



Codorus Valley Bancorp, Inc.

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

February 1, 2013

Dear Shareholder,

I am pleased to report that earnings for the year 2012 increased 69 percent above the year 2011. The Corporation paid cash dividends totaling \$.382 per common share, an increase of \$0.048 or 14 percent per share and distributed a 5 percent common stock dividend in 2012. The market price of the Corporation's common stock ended the year 2012 at \$15.05 per share, a \$7.15 increase per share over year-end 2011. More information about Codorus Valley Bancorp, Inc.'s (Codorus Valley or Corporation) financial performance for the year 2012 follows.

The Corporation earned \$2,391,000 or \$0.54 per share basic, \$0.53 per share diluted, for the quarter ended December 31, 2012, compared to the \$2,423,000 or \$0.55 per share, basic and diluted, for the quarter ended December 31, 2011. The \$32,000 or 1 percent decrease in the fourth quarter earnings for 2012, compared to the fourth quarter of 2011, was the result of increases in total noninterest expense and provision for loan losses, which more than offset an increase in net interest income and a decrease in preferred stock dividends. Explanations for these increases and decreases are similar to those provided for in the annual earnings comparison that follows, with the exception of the provision for loan losses, which can vary significantly from quarter to quarter depending upon the amount and timing of loan impairments.

For the full year 2012, net income available to common shareholders was \$9,010,000 or \$2.03 per share basic, \$2.00 per share diluted, compared to \$5,319,000 or \$1.22 per share basic, \$1.21 per share diluted. Per share amounts, for all periods, were adjusted for the 5 percent common stock dividend that was declared by the Board of Directors on October 9, 2012 and paid December 11, 2012.

The \$3,691,000 or 69 percent increase in earnings for the year 2012, compared to the year 2011, was primarily the result of increases in net interest income and noninterest income and decreases in the provision for loan losses and preferred stock dividends and discount accretion, which more than offset increases in noninterest expense and provision for income taxes.

The \$2,933,000 or 9 percent increase in net interest income resulted from an increase in the average volume of earning assets, principally commercial loans, and a decrease in funding costs. The decrease in funding costs primarily resulted from a larger proportion of low cost core deposits to total deposits and lower interest rates generally paid on all deposit products, which reflected unusually low market interest rates.

The \$832,000 or 11 percent increase in noninterest income was primarily the result of a \$550,000 or 71 percent increase in gains from the sale of loans held for sale (i.e., residential mortgage loans). Market interest rates decreased to record low levels during the year 2012, leading to an increase in residential mortgage loan refinancings. A \$302,000 or 29 percent increase in gains from the sale of investment securities also contributed to the increase in total noninterest income. U.S. agency mortgage-backed securities (MBS) were selectively sold at a gain to remove relatively low yielding instruments that were prepaying principal faster than anticipated and small odd-lot securities from the MBS portfolio.

The \$3,185,000 or 65 percent decrease in the provision for loan losses for the year 2012 reflected improved credit quality and a decrease in loan impairment charges compared to the year 2011.

The \$1,076,000 or 74 percent decrease in preferred stock dividends and discount accretion reflected a decrease in the dividend rate paid on the Small Business Lending Fund preferred stock and the redemption of preferred stock under the U.S. Treasury's Capital Purchase Program in the third quarter of the prior year.

Noninterest expense increased \$2,849,000 or 11 percent for the year 2012, compared to the year 2011, due primarily to increases in personnel expenses and foreclosed real estate costs. The \$1,564,000 or 11 percent increase in personnel costs was due to normal business growth, which included the impact of franchise expansion in September 2011 with the opening of the Westminster, MD location, and the recognition of annual performance incentives. The \$1,129,000 or 66 percent increase in foreclosed real estate costs reflected increased provisioning for impairment losses, including a \$1,027,000 provision relating to a foreclosed property, as previously reported on Form-8-K filed on August 30, 2012.

The provision for income taxes increased \$1,486,000 or 92 percent for the year 2012, compared to the year 2011, as a result of the 49 percent increase in income before income taxes.

On December 31, 2012, total assets were approximately \$1,060,000,000, representing a \$48,000,000 or 5 percent increase above December 31, 2011. Compared to one year ago, asset growth occurred primarily in the commercial loan portfolio and was funded primarily by an increase in core deposits. Additional financial information follows this letter.

In other news, on January 8, 2013, Codorus Valley's Board of Directors declared a regular quarterly cash dividend of \$0.11 per common share, payable on February 12, 2013, to shareholders of record at the close of business on January 22, 2013. If you do not participate in the Company's Dividend Reinvestment and Stock Purchase Plan (DRSPP), your dividend check is enclosed. To enroll in the DRSPP you may contact the Company's plan administrator Wells Fargo Shareholder Services at 800-468-9716. The Board of Directors regularly reviews the dividend policy and can be expected to approve future changes to it as they deem necessary and appropriate.

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, written over a light blue horizontal line.

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

CODORUS VALLEY BANCORP, INC.
CONSOLIDATED FINANCIAL HIGHLIGHTS
Unaudited

	Year ended December 31,		
	<u>2012</u>	<u>2011</u>	<u>%chg</u>
Selected financial information			
(dollars in thousands)			
Assets	\$1,059,737	\$1,012,132	4.7
Shareholders' equity	\$101,331	\$93,242	8.7
Net income available to common shareholders	\$9,010	\$5,319	69.4
Common shares outstanding, as adjusted	4,482,319	4,412,736	1.6

Ratios

Return on average assets	0.90%	0.69%	30.4
Return on average equity	9.55%	8.04%	18.8
Capital leverage	10.02%	9.62%	4.2

Per share information

(adjusted for stock dividend)

Net income per common share, basic	\$2.03	\$1.22	66.4
Net income per common share, diluted	\$2.00	\$1.21	65.3
Book value per common share	\$17.03	\$15.46	10.2

Common stock & dividend information

NASDAQ Global Market symbol: CVLY

(Cash dividends and stock price are adjusted for the common stock dividend paid December 11, 2012.)

	<u>2012</u>			<u>2011</u>		
	<u>\$high</u>	<u>\$low</u>	<u>\$div</u>	<u>\$high</u>	<u>\$low</u>	<u>\$div</u>
First quarter	10.67	7.89	0.086	10.70	8.86	0.076
Second quarter	13.22	10.26	0.086	10.71	9.54	0.086
Third quarter	15.39	12.62	0.105	10.48	8.33	0.086
Fourth quarter	16.00	13.52	0.105	9.29	7.84	0.086

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