



Larry J. Miller
Vice Chairman, President and
Chief Executive Officer

August 1, 2014

Dear Shareholder,

We are pleased to report that Codorus Valley Bancorp, Inc.'s second quarter 2014 net income available to common shareholders (i.e., earnings) was \$2,755,000 or \$0.50 per share basic, \$0.49 per share diluted, compared to earnings of \$2,583,000 or \$0.55 per share basic, \$0.54 per share diluted, for the second quarter of 2013. For the first six months of 2014, earnings totaled \$5,696,000 or \$1.11 per share basic, \$1.08 per share diluted. Earnings per share were impacted by the 650,000 shares of common stock issued in March 2014 pursuant to the private placement as previously reported. Comparatively, the Corporation earned \$5,182,000 or \$1.10 per share basic, \$1.08 per share diluted, for the first six months of 2013.

Second quarter commentary

Highlights for the quarter ended June 30, 2014, include:

- Earnings for the current quarter increased \$172,000 or 7 percent above the second quarter of 2013, due to an increase in net interest income and a decrease in the provision for loan losses, which more than offset a decrease in noninterest income and increases in noninterest expense and income taxes.
- PeoplesBank recently purchased an office building located at 3100 Market Street, Camp Hill, PA (Cumberland County) to be used principally as a business banking center with a planned opening date in the fourth quarter of 2014.
- PeoplesBank recently received regulatory approval to construct a full service banking office in Shrewsbury, PA with groundbreaking to occur in August and a planned opening date in December 2014. The addition of the Shrewsbury and Camp Hill offices will result in 22 locations for PeoplesBank.
- In May, the Corporation redeemed \$13 million of the \$25 million in outstanding shares of preferred stock held by the United States Department of the Treasury under its Small Business Lending Fund Program. The redemption was funded primarily with approximately \$13 million the Corporation raised in a private placement of shares of its common stock earlier in the year.

Other news

On July 22, 2014, the Corporation and Madison Bancorp, Inc. (Madison) jointly announced the signing of a definitive merger agreement pursuant to which the Corporation will acquire Madison in an all-cash transaction valued at approximately \$14.4 million. Under the terms of the agreement, each Madison shareholder will receive cash at \$22.90 per share. The

acquisition serves to strengthen the Corporation's presence in the demographically attractive Harford and Baltimore Counties in Maryland and will provide its principal subsidiary, PeoplesBank, A Codorus Valley Company, with four new financial center locations, approximately \$140 million in assets, and \$130 million in deposits. Clients of both companies will now have access to a broader network of conveniently located financial centers and ATMs as well as expanded commercial and small business banking services, enhanced technology, and wealth management opportunities. Both companies have deep roots in the communities we serve, and together we intend to continue to play an important role in the growth and development of this region. It is anticipated that the transaction will be completed in the fourth quarter of 2014/first quarter of 2015, pending regulatory approvals, the approval of the shareholders of Madison, and the satisfaction of other closing conditions.

As recently announced, the Corporation's Board of Directors declared a regular quarterly cash dividend of \$0.125 per common share on July 8, 2014, payable on August 12, 2014, to shareholders of record at the close of business on July 22, 2014. This quarterly cash dividend is one half cent more than the previous two quarters' cash dividend. If you do not currently participate in the Company's Dividend Reinvestment and Stock Purchase Plan (DRSPP) but wish to enroll, you may contact the Company's plan advisor Wells Fargo Shareowner Services at 800-468-9716.

Review of operations

The \$514,000 or 10 percent increase in net income available to common shareholders for the six months ended June 30, 2014, compared to the six months ended June 30, 2013, was primarily the result of an increase in net interest income, which more than offset a decrease in noninterest income and increases in noninterest expense and provision for income taxes, as described below.

The \$2,257,000 or 12 percent increase in net interest income was due primarily to an increase in interest income and fees from an increase in the volume of earnings assets, principally commercial loans, and a decrease in funding costs. While the low interest rate environment lowered yields on earning assets it also lowered funding costs on deposit products and borrowings.

The provision for loan losses totaled \$850,000 for the first six months of 2014, which supported a larger loan portfolio and replenished the allowance for loan losses for net charge-offs totaling \$365,000. Comparatively, the provision totaled \$820,000 for the first six months of 2013 with net charge-offs totaling \$663,000.

The \$397,000 or 10 percent decrease in noninterest income for the current period, compared to the first six months of 2013, was primarily the result of decreases in net gains from the sale of loans held for sale and income from mutual fund, annuity and insurance sales. The \$459,000 or 72 percent decrease in net gains from the sale of loans held for sale (i.e., residential mortgage loans) reflects a sharp decrease in refinancing demand and higher mortgage interest rates. The \$97,000 or 23 percent decrease in income from mutual fund, annuity and insurance sales reflects a decrease in sales volume and loss of accounts as a result of staff resignations in the year 2013.

The \$1,224,000 or 8 percent increase in noninterest expense for the current period, compared to the first six months of 2013, was driven primarily by increases in personnel and marketing expenses. Personnel expense increased \$309,000 or 4 percent as a result of expanding the banking franchise in the year 2013 and normal business growth. Marketing expense increased \$320,000 or 80 percent primarily as a result of non-recurring costs to promote PeoplesBank's 150th year in business.

The \$103,000 or 5 percent increase in the provision for income taxes for the current period, compared to the first six months of 2013, was due to an 8 percent increase in income before income taxes. The current period provision includes a non-recurring \$171,000 decrease in federal income tax, which resulted from an increase in the net deferred tax asset account on the Corporation's balance sheet. The increase in the net deferred tax asset reflected an anticipated increase in the Corporation's federal statutory income tax rate from 34 percent to 35 percent.

Review of financial condition

On June 30, 2014, total assets were approximately \$1.2 billion, representing a \$102 million or 9 percent increase, compared to June 30, 2013. Compared to one year ago, asset growth occurred primarily in the commercial loan portfolio and was funded primarily by an increase in core deposits, time deposits and low-rate advances from the Federal Home Loan Bank of Pittsburgh. The growth of core deposits is a particular focus of the Corporation because the rates are relatively low, are a source of fee income and provide the opportunity to cross-sell other financial products and services. The Corporation excludes time deposits in its definition of core deposits.

As a result of profitable operations, the Corporation's capital level remained sound as evidenced by capital ratios that exceed current regulatory requirements for well capitalized institutions. Additional financial information follows this letter.

On behalf of the Board of Directors, the Leadership Team, and all who serve our clients on a daily basis, thank you for your long-term investment in Codorus Valley Bancorp, Inc. and your continued confidence.

Sincerely,

A handwritten signature in black ink, appearing to read "Larry J. Miller". The signature is fluid and cursive, with the first name "Larry" being the most prominent part.

Larry J. Miller
Vice-Chairman, President, and CEO

CODORUS VALLEY BANCORP, INC.
CONSOLIDATED FINANCIAL HIGHLIGHTS
Unaudited

As of and for the six months ended
June 30,

	<u>2014</u>	<u>2013</u>	<u>%chg</u>
Selected financial information			
(dollars in thousands)			
Assets	\$1,200,638	\$1,099,050	9.2
Shareholders' equity	\$113,681	\$103,256	10.1
Net income available to common shareholders	\$5,696	\$5,182	9.9
Common shares outstanding, as adjusted	5,489,784	4,746,129	15.7

Ratios

Return on average assets	0.99%	0.99%	0.0
Return on average equity	10.21%	10.26%	(0.5)
Capital leverage	10.04%	10.28%	(2.3)

Per share information

(adjusted for stock dividend)			
Net income per common share, basic	\$1.11	\$1.10	0.9
Net income per common share, diluted	\$1.08	\$1.08	0.0
Book value per common share	\$18.52	\$16.49	12.3

Common stock & dividend information

NASDAQ Global Market symbol: CVLY
(Cash dividends and stock price are adjusted for common stock dividends.)

	<u>2014</u>			<u>2013</u>		
	<u>\$high</u>	<u>\$low</u>	<u>\$div</u>	<u>\$high</u>	<u>\$low</u>	<u>\$div</u>
First quarter	22.35	19.14	0.120	16.10	12.61	0.105
Second quarter	21.92	19.45	0.120	16.75	14.52	0.105
Third quarter				18.19	16.43	0.114
Fourth quarter				21.98	16.73	0.114

Nasdaq market makers

Boening & Scattergood, Inc.	800-842-8928 or 610-862-5368
Janney Montgomery Scott LLC	800-999-0503 or 717-779-2720
Sandler O'Neill & Partners, L.P. (institutional trades only)	800-635-6871 or 212-466-8000

Stock transfer agent

Wells Fargo Bank, N.A. 800-468-9716
(www.wellsfargo.com/shareownerservices)

Shareholder inquiries

Shareholder contact line 717-747-1519 or 888-846-1970 ext. 519

Additional financial information is available via the Internet:

www.peoplesbanknet.com

Select Investor Relations, then choose from the menu of options