 and $1.195 billion at December 31, 2018, an increase of $39.7 million, or 3.3%. The increase was primarily due to organic growth of $35.3 million in commercial real estate loans, $12.8 million in residential real estate loans and $4.7 million in consumer loans. Loans included deferred costs, net of deferred fees, of $1.5 million and discounts on acquired loans of $1.1 million at September 30, 2019, compared to $789 thousand and $1.4 million, respectively, at December 31, 2018. We do not engage in foreign or subprime lending activities. See Note 5, “Loans and Allowance for Credit Losses”, in the Notes to Consolidated Financial Statements and below under the caption “Allowance for Credit Losses” for additional information.

Our loan portfolio has a commercial real estate loan concentration, which is generally defined as a combination of certain construction and commercial real estate loans. Construction loans were $116.4 million, or 9.4% of total loans, at September 30, 2019 and $127.6 million, or 10.7% of total loans at December 31, 2018. Commercial real estate loans were $558.7 million, or 45.2% of total loans, at September 30, 2019, compared to $523.4 million, or 43.8% of total loans, at December 31, 2018.

The federal banking regulators have issued guidance for those institutions which are deemed to have concentrations in commercial real estate lending. Pursuant to the supervisory criteria contained in the guidance for identifying institutions with a potential commercial real estate concentration risk, institutions which have (1) total reported loans for construction, land development, and other land acquisitions which represent 100% or more of an institution’s total risk-based capital; or (2) total non-owner occupied commercial real estate loans representing 300% or more of the institution’s total risk-based capital and the institution’s non-owner occupied commercial real estate loan portfolio (including construction) has increased 50% or more during the prior 36 months are identified as having potential commercial real estate concentration risk. Institutions which are deemed to have concentrations in commercial real estate lending are expected to employ heightened levels of risk management with respect to their commercial real estate portfolios, and may be required to hold higher levels of capital. The Company, like many community banks, has a concentration in commercial real estate loans, and the Company has experienced significant growth in its commercial real estate portfolio in recent years. At September 30, 2019, non-owner-occupied commercial real estate loans (including construction, land and land development loans) represented 276.0% of total risk-based capital. At such time, construction, land and land development loans represented 68.6% of total risk-based capital.

The commercial real estate portfolio (including construction) has increased 91.6% during the prior 36 months. Management has extensive experience in commercial real estate lending, and has implemented and continues to maintain heightened risk management procedures, as well as strong underwriting criteria with respect to its commercial real estate portfolio. Monitoring practices include periodic stress testing analysis to evaluate changes to cash flows, owing to interest rate increases and declines in net operating income. We may be required to maintain higher levels of capital as a result of our commercial real estate concentrations, which could require us to obtain additional capital or be required to sell/participate portions of loans, which may adversely affect shareholder returns.

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 loans and is decreased by current period charge-offs of uncollectible loans. Management evaluates the adequacy of the allowance for credit losses at least quarterly and adjusts the provision for credit losses based on this analysis. The evaluation of the adequacy of the allowance for credit losses is based primarily on a risk rating system of individual loans, as well as on a collective evaluation of smaller balance homogenous loans, each grouped by loan type. Each loan type is assigned allowance factors based on criteria such as past credit loss experience, local economic and industry trends, and other measures which may impact collectability. Please refer to the discussion above under the caption “Critical Accounting Policies” for an overview of the underlying methodology management employs to maintain the allowance.

Net charge-offs were $67 thousand for the third quarter of 2019, $100 thousand for the third quarter of 2018 and $313 thousand for the second quarter of 2019. Management remains focused on its efforts to dispose of problem loans and to prudently charge-off nonperforming loans to enable the Company to continue to improve its overall credit quality. Total past due loans were $9.7 million for the third quarter of 2019 when compared to $3.9 million at December 31, 2018. The increase in past due loans is due to timing of collections and is not indicative of a negative trend for credit quality. In addition, loans classified as pass/watch and substandard of $173.5 million and $18.3 million for the third quarter of 2019 declined from $194.5 million and $24.6 million at December 31, 2018 which also contributed to the improved credit quality of the loan portfolio. The allowance for credit losses as a percentage of period-end loans was 0.85% at September 30, 2019, and 0.87% at both September 30, 2018 and December 31, 2018. Management believes that the provision for credit losses and the resulting allowance was adequate to provide for probable losses inherent in our loan portfolio at September 30, 2019.

The following table presents a summary of the activity in the allowance for credit losses at or for the three and nine months ended September 30, 2019 and 2018.

	At or for Three Months Ended September 30,		At or for Nine Months Ended September 30,	
(Dollars in thousands)	**2019**	2018	**2019**	2018
Allowance balance - beginning of period	**$ 10,305**	$ 10,121	**$ 10,343**	$ 9,781
Charge-offs:				
Construction	**—**	—	**(3)**	(379)
Residential real estate	**(86)**	(109)	**(509)**	(288)
Commercial real estate	**—**	—	**—**	—
Commercial	**(98)**	(137)	**(260)**	(263)
Consumer	**—**	—	**(29)**	(24)
Total	**(184)**	(246)	**(801)**	(954)
Recoveries:				
Construction	**1**	3	**8**	18
Residential real estate	**12**	5	**23**	91
Commercial real estate	**7**	5	**114**	23
Commercial	**96**	122	**248**	144
Consumer	**1**	11	**3**	11
Totals	**117**	146	**396**	287
Net charge-offs	**(67)**	(100)	**(405)**	(667)
Provision for credit losses	**200**	307	**500**	1,214
Allowance balance - end of period	**$ 10,438**	$ 10,328	**$ 10,438**	$ 10,328
Average loans outstanding during the period	**$1,235,374**	$1,174,513	**$1,219,623**	$1,140,925
Net charge-offs (annualized) as a percentage of average loans outstanding during the period	**0.02 %**	0.03 %	**0.04 %**	0.08 %
Allowance for credit losses at period end as a percentage of total period end loans	**0.85 %**	0.87 %	**0.85 %**	0.87 %

Nonperforming Assets and Accruing TDRs

As shown in the following table, nonperforming assets decreased $4.7 million to $13.3 million at September 30, 2019 from $18.0 million at December 31, 2018, primarily due to a decrease in nonaccrual loans of $4.1 million, or 24.8%. Accruing TDRs decreased $1.1 million to $7.6 million at September 30, 2019 from $8.7 million at December 31, 2018. Additionally, other real estate owned decreased $1.1 million, or 94.0% when compared to December 31, 2018. The decrease in nonaccrual loans was due to two residential relationships in which the collateral was sold by the borrower and the loans were subsequently paid off. The decrease in accruing TDRs was due to normal payments and one payoff of $353 thousand. The ratio of nonaccrual loans and accruing TDRs to total loans decreased to 1.63% at September 30, 2019 from 2.12% at December 31, 2018.

The Company continues to focus on the resolution of its nonperforming and problem assets. The efforts to accomplish this goal include frequently contacting borrowers until the delinquency is cured or until an acceptable payment plan has been agreed upon; obtaining updated appraisals; provisioning for credit losses; charging-off loans; transferring loans to other real estate owned; aggressively marketing other real estate owned. The reduction of nonperforming and problem assets is and will continue to be a high priority for the Company.

The following table summarizes our nonperforming assets and accruing TDRs at September 30, 2019 and December 31, 2018.

(Dollars in thousands)	September 30, 2019	December 31, 2018
Nonperforming assets		
Nonaccrual loans		
Construction	$ —	$ 2,842
Residential real estate	2,059	4,099
Commercial real estate	10,163	9,374
Commercial	308	340
Consumer	—	—
Total nonaccrual loans	12,530	16,655
Loans 90 days or more past due and still accruing		
Construction	—	—
Residential real estate	584	139
Commercial real estate	—	—
Commercial	128	—
Consumer	—	—
Total loans 90 days or more past due and still accruing	712	139
Other real estate owned	74	1,222
Total nonperforming assets	$ 13,316	$ 18,016
Accruing TDRs		
Construction	$ 43	$ 51
Residential real estate	4,069	4,454
Commercial real estate	3,476	4,158
Commercial	—	—
Consumer	—	—
Total accruing TDRs	$ 7,588	$ 8,663
Total nonperforming assets and accruing TDRs	$ 20,904	$ 26,679
As a percent of total loans:		
Nonaccrual loans	1.01 %	1.39 %
Accruing TDRs	0.61 %	0.72 %
Nonaccrual loans and accruing TDRs	1.63 %	2.12 %
As a percent of total loans and other real estate owned:		
Nonperforming assets	1.08 %	1.51 %
Nonperforming assets and accruing TDRs	1.69 %	2.23 %
As a percent of total assets:		
Nonaccrual loans	0.80 %	1.12 %
Nonperforming assets	0.85 %	1.21 %
Accruing TDRs	0.49 %	0.58 %
Nonperforming assets and accruing TDRs	1.34 %	1.80 %

Investment Securities

The investment portfolio is comprised of debt securities that are classified either available for sale or held to maturity. Investment securities available for sale are stated at estimated fair value based on quoted prices. They represent securities which may be sold as part of the asset/liability management strategy or in response to changing interest rates. Net unrealized holding gains and losses on these securities are reported net of related income taxes as accumulated other comprehensive income (loss), a separate component of stockholders' equity.

Investment securities in the held to maturity category are stated at cost adjusted for amortization of premiums and accretion of discounts. We have the intent and current ability to hold such securities until maturity. At September 30, 2019, 93.5% of the portfolio of debt securities was classified as available for sale and 6.5% was classified as held to maturity, compared to 96.3% and 3.7% respectively, at December 31, 2018. See Note 4 – "Investment Securities", in the Notes to Consolidated Financial Statements for additional details on the composition of our investment portfolio.

Investment securities including restricted stock totaled $154.7 million at September 30, 2019, a $13.5 million, or 8.1%, decrease since December 31, 2018. The decrease was due to the roll-off of investment securities, the proceeds of which were redeployed to fund loan growth during the first nine months of 2019. At September 30, 2019, 75.6% of the securities available for sale were mortgage-backed and 24.4% were U.S. Government agencies, compared to 78.2% and 21.8%, respectively, at year-end 2018. Our investments in mortgage-backed securities are issued or guaranteed by U.S. Government agencies or government-sponsored agencies.

Deposits

Total deposits at September 30, 2019 totaled $1.3 billion, an increase of $113.2 million, or 9.3% when compared to the level at December 31, 2018. The increase in total deposits primarily consisted of increases in interest-bearing checking deposits of $48.7 million, noninterest-bearing deposits of $32.1 million, time deposits greater than $100 thousand of $25.2 million, other time deposits of $8.8 million and savings and money market accounts of $8.3 million, partially offset by a decrease in brokered deposits of $10.0 million. The Company has continued its efforts in 2019 to focus on growing core deposits as an alternative to short-term borrowings for funding loan growth.

Short-Term Borrowings

Short-term borrowings decreased by $43.5 million, or 71.6%, to $17.3 million at September 30, 2019 when compared to December 31, 2018. The decrease in short-term borrowings was the result of utilizing cash received from the sale of the Company's former insurance subsidiary on December 31, 2018 as well as growth in core deposits. Short-term borrowings generally consist of securities sold under agreements to repurchase, which are issued in conjunction with cash management services for commercial depositors, 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 September 30, 2019 and December 31, 2018, short-term borrowings consisted of borrowings from the FHLB and repurchase agreements.

Long-Term Debt

The Company uses long-term borrowings to meet longer term liquidity needs, specifically to fund loan growth when liquidity from deposit growth is not sufficient. The Company had $15.0 million outstanding at September 30, 2019 and December 31, 2018. The $15.0 million in fixed rate long-term borrowings from the FHLB carries an interest rate of 2.82% and will mature in April 2020.

Liquidity and Capital Resources

We derive liquidity through increased customer deposits, non-reinvestment of the cash flow from the investment portfolio, loan repayments, borrowings and income from earning assets. As seen in the Consolidated Statements of Cash Flows in the Financial Statements, the net increase in cash and cash equivalents was $36.1 million for the first nine months of 2019 compared to an increase of $17.0 million for the first nine months of 2018. The increase in cash and cash equivalents in 2019 was mainly due to an increase in total deposits of $113.2 million along with cash received from the sale of its formerly owned subsidiary, Avon-Dixon, for $25.2 million in net cash proceeds.

To the extent that deposits are not adequate to fund customer loan demand, liquidity needs can be met in the short-term fund markets. The Bank has arrangements with other corresponding banks whereby it has $15 million available in federal funds lines of credit and a reverse repurchase agreement available to meet any short-term needs which may not otherwise be funded by the Bank's portfolio of readily marketable investments that can be converted to cash. The Bank is also a member of the FHLB, which provides another source of liquidity. Through the FHLB, the Bank had credit availability of approximately $243.6 million and $154.7 million at September 30, 2019 and December 31, 2018, respectively. The Bank has pledged, under a blanket lien, all qualifying residential and commercial real estate 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 increased $10.8 million to $194.0 million at September 30, 2019 when compared to December 31, 2018 primarily due to current year's earnings and a change in accumulated other comprehensive income of $3.0 million, or 101.1%.

CBLR

On September 17, 2019, the FDIC finalized a rule that introduces an optional simplified measure of capital adequacy for qualifying community banking organizations (i.e., the community bank leverage ratio (CBLR) framework), as required by the Economic Growth, Regulatory Relief and Consumer Protection Act. The CBLR framework is designed to reduce burden by removing the requirements for calculating and reporting risk-based capital ratios for qualifying community banking organizations that opt into the framework.

In order to qualify for the CBLR framework, a community banking organization must have a tier 1 leverage ratio of greater than 9 percent, less than $10 billion in total consolidated assets, and limited amounts of off-balance-sheet exposures and trading assets and liabilities. A qualifying community banking organization that opts into the CBLR framework and meets all requirements under the framework will be considered to have met the well-capitalized ratio requirements under the Prompt Corrective Action regulations and will not be required to report or calculate risk-based capital.

The CBLR framework will be available for banks to use in their March 31, 2020, Call Report. The Company is currently evaluating whether to opt into the CBLR framework.

Basel III

Under final FRB and FDIC approved rules implementing the Basel Committee on Banking Supervision's capital guidelines for U.S. banks minimum requirements increased for both the quantity and quality of capital held by the Bank. The Basel III capital standards substantially revised the risk based capital requirements applicable to bank holding companies and their depository institution subsidiaries, including the definitions and the components of Tier 1 capital and Total Capital, the method of evaluating risk-weighted assets, institutions of a capital conservation buffer, and other matters affecting regulatory capital ratios. Strict eligibility criteria for regulatory capital instruments were also implemented under the rules.

The phase-in period for the final rules became effective for the Bank on January 1, 2015, with full compliance with all of the final rules' requirements phased in over a multi-year schedule, which was fully phased in on January 1, 2019. As of September 30, 2019, the Bank's capital levels remained characterized as "well-capitalized" under the new rules.

The following tables present the applicable capital ratios as of September 30, 2019 and December 31, 2018.

September 30, 2019	Tier 1 leverage ratio	Common Equity Tier 1 ratio	Tier 1 risk-based capital ratio	Total risk-based capital ratio
Shore United Bank	10.65 %	12.83 %	12.83 %	13.70 %

December 31, 2018	Tier 1 leverage ratio	Common Equity Tier 1 ratio	Tier 1 risk-based capital ratio	Total risk-based capital ratio
Shore United Bank	9.79 %	11.84 %	11.84 %	12.73 %

Item 3. Quantitative and Qualitative Disclosures about Market Risk.

Our primary market risk is 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 2018 Annual Report under the caption "Market Risk Management and Interest Sensitivity". 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, 2018.

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 principal executive officer ("PEO") and its 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 and procedures as of September 30, 2019 was carried out under the supervision and with the participation of management, including the PEO and the PAO. Based on that evaluation, the Company's management, including the PEO and the PAO, has concluded that our disclosure controls and procedures are, in fact, effective at the reasonable assurance level at September 30, 2019.

There was no change in our internal control over financial reporting during the third quarter of 2019 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II – OTHER INFORMATION

Item 1. Legal Proceedings

From time to time the Company may become involved in legal proceedings. At the present time, there are no proceedings which the Company believes will have a material adverse impact on the financial condition or earnings of the Company.

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 2018 Annual Report. Management does not believe that any material changes in our risk factors have occurred since they were last disclosed in our 2018 Annual Report.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

On April 24, 2019 the Corporation's Board of Directors approved a stock repurchase program. Under the stock repurchase program, the Corporation is authorized to repurchase up to $10 million, or approximately 5%, of its common stock for 2019 and 2020. The program may be limited or terminated at any time without prior notice. During the three months ended September 30, 2019, the Corporation repurchased 36,700 shares under the recently approved stock repurchase program.

The following table provides information with respect to purchases made by or on behalf of us or any "affiliated purchaser" (as defined in Rule 10b-18(a)(3) under the Exchange Act) of our common stock during the third quarter of 2019.

Period	Total Number Of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of the Publicly Announced Plans or Programs	Maximum Dollar Value Of Shares that May Yet Be Purchased Under the Plans or Programs
July 1, 2019 to July 31, 2019	—	$ —	—	$ 10,000,000
August 1, 2019 to August 31, 2019	29,900	15.21	29,900	9,545,138
September 1, 2019 to September 30, 2019	6,800	15.19	6,800	9,441,824
Total	36,700	$ 15.21	36,700	

Item 3. Defaults Upon Senior Securities

None

Item 4. Mine Safety Disclosures

Not Applicable

Item 5. Other Information

None

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.

EXHIBIT INDEX

Exhibit Number	Description
10.1	Supplemental Executive Retirement Plan for Lloyd L. Beatty, Jr. (Incorporated by reference to Exhibit 10.1 to the Company's Form 8-K filed on July 25, 2019).
10.2	Supplemental Executive Retirement Plan for Edward C. Allen (Incorporated by reference to Exhibit 10.2 to the Company's Form 8-K filed on July 25, 2019).
10.3	Supplemental Executive Retirement Plan for Donna J. Stevens (Incorporated by reference to Exhibit 10.3 to the Company's Form 8-K filed on July 25, 2019).
31.1	Certifications of the Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act (filed herewith).
31.2	Certifications of the Principal Accounting Officer pursuant to Section 302 of the Sarbanes-Oxley Act (filed herewith).
32	Certification pursuant to Section 906 of the Sarbanes-Oxley Act (furnished herewith).
101	Interactive Data File
101.INS	XBRL Instance Document (filed herewith)
101.SCH	XBRL Taxonomy Extension Schema (filed herewith)
101.CAL	XBRL Taxonomy Extension Calculation Linkbase (filed herewith)
101.DEF	XBRL Taxonomy Extension Definition Linkbase (filed herewith)
101.LAB	XBRL Taxonomy Extension Label Linkbase (filed herewith)
101.PRE	XBRL Taxonomy Extension Presentation Linkbase (filed herewith)

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: November 8, 2019	By: /s/ Lloyd L. Beatty, Jr. Lloyd L. Beatty, Jr. President & Chief Executive Officer (Principal Executive Officer)
Date: November 8, 2019	By: /s/ Edward C. Allen Edward C. Allen Executive Vice President & Chief Financial Officer (Principal Accounting Officer)

EXHIBIT 31.1

Certifications of the Principal Executive Officer
Pursuant to Securities Exchange Act Rules 13a-1 and 15d-14
As adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Lloyd L. Beatty, Jr., certify that:

1. I have reviewed this report on Form 10-Q of Shore Bancshares, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 8, 2019

By: /s/ Lloyd L. Beatty, Jr.
Lloyd L. Beatty, Jr.
President and Chief Executive Officer
(Principal Executive Officer)

EXHIBIT 31.2

Certifications of the Principal Accounting Officer
Pursuant to Securities Exchange Act Rules 13a-1 and 15d-14
As adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Edward C. Allen, certify that:

1. I have reviewed this report on Form 10-Q of Shore Bancshares, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 8, 2019

By: /s/ Edward C. Allen
Edward C. Allen
Executive Vice President and Chief Financial Officer
(Principal Financial Officer)

EXHIBIT 32

Certification of Periodic Report
Pursuant to 18 U.S.C. Section 1350
As adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Pursuant to, and for purposes only of, 18 U.S.C. § 1350, the undersigned hereby certify that (i) the Quarter Report of Shore Bancshares, Inc. on Form 10-Q for the Quarter ended September 30, 2019 filed with the Securities and Exchange Commission (the "Report") fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, and (ii) information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Shore Bancshares, Inc.

Date: November 8, 2019	/s/ Lloyd L. Beatty, Jr. Lloyd L. Beatty, Jr. President and Chief Executive Officer (Principal Executive Officer)
Date: November 8, 2019	/s/ Edward C. Allen Edward C. Allen Executive Vice President and Chief Financial Officer (Principal Financial Officer)