CODORUS VALLEY BANCORP INC
Form 10-Q
November 13, 2006

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2006

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: 0-15536

CODORUS VALLEY BANCORP, INC.
(Exact name of registrant as specified in its charter)

Pennsylvania	23-2428543
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

105 Leader Heights Road, P.O. Box 2887, York, Pennsylvania	17405
(Address of principal executive offices)	(Zip code)

717-747-1519
(Registrant's telephone number, including area code)

Not Applicable
(Former name, former address and former fiscal year, if changed since the last report.)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [X] No [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer [ ]   Accelerated filer [ ]   Non-accelerated filer [X]

Indicate by check mark whether the registrant is a shell company (as defined in

Rule 12b-2 of the Exchange Act). Yes [ ] No [X]

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. On October 24, 2006, 3,499,833 shares of common stock, par value $2.50, were outstanding, which includes the effect of the 5 percent stock dividend declared October 10, 2006.

Codorus Valley Bancorp, Inc.
FORM 10-Q INDEX

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Codorus Valley Bancorp, Inc.
Consolidated Balance Sheets

(dollars in thousands, except per share data)	Unaudited September 30, 2006	December 31, 2005
ASSETS		
Interest bearing deposits with banks	$ 156	$ 126
Cash and due from banks	12,633	11,959
Federal funds sold	13,181	0
Total cash and cash equivalents	25,970	12,085
Securities available-for-sale	64,206	58,111
Securities held-to-maturity (fair value $9,547 for 2006 and $9,686 for 2005)	9,097	9,101
Restricted investment in bank stock, at cost	1,962	2,452
Loans held for sale	1,616	1,522
Loans (net of deferred fees of $489 in 2006 and $537 in 2005)	397,033	368,109
Less-allowance for loan losses	(2,969)	(2,538)
Net loans	394,064	365,571
Premises and equipment, net	10,703	10,962
Other assets	16,779	16,248
Total assets	$524,397	$476,052
LIABILITIES		
Deposits		
Noninterest bearing	$ 49,511	$ 49,369
Interest bearing	383,909	335,785
Total deposits	433,420	385,154
Short-term borrowings	0	9,781
Long-term debt	45,743	39,712
Other liabilities	3,106	2,676
Total liabilities	482,269	437,323
SHAREHOLDERS' EQUITY		
Preferred stock, par value $2.50 per share; 1,000,000 shares authorized; 0 shares issued and outstanding	0	0
Common stock, par value $2.50 per share; 10,000,000 shares authorized; 3,499,833 shares issued and outstanding on 9/30/06 and 3,160,821 on 12/31/05	8,750	7,902
Additional paid-in capital	28,796	23,035
Retained earnings	4,752	8,204
Accumulated other comprehensive loss	(170)	(412)
Total shareholders' equity	42,128	38,729
Total liabilities and shareholders' equity	$524,397	$476,052

See accompanying notes.

Codorus Valley Bancorp, Inc.
Consolidated Statements of Income
Unaudited

(dollars in thousands, except per share data)	Three months ended September 30, 2006	Three months ended September 30, 2005	Nine months ended September 30, 2006	Nine months ended September 30, 2005
INTEREST INCOME				
Loans, including fees	$7,614	$5,748	$21,734	$ 16,137
Investment securities				
Taxable	613	627	1,818	1,841
Tax-exempt	195	118	494	321
Dividends	31	15	101	51
Other	205	35	248	64
Total interest income	8,658	6,543	24,395	18,414
INTEREST EXPENSE				
Deposits	3,511	1,903	9,015	5,082
Federal funds purchased and other short-term borrowings	0	5	133	62
Long-term debt	612	478	1,571	1,270
Total interest expense	4,123	2,386	10,719	6,414
Net interest income	4,535	4,157	13,676	12,000
PROVISION FOR LOAN LOSSES	145	150	500	525
Net interest income after provision for loan losses	4,390	4,007	13,176	11,475
NONINTEREST INCOME				
Trust and investment services fees	299	276	939	856
Service charges on deposit accounts	480	424	1,400	1,193
Mutual fund, annuity and insurance sales	278	252	923	898
Income from bank owned life insurance	70	70	197	201
Other income	110	136	389	387
Gain on sales of mortgages	61	136	210	278
Loss on sales of securities	0	0	0	(86)
Total noninterest income	1,298	1,294	4,058	3,727
NONINTEREST EXPENSE				
Personnel	2,208	2,016	6,487	5,778
Occupancy of premises, net	321	340	1,053	991
Furniture and equipment	299	307	1,043	938
Postage, stationery and supplies	79	119	318	364
Professional and legal	104	97	214	238
Marketing and advertising	138	161	391	427
Other	631	527	2,037	1,642
Total noninterest expense	3,780	3,567	11,543	10,378

Income before income taxes	1,908	1,734	5,691	4,824
PROVISION FOR INCOME TAXES	501	451	1,500	1,228
Net income	$1,407	$1,283	$ 4,191	$ 3,596
Net income per share, basic	$ 0.40	$ 0.37	$ 1.20	$ 1.04
Net income per share, diluted	$ 0.39	$ 0.36	$ 1.18	$ 1.02

See accompanying notes.

Codorus Valley Bancorp, Inc.
Consolidated Statements of Cash Flows
Unaudited

(dollars in thousands)	Nine months ended September 30, 2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 4,191	$ 3,596
Adjustments to reconcile net income to net cash provided by operations		
Depreciation	882	825
Provision for loan losses	500	525
Provision for losses on foreclosed real estate	0	17
Deferred federal income tax expense	28	0
Amortization of investment in real estate partnership	363	354
Income from bank owned life insurance	(197)	(201)
Originations of held for sale mortgages	(16,546)	(21,831)
Proceeds from sales of held for sale mortgages	16,662	21,966
Gain on sales of held for sale mortgages	(210)	(278)
Loss on sales of securities	0	86
Gain on sales of foreclosed real estate	0	(148)
Gain on sales of fixed assets	(43)	(3)
Stock-based compensation expense	39	0
Increase in accrued interest receivable and other assets	(657)	(330)
Increase in accrued interest payable and other liabilities	493	78
Other, net	202	228
Net cash provided by operating activities	5,707	4,884
CASH FLOWS FROM INVESTING ACTIVITIES		
Securities available-for-sale		
Purchases	(15,187)	(13,862)
Maturities and calls	9,339	11,003
Sales	0	3,918
Net decrease in restricted investment in bank stock	490	104
Net increase in loans made to customers	(29,040)	(38,295)
Purchases of premises and equipment	(635)	(1,810)
Investment in real estate partnership	0	(420)
Investment in nonconsolidated subsidiary	(217)	0

Investment in life insurance	(7)	(7)
Purchase of insurance agency assets	(63)	(60)
Proceeds from the sale of premises and equipment	55	0
Proceeds from sales of foreclosed real estate	0	1,680
Net cash used in investing activities	(35,265)	(37,749)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in demand and savings deposits	25,211	22,835
Net increase in time deposits	23,055	16,998
Net decrease in short-term borrowings	(9,781)	(12,337)
Proceeds from issuance of long-term debt	7,217	13,500
Repayment of long-term debt	(1,186)	(1,014)
Dividends paid	(1,254)	(1,143)
Issuance of common stock	187	225
Cash paid in lieu of fractional shares	(6)	(6)
Net cash provided by financing activities	43,443	39,058
Net increase in cash and cash equivalents	13,885	6,193
Cash and cash equivalents at beginning of year	12,085	8,085
Cash and cash equivalents at end of period	$ 25,970	$ 14,278

See accompanying notes.

Codorus Valley Bancorp, Inc.
Consolidated Statements of Changes in Shareholders' Equity
Unaudited

(dollars in thousands, except per share data)	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensiv (Loss) Incom
For the nine months ended Setpember 30, 2006				
Balance, December 31, 2005	$7,902	$23,035	$ 8,204	$(412)
Comprehensive income:				
Net income			4,191	
Other comprehensive income, net of tax:				
Unrealized gains on securities, net				242
Total comprehensive income				
Cash dividends ($.36 per share, adjusted)			(1,254)	
(2) 5% stock dividends - 324,372 shares at fair value	811	5,572	(6,389)	
Stock-based compensation		39		
Issuance of common stock - 14,640 shares under stock option plan	37	150		
Balance, September 30, 2006	$8,750	$28,796	$ 4,752	$(170)
For the nine months ended September 30, 2005				

Balance, December 31, 2004	$7,481	$20,293	$ 8,034	$ 174
Comprehensive income:				
Net income			3,596	
Other comprehensive loss, net of tax:				
Unrealized losses on securities, net				(404)
Total comprehensive income				
Cash dividends ($.329 per share, adjusted)			(1,143)	
5% stock dividend - 149,593 shares at fair value	374	2,513	(2,893)	
Issuance of common stock - 14,638 shares under stock option plan	37	188		
Balance, September 30, 2005	$7,892	$22,994	$ 7,594	$(230)

See accompanying notes.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1--BASIS OF PRESENTATION

The interim financial statements are unaudited. However, they reflect all adjustments that are, in the opinion of management, necessary to present fairly the financial condition and results of operations for the reported periods, and are of a normal and recurring nature.

These statements should be read in conjunction with the notes to the audited financial statements contained in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2005.

The consolidated financial statements include the accounts of Codorus Valley Bancorp, Inc. and its wholly owned bank subsidiary, PeoplesBank, A Codorus Valley Company (PeoplesBank), and its wholly owned nonbank subsidiary, SYC Realty Company, Inc., (collectively referred to as Codorus Valley or Corporation). PeoplesBank has two wholly owned subsidiaries, Codorus Valley Financial Advisors, Inc. and SYC Settlement Services, Inc. All significant intercompany account balances and transactions have been eliminated in consolidation. The combined results of operations of the nonbank subsidiaries are not material to the consolidated financial statements.

The results of operations for the nine month period ended September 30, 2006 are not necessarily indicative of the results to be expected for the full year.

NOTE 2--SIGNIFICANT ACCOUNTING POLICIES

Stock dividend and per share computations

All per share computations include the effect of stock dividends declared through October 10, 2006. The weighted average number of shares of common stock outstanding used for basic and diluted calculations follows.

	Three months ended September 30,		Nine months ended September 30,	
(dollars in thousands, except per share data)	2006	2005	2006	2005

Net income	$1,407	$1,283	$4,191	$3,596
Weighted average shares outstanding (basic)	3,486	3,479	3,485	3,473
Effect of dilutive stock options	81	64	80	69
Weighted average shares outstanding (diluted)	3,567	3,543	3,565	3,542
Basic earnings per share	$ .40	$ .37	$ 1.20	$ 1.04
Diluted earnings per share	$ .39	$ .36	$ 1.18	$ 1.02

Stock-Based Compensation

The Corporation adopted Statement of Financial Accounting Standards No. 123R, "Share-Based Payments" (Statement 123R) in the first quarter of 2006, using the "modified prospective method." Prior to the implementation of FAS 123R, stock options issued under shareholder approved employee and director stock option plans were accounted for under Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" (APB 25). Under APB 25, no compensation expense was

recognized related to these plans. Stock options are granted at exercise prices not less than the fair value of the common stock on the date of grant. See Note 6 - Stock-Based Compensation.

Comprehensive income

Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities, are reported as a separate component of the equity section of the balance sheet, such items, along with net income, are components of comprehensive income. The components of other comprehensive income (loss) and related tax effects are presented in the following table:

	Three months ended September 30,		Nine months ended September 30,	
(Dollars in thousands)	2006	2005	2006	2005
Unrealized holding gains (losses) arising during the period	$1,147	$(477)	$ 367	$(698)
Reclassification adjustment for losses (gains) included in income	0	0	0	86
Net unrealized gains (losses)	1,147	(477)	367	(612)
Tax effect	(390)	162	(125)	208
Net of tax amount	$ 757	$(315)	$ 242	$(404)

Recent Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board issued FASB Statement No. 157, "Fair Value Measurements," which defines fair value, establishes a framework for measuring fair value under Generally Accepted Accounting Principles, and expands disclosures about fair value measurements. FASB Statement No. 157 applies to other accounting pronouncements that require or permit fair value measurements. The new guidance is effective for financial statements issued for fiscal years beginning after November 15, 2007, and for interim periods within those fiscal years. The Corporation is currently evaluating the potential impact, if any, of the adoption of FASB Statement No. 157 on our consolidated financial position, results of operations and cash flows.

In June 2006, the Financial Accounting Standards Board issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes." The interpretation clarifies the accounting for uncertainty in income taxes recognized in a company's financial statements in accordance with Statement of Financial Accountings Standards No.109, "Accounting for Income Taxes." Specifically, the pronouncement prescribes a recognition threshold and a measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The interpretation also provides guidance on the related derecognition, classification, interest and penalties, accounting for interim periods, disclosure and transition of uncertain tax positions. The interpretation is effective for fiscal years beginning after December 15, 2006. The Corporation is evaluating the impact of this new pronouncement on its consolidated financial statements.

NOTE 3--DEPOSITS

The composition of deposits on September 30, 2006 and December 31, 2005, was as follows:

(Dollars in thousands)	September 30, 2006	December 31, 2005
Noninterest bearing demand	$ 49,511	$ 49,369
NOW	39,876	50,638
Money market	136,396	97,601
Savings	18,241	21,205
Time CDs less than $100,000	139,952	125,572
Time CDs $100,000 or more	49,444	40,769
Total deposits	$433,420	$385,154

NOTE 4--LONG-TERM DEBT

A summary of long-term debt at September 30, 2006 and December 31, 2005 follows:

(Dollars in thousands)	September 30, 2006	December 31, 2005

Obligations of PeoplesBank to FHLBP		
Due 2007, 4.69%, amortizing	112	439
Due 2007, 4.68%	7,000	7,000
Due 2009, 3.47%, convertible quarterly after December 2006	5,000	5,000
Due 2010, 4.32%	6,000	6,000
Due 2011, 4.30%, amortizing	4,569	4,757
Due 2012, 4.25%, amortizing	2,079	2,319
Due 2013, 3.46%, amortizing	3,521	3,869
Due 2014, 6.43%, convertible quarterly after July 2009	5,000	5,000
Obligations of Codorus Valley Bancorp, Inc.		
Due 2011, floating rate based on 1 month LIBOR plus 1.50%, amortizing	1,582	1,641
Due 2034, floating rate based on 3 month LIBOR plus 2.02%, callable quarterly after December 2009	3,093	3,093
Due 2036, floating rate based on 3 month LIBOR plus 1.54%, callable quarterly after July 2011	7,217	0
	45,173	39,118
Capital lease obligation	570	594
Total long-term debt	$45,743	$39,712

PeoplesBank's obligations to FHLBank Pittsburgh are fixed rate and fixed/floating (convertible) rate instruments. The FHLBank Pittsburgh has an option on the convertible borrowings to convert the rate to a floating rate after the expiration of a specified period. The floating rate is based on the LIBOR index plus a spread. If the FHLBank Pittsburgh elects to exercise its conversion option, PeoplesBank may repay the converted loan without a prepayment penalty.

Codorus Valley has three long-term obligations. The first is due 2011 and is secured by a mortgage on the Codorus Valley Corporate Center office building at 105 Leader Heights Road, York, Pennsylvania. The second and third obligations are due 2034 and 2036 and represent the issuance of trust preferred debt securities. Trust preferred debt securities were issued to support planned growth and are included in Tier 1 capital for regulatory capital purposes.

NOTE 5--REGULATORY MATTERS

Codorus Valley and PeoplesBank are subject to various regulatory capital requirements administered by banking regulators. Failure to meet minimum capital requirements can initiate certain mandatory and possible additional discretionary actions by regulators that, if undertaken, could have a material effect on Codorus Valley's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, Codorus Valley and PeoplesBank must meet specific capital guidelines that involve quantitative measures of assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The capital amounts and classifications are also subject to qualitative judgments by the regulators.

Quantitative measures established by regulators to ensure capital adequacy require Codorus Valley and PeoplesBank to maintain minimum ratios, as set forth below, to total and Tier 1 capital as a percentage of risk-weighted assets, and of Tier 1 capital to year-to-date average assets (leverage ratio). Management believes that Codorus Valley and PeoplesBank were well capitalized on September 30, 2006, based on FDIC capital guidelines.

	ACTUAL		MINIMUM FOR CAPITAL ADEQUACY		W
(dollars in thousands)	AMOUNT	RATIO	AMOUNT	RATIO	
CODORUS VALLEY BANCORP, INC. (CONSOLIDATED)					
AT SEPTEMBER 30, 2006					
Capital ratios:					
Tier 1 risk based	$51,844	12.11%	> or = $17,121	> or = 4.0%	
Total risk based	54,813	12.81	> or = 34,242	> or = 8.0	
Leverage	51,844	9.98	> or = 20,765	> or = 4.0	
AT DECEMBER 31, 2005					
Capital ratios:					
Tier 1 risk based	$41,658	10.61%	> or = $15,699	> or = 4.0%	
Total risk based	44,196	11.26	> or = 31,398	> or = 8.0	
Leverage	41,658	9.57	> or = 17,420	> or = 4.0	
PEOPLESBANK, A CODORUS VALLEY COMPANY					
AT SEPTEMBER 30, 2006					
Capital ratios:					
Tier 1 risk based	$47,489	11.25%	> or = $16,885	> or = 4.0%	> o
Total risk based	50,458	11.95	> or = 33,770	> or = 8.0	> o
Leverage	47,489	9.26	> or = 20,525	> or = 4.0	> o
AT DECEMBER 31, 2005					
Capital ratios:					
Tier 1 risk based	$37,201	9.62%	> or = $15,463	> or = 4.0%	> o
Total risk based	39,739	10.28	> or = 30,926	> or = 8.0	> o
Leverage	37,201	8.66	> or = 17,184	> or = 4.0	> o

* To be well capitalized under prompt corrective action provisions.

NOTE 6--STOCK-BASED COMPENSATION

The Corporation adopted Statement of Financial Accounting Standards No. 123R, "Share-Based Payments" (Statement 123R) in the first quarter of 2006, using the "modified prospective method." Statement 123R requires that the fair value of equity awards to employees be recognized as compensation expense over the period during which an employee is required to provide service in exchange for such award. Compensation expense of $15,000 net of $0 tax effect for the three months ended September 30, 2006 and $40,000 net of $0 tax effect for the nine months ended September 30, 2006 was included in net income and earnings per share. Comparatively, the impact on net income and earnings per share during 2005 that would have occurred if compensation expense would have been recognized based on the estimated fair value of the options on the date of grant is as follows:

(Dollars in thousands, except per share data)	Three months ended September 30, 2005	Nine months ended September 30, 2005
Reported net income	$1,283	$3,596
Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects of $0 and $0	(81)	(119)
Pro forma net income	$1,202	$3,477
Reported basic earnings per share	$.37	$1.04
Reported diluted earnings per share	$.36	$1.02
Pro forma basic earnings per share	$.35	$1.00
Pro forma diluted earnings per share	$.34	$.98

The Corporation's equity awards consist of stock options granted under three stock option plans as follows: a 2000 Stock Incentive Plan (2000 Plan), a 1998 Independent Directors Stock Option Plan (1998 Plan) and a 1996 Stock Incentive Plan (1996 Plan), collectively the Option Plans. All options available for grant under the 1998 and 1996 Plans have been granted. The 2000 Plan also allows for the granting of stock appreciation rights and restricted stock, none of which have been granted to date at September 30, 2006.

Shares reserved and available for issuance as of September 30, 2006, adjusted for stock dividends declared, were 134,374 for the 2000 Plan, 135,823 for the 1998 Plan, and 86,688 for the 1996 Plan. Shares reserved for future issuance under each plan are subject to adjustment in the event of specified changes in the Corporation's capital structure. Options awarded under these plans to date have been granted with an exercise price equal to the fair value of the stock on the grant date, a minimum vesting period of six months and an expiration period of ten years. Upon exercise, the Corporation has historically issued from its authorized, but unissued, common stock to satisfy the options.

The grant-date fair value, adjusted for stock dividends declared, of options granted in June 2006 was $6.95 and in June 2005 was $6.53. The fair value of the options awarded under the Option Plans is

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estimated on the date of grant using the Black-Scholes valuation model, which is dependent upon certain assumptions as presented below.

	2006	2005
Expected life (in years)	5.25	6.12
Risk-free interest rate	5.19%	3.89%
Expected volatility	46.4%	48.3%
Expected dividend yield	2.7%	2.6%

The expected life of the options was estimated using one half of the exercise period plus the vesting period and represents the period of time that options granted are expected to be outstanding. The risk-free interest rate is the U.S. Treasury rate commensurate with the expected life of the options on the grant date. Volatility of the Corporation's stock price was based on historical volatility. Dividend yield was based on dividends for the most current year divided by the average market price for the most current year.

A summary of stock options activity from all Plans, adjusted for stock dividends declared, is shown below.

	OPTIONS	WEIGHTED AVERAGE EXERCISE PRICE PER SHARE	WEIGHTED AVERAGE REMAINING CONTRACTUAL TERM	AGGREGAT INTRINSIC VA ($000)
Outstanding at January 1, 2006	288,922	$13.03	4.7 years	$1,628
Granted	525	18.00		
Exercised	(15,372)	8.81		
Outstanding at September 30, 2006	274,075	$13.28	4.2 years	$1,477
Exerciseable at September 30, 2006	248,447	$12.90	3.7 years	$1,433

Intrinsic value represents the amount by which the market price of the stock on the measurement date exceeded the exercise price of the option. The intrinsic value of options exercised during the first nine months of 2006 was $149,000 and 2005 was $78,000. Cash received from such exercises in 2006 was $135,000 and the tax benefit recognized was $51,000 and in 2005 was $198,000 and the tax benefit recognized was $26,000.

As of September 30, 2006, total unrecognized compensation cost related to nonvested options was $91,000. The cost is expected to be recognized over a weighted average period of 1.6 years.

NOTE 7--CONTINGENT LIABILITIES

Management is not aware of any material contingent liabilities on September 30, 2006.

NOTE 8--GUARANTEES

Codorus Valley does not issue any guarantees that would require liability recognition or disclosure, other than its standby letters of credit. Standby letters of credit written are conditional commitments issued by the PeoplesBank to guarantee the performance of a customer to a third party. Generally, all letters of credit, when issued have expiration dates within one year. The credit risk involved in issuing letters of credit is essentially the same as those that are involved in extending loan facilities to customers. The Corporation generally holds collateral and/or personal guarantees supporting these commitments. The Corporation had $7,470,279 of standby letters of credit on September 30, 2006,

compared to $2,777,000 on December 31, 2005. Management believes that the proceeds obtained through a liquidation of collateral and the enforcement of guarantees would be sufficient to cover the potential amount of future payment required under the corresponding guarantees. The current amount of the liability as of September 30, 2006 and December 31, 2005, for guarantees under standby letters of credit issued, is not material.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Management's discussion and analysis of the significant changes in the results of operations, capital resources and liquidity presented in the accompanying consolidated financial statements for Codorus Valley Bancorp, Inc. (Codorus Valley or Corporation), a bank holding company, and its wholly owned subsidiary, PeoplesBank, A Codorus Valley Company (PeoplesBank), are provided below. Codorus Valley's consolidated financial condition and results of operations consist almost entirely of PeoplesBank's financial condition and results of operations. Current performance does not guarantee and may not be indicative of similar performance in the future.

FORWARD-LOOKING STATEMENTS:

Management of the Corporation has made forward-looking statements in this Form 10-Q. These forward-looking statements are subject to risks and uncertainties. Forward-looking statements include information concerning possible or assumed future results of operations of the Corporation and its subsidiaries. When words such as "believes," "expects," "anticipates" or similar expressions occur in the Form 10-Q, management is making forward-looking statements.

Readers should note that many factors, some of which are discussed elsewhere in this report and in the documents that management incorporates by reference, could affect the future financial results of the Corporation and its subsidiaries, both individually and collectively, and could cause those results to differ materially from those expressed in the forward-looking statements contained or incorporated by reference in this Form 10-Q. These factors include:

- operating, legal and regulatory risks;

- economic, political and competitive forces affecting banking, securities, asset management and credit services businesses; and

- the risk that management's analysis of these risks and forces could be incorrect and/or that the strategies developed to address them could be unsuccessful.

The Corporation undertakes no obligation to publicly revise or update these forward-looking statements to reflect events or circumstances that arise after the date of this report. Readers should carefully review the risk factors described in other documents that Codorus Valley files periodically with the Securities and Exchange Commission.

CRITICAL ACCOUNTING ESTIMATES:

Disclosure of Codorus Valley's significant accounting policies is included in Note 1 to the consolidated financial statements of the 2005 Annual Report on Form 10-K for the period ended December 31, 2005. Some of these policies are particularly sensitive, requiring management to make significant judgments, estimates and assumptions. Additional information is contained in Management's Discussion and Analysis for the most sensitive of these issues, including the provision and allowance for loan losses, located on pages 17 and 23 of this Form 10-Q.

Management makes significant estimates in determining the allowance for loan losses. Management considers a variety of factors in establishing this estimate such as current economic conditions, diversification of the loan portfolio, delinquency statistics, results of internal loan reviews, financial and managerial strengths of borrowers, adequacy of collateral, if collateral dependent, or present value of future cash flows and other relevant factors. Estimates related to the value of collateral also have a significant impact on whether or not management continues to accrue income on delinquent loans and on the amounts at which foreclosed real estate is recorded on the statement of financial condition.

The Corporation changed its method of accounting for stock-based compensation in 2006, in accordance with Financial Accounting Statement No. 123(R), which is described in Note 6 - Stock-Based Compensation of this report. Based on stock options outstanding on September 30, 2006, approximately $91,000 will be expensed over the weighted average period of 1.6 years.

Management discussed the development and selection of critical accounting estimates and related Management Discussion and Analysis disclosure with the Audit Committee. There were no material changes made to the critical accounting estimates during the periods presented within this report.

THREE MONTHS ENDED SEPTEMBER 30, 2006,
COMPARED TO THREE MONTHS ENDED SEPTEMBER 30, 2005

OVERVIEW

Net income for the three-month period ended September 30, 2006, was $1,407,000 or $.40 per share ($.39 diluted), compared to $1,283,000 or $.37 per share ($.36 diluted), for the same period of 2005. The $124,000 or 10 percent increase in net income was the result of an increase in net interest income, which more than offset an increase in noninterest expense. The $378,000 or 9 percent increase in net interest income was primarily the result of increases in the volume of business and consumer loans. An increase in yield on floating rate business loans, the result of rising short-term market interest rates, also contributed. The $213,000 or 6 percent increase in noninterest expense was primarily attributable to increases in personnel and other expense. Current period personnel expense reflected the planned addition of key sales and support staff, increased health insurance premiums and normal merit increases. The increase in other expense reflected increases in various expenses including: automated teller machine/point of sale processing expense, Pennsylvania shares tax, problem loan carrying costs, and employee related expenses associated with training, seminars and business meetings.

NET INTEREST INCOME

Net interest income for the three-month period ended September 30, 2006, was $4,535,000, an increase of $378,000 or 9 percent above the same period in 2005. The increase in net interest income was primarily the result of increases in the volume of business and consumer loans. An increase in yield on floating rate business loans, the result of rising short-term market interest rates, also contributed. The increase in other interest income resulted from an increase in the volume and yield on federal funds sold, ie., overnight investments, which increased in response to strong deposit growth. Earning assets averaged $477 million and yielded 7.31 percent (tax equivalent basis) for the third quarter of 2006, compared to $405 million and 6.48 percent, respectively, for the third quarter of 2005.

Rising short-term market interest rates, a slightly inverted US treasury yield curve, and competitive pricing pressures increased funding costs during the current period, which lowered net interest margin. Interest bearing liabilities averaged $429 million at an average rate of 3.81 percent for the third quarter

of 2006, compared to $354 million and 2.67 percent, respectively, for the third quarter of 2005. The $75 million or 21 percent increase in the average volume of interest bearing liabilities occurred primarily in money market deposits and floating rate CDs. The net interest margin, on a tax equivalent basis, was 3.88 percent for the third quarter of 2006, compared to 4.14 percent for the same period in 2005.

PROVISION FOR LOAN LOSSES

A $145,000 provision expense for loan losses was recorded for the three-month period ended September 30, 2006, compared to $150,000 for the same period in 2005. The current period provision was based on management's assessment of overall credit quality and macro-economic factors such as the relatively high level of energy costs and interest rates, and a downturn in the real estate market, which could portend debt service problems for some of our borrowers.

NONINTEREST INCOME

Total noninterest income for the current three-month period was $1,298,000, which was approximately the same amount for the third quarter of 2005. During the current period increases in income from wealth management and deposit services were largely offset by a decrease in income from real estate settlement services and gains from the sale of mortgages due to a downturn in the real estate market.

NONINTEREST EXPENSE

Total noninterest expense for the current three-month period was $3,780,000, an increase of $213,000 or 6 percent above the third quarter of 2005. The increase was attributable primarily to a $192,000 or 10 percent increase in personnel expense, which reflected the planned addition of key sales and support staff, increased health insurance premiums and normal merit increases. Other expense increased $104,000 or 20 percent due to increases in various expenses including: automated teller machine/point of sale processing expense, Pennsylvania shares tax, problem loan carrying costs and employee related expenses associated with training, seminars and business meetings. The current period reflected a $40,000 or 34 percent decrease in postage, stationery and supplies, and a $23,000 or 14 percent decrease in marketing and advertising expense compared to the third quarter of 2005. Both expenses in the third quarter of 2005 were relatively high due to corporate expansion and implementation of a branding initiative.

INCOME TAXES

The provision for income tax was $501,000 for the third quarter of 2006, compared to $451,000 for the same quarter in 2005. The $50,000 or 11 percent increase in the tax provision was due in part to an increase in federal income tax which resulted from a 10 percent increase in pretax income. An increase in state income taxes also contributed to the overall increase in income tax. Codorus Valley's effective federal income tax rate was approximately 25 percent, compared to a marginal tax rate of 34 percent.

NINE MONTHS ENDED SEPTEMBER 30, 2006,
COMPARED TO NINE MONTHS ENDED SEPTEMBER 30, 2005

INCOME STATEMENT ANALYSIS

OVERVIEW

Net income for the nine month period ended September 30, 2006, was $4,191,000 or $1.20 per share ($1.18 diluted), compared to $3,596,000 or $1.04 per share ($1.02 diluted), for the same period of 2005. The $595,000 or 17 percent increase in net income was the result of increases in net interest income and noninterest income, which more than offset an increase in noninterest expense. The $1,676,000 or 14 percent increase in net interest income was attributable to an increase in interest income and fees from a larger volume of business and consumer loans, and higher yields on floating rate business loans. The net interest margin was 4.06 percent for the current period compared to 4.16 percent for the first nine months of 2005. The decrease in the net interest margin reflects increased funding costs attributable to deposit growth and higher rates affected by a flat/slightly inverted US treasury yield curve and competitive price pressures. The $331,000 or 9 percent increase in noninterest income was attributable primarily to increases in income from deposit and wealth management services. The $1,165,000 or 11 percent increase in noninterest expense was attributable to increases in personnel, furniture and equipment and occupancy expenses associated in part with corporate expansion in the prior year, and normal business growth. The other expense category, comprised of many individual expenses, also increased due primarily to increases in problem asset carrying costs, ATM/point-of-sale processing expense and charitable donations, among others.

Net income as a percentage of average shareholder's equity (return on equity or ROE), was 13.85 percent for the first nine months (annualized) of 2006, compared to 12.85 percent for the same period of 2005. Net income as a percentage of average total assets (return on assets or ROA), was 1.12 percent for both periods. The efficiency ratio (noninterest expense as a percentage of net operating revenue) for the current period was 63.6 percent, compared to 64.5 percent for the first nine months of 2005.

Total assets of the Corporation on September 30, 2006, were approximately $524 million, an increase of $48 million or 10 percent above December 31, 2005. Asset growth occurred primarily in business and consumer loans, which were funded primarily by growth in money market and CD deposits.

On September 30, 2006, nonperforming assets as a percentage of total loans and net foreclosed real estate were 1.38 percent, compared to 0.36 percent for September 30, 2005. Information regarding nonperforming assets is provided in the Risk Management section of this report, including Table 3--Nonperforming Assets. Based on a recent evaluation of probable loan losses and the current loan portfolio, management believes that the allowance is adequate to support losses inherent in the loan portfolio on September 30, 2006. An analysis of the allowance is provided in Table 4--Analysis of Allowance for Loan Losses.

Throughout the current period Codorus Valley maintained a capital level well above minimum regulatory quantitative requirements. Currently, there are three federal regulatory definitions of capital that take the form of minimum ratios. Note 5--Regulatory Matters, shows that the Corporation and PeoplesBank were well capitalized on September 30, 2006.

A more detailed analysis of the factors and trends affecting corporate earnings follows.

NET INTEREST INCOME

Net interest income for the nine month period ended September 30, 2006, was $13,676,000, an increase of $1,676,000 or 14 percent above the same period in 2005. Earning assets averaged $461 million and yielded 7.17 percent (tax equivalent) for 2006, compared to $391 million and 6.35 percent (tax equivalent), respectively, for 2005. The $69 million or 18 percent increase in average earning assets occurred primarily in business loans and secondarily in consumer installment loans. The average portfolio balance of investment securities for the current period was $71 million compared to $73 million for 2005; however, the yield for the current nine month period averaged 4.99 percent (tax equivalent) or 64 basis points above 2005. The increase in other interest income resulted from an increase in the volume and yield on federal funds sold, ie., overnight investments, which increased in response to strong deposit growth.

Rising short-term market interest rates, a slightly inverted US treasury yield curve, and competitive pricing pressures continued to increase funding costs throughout 2006, which lowered net interest margin. Interest bearing liabilities averaged $410 million at an average rate of 3.50 percent for the first nine months of 2006, compared to $344 million and 2.49 percent, respectively, for the same period of 2005. The $66 million or 19 percent increase in the average volume of interest bearing liabilities occurred primarily in money market deposits and floating rate CDs. Deposit growth was favorably impacted by the introduction of new money market products and the addition of two financial centers in March 2005. The net interest margin, on a tax equivalent basis, was 4.06 percent for the first nine months of 2006, compared to 4.16 percent for the same period in 2005.

In the period ahead, management expects that growth in net interest income will continue to be constrained as a result of a flat/slightly inverted US treasury yield curve environment and competitive pricing pressures. It is also possible that some or most of the $9 million portfolio of securities held-to-maturity will be called, at a premium, on the first call date, which ranges from December 2006 through June 2007. As described within the Balance Sheet Review section of this report, if the securities are called it will result in a short-term increase in interest income due to the recognition of the call premium; however, replacement yields are expected to be lower.

PROVISION FOR LOAN LOSSES

A $500,000 provision expense for loan losses was recorded for the nine month period ended September 30, 2006, compared to $525,000 for the same period in 2005. The current period provision was based on management's assessment of overall credit quality, loan growth and macro-economic factors such as relatively high energy costs and interest rates, and a downturn in the real estate market. Information regarding nonperforming assets and the allowance for loan losses can be found within those sections of this report.

NONINTEREST INCOME

The following table presents the components of total noninterest income for the nine month period ended September 30, 2006, compared to the same period for 2005.

Table 1 - Noninterest income

(dollars in thousands)	Nine months ended September 30, 2006	2005	Change Increase (Decrease) $	%
Trust and investment services fees	$ 939	$ 856	$ 83	10%
Service charges on deposit accounts	1,400	1,193	207	17
Mutual fund, annuity and insurance sales	923	898	25	3
Income from bank owned life insurance	197	201	(4)	(2)
Other income	389	387	2	1
Gain on sales of mortgages	210	278	(68)	(24)
Loss on sales of securities	0	(86)	86	(100)
Total noninterest income	$4,058	$3,727	$331	9%

The discussion that follows addresses changes within selected categories of noninterest income.

Trust and investment services fees--For the first nine months of 2006, trust fees increased $83,000 or 10 percent above 2005 due primarily to business growth.

Service charges on deposit accounts--For the first nine months of 2006, service charges on deposits increased $207,000 or 17 percent above 2005 due to an increase in the volume of transactions and number of accounts. Check card (debit card) and automated teller machine (ATM) commissions, and overdraft fees continued to trend up in response to increased customer usage of check cards.

Other income--The other income category is comprised of many individual fees. For the first nine months of 2006, other income was $389,000, approximately the same amount as 2005. The current period contains a nonrecurring gain of $45,000 from the sale of two small parcels of land, totaling .3 acre, to the local township for a road throughway. One parcel was held by Codorus Valley Bancorp, Inc. and the other was held by its subsidiary PeoplesBank. The gain from the sale was offset to some degree by a $37,000 decrease in income from real estate settlement services, which resulted in part from a downturn in the real estate market and competition.

Gain on sales of mortgages--For the first nine months of 2006, gains from the sale of mortgages decreased $68,000 or 24 percent below the prior year due to a decline in the volume of sales. The relatively high level of market interest rates and home prices has resulted in a downturn in the real estate market, which adversely affects mortgage banking operations.

Loss on sales of securities--For 2005, an infrequent loss of $86,000 was recognized from the sale of securities available-for-sale in connection with an "investment swap." The swap entailed selling low yielding investments at a loss and replacing them with higher yielding investments, which increased portfolio yield and interest income. There was no comparable transaction in 2006.

NONINTEREST EXPENSE

The following table presents the components of total noninterest expense for the nine month period ended September 30, 2006, compared to the same period for 2005.

Table 2 - Noninterest expense

	Nine months ended September 30,		Change Increase (Decrease)	
(dollars in thousands)	2006	2005	$	%
Personnel	$ 6,487	$ 5,778	$ 709	12%
Occupancy of premises, net	1,053	991	62	6
Furniture and equipment	1,043	938	105	11
Postage, stationery and supplies	318	364	(46)	(13)
Professional and legal	214	238	(24)	(10)
Marketing and advertising	391	427	(36)	(8)
Other	2,037	1,642	395	24
Total noninterest expense	$11,543	$10,378	$1,165	11%

The discussion that follows addresses changes in selected categories of noninterest expense.

Personnel--For the first nine months of 2006, personnel expense, comprised of wages, payroll taxes and employee benefits, increased $709,000 or 12 percent above 2005 due to: planned staff additions, including financial center expansion in the prior year; increased health insurance premiums; and normal merit increases.

Occupancy of premises, net--For the first nine months of 2006, occupancy of premises expense increased $62,000 or 6 percent above 2005 due primarily to financial center expansion and renovation in the prior period.

Furniture and equipment--For the first nine months of 2006, furniture and equipment expense increased $105,000 or 11 percent above 2005 due in part to financial center expansion and renovation in the prior period. Current period expense was also impacted by the timing of ATM maintenance contracts and the bulk replacement of personal computers.

Postage, stationery and supplies--For the first nine months of 2006, postage, stationery and supplies decreased $46,000 or 13 percent below 2005. The prior period was relatively high due to corporate expansion and implementation of a branding initiative.

Professional and legal--For the first nine months of 2006, professional and legal expense decreased $24,000 or 10 percent below 2005 due to the settlement of two lawsuits arising from routine bank business. During 2006, one of the aforementioned lawsuits resulted in a $32,000 reimbursement to PeoplesBank for legal expenses that it incurred in a prior period.

In the period ahead, consulting and auditing expenses are likely to increase as

Codorus Valley implements compliance with Section 404 of the Sarbanes-Oxley Act of 2002. Section 404 requires publicly held companies to formally assess the adequacy of controls over financial reporting, subject to independent audit verification. The compliance deadline for Codorus Valley, a non-accelerated filer, is presently December 31, 2007.

Marketing and advertising--For the first nine months of 2006, marketing and advertising expense decreased $36,000 or 8 percent below 2005. The prior period included expense associated with a

branding initiative for subsidiary PeoplesBank as well as costs to promote the addition of two financial centers.

Other-- The other expense category is comprised of many individual expenses. For the first nine months of 2006, other expense increased $395,000 or 24 percent above 2005. The increase was due largely to increases in: problem asset carrying costs (the current period reflected a larger portfolio of nonaccrual loans, the prior period included a $151,000 gain from the sale of collateral), ATM/point-of-sale processing expense (transaction volume), and charitable donations, among others. Normal business growth also contributed to the increase in other expense.

INCOME TAXES

The provision for income tax was $1,500,000 for the current nine month period representing a $272,000 or 22 percent increase above the same period in 2005. Approximately $219,000 of the increase was attributable to an increase in federal income tax which resulted from an 18% increase in pretax income. Federal income tax for both periods was reduced by the recognition of tax credits from investments in low income housing partnerships. For the current period, tax credits totaled $238,000, compared to $248,000 for the first nine months of 2005. Codorus Valley's effective federal income tax rate was approximately 25 percent, compared to a marginal tax rate of 34 percent. Additionally, state income taxes increased $53,000 above 2005 due primarily to the implementation of a loan production office in Maryland in January 2006.

BALANCE SHEET REVIEW

FEDERAL FUNDS SOLD

On September 30, 2006, federal funds sold, ie., overnight investments, were $13 million, compared to $0 for year-end 2005. The increase in federal funds sold was caused primarily by an increase in liquidity from strong deposit growth throughout the current period as described under the Deposits section of this report.

SECURITIES AVAILABLE-FOR-SALE

On September 30, 2006, securities available-for-sale was $64 million, compared to $58 million for year-end 2005. The 10 percent increase occurred primarily from the purchase of high quality, tax-exempt municipal bonds with maturities that range from eight to ten years.

SECURITIES HELD-TO-MATURITY

The $9 million portfolio of securities held-to-maturity consists of 13 fixed rate, junior subordinated debt instruments that become callable for the first time in December 2006 through June 2007, with one exception which becomes callable in March 2008. If the securities are not called on their first call date they become continuously callable thereafter. If the securities are called, the issuer will be required to pay a call premium, which averages 4% on the first call date. The call premium amortizes (decreases) over the next ten years to par value. If the securities are called, it will result in a short-term increase in interest income due to the recognition of the call premium; however, replacement yields are expected to be lower.

LOANS

On September 30, 2006, loans were approximately $397 million, an increase of $29 million or 8 percent above year-end 2005. The increase was primarily attributable to an increase in business loans and to a lesser degree consumer loans. The year-to-date average yield (tax-equivalent basis) on loans was 7.61 percent for September 30, 2006, compared to 6.84 percent for the first nine months of 2005.

DEPOSITS

On September 30, 2006, total deposits were approximately $433 million, an increase of $48 million or 13 percent above year-end 2005. The increase in deposits, which reflected the continuation of a long trend of successful sales efforts, occurred primarily within the money market and CD categories, as shown in Note 3--Deposits of this report. The increase in money market deposits was partially the result of new money market products, which were priced competitively and heavily promoted. CD growth occurred in variable rate CD's, which re-price weekly based on the one year US Treasury bond rate. The trend of rising short-term interest rates, since July 2004, was a factor in overall deposit growth and product selection by bank customers. The increase in deposits was also attributable in part to the addition of two financial centers in March of 2005. The year-to-date average rate paid on interest-bearing deposits was 3.31 percent for September 30, 2006, compared to 2.22 percent for the first nine months of 2005.

SHORT-TERM BORROWINGS AND LONG-TERM DEBT

On September 30, 2006, there were no short-term borrowings, compared to $10 million outstanding at year-end 2005. Deposit growth during the current period provided funds to repay short-term borrowings. On September 30, 2006, long-term debt was $46 million, compared to $40 million for year-end 2005. During June 2006, Codorus Valley issued $7.2 million in trust preferred debt securities to support planned corporate growth. This obligation has a 30-year maturity, but is callable at quarterly intervals after the fifth year. The interest rate is variable tied to the 3-month LIBOR rate plus 154 basis points. A listing of outstanding long-term debt instruments is provided in Note 4--Long-term Debt of this report. The year-to-date average rate paid on long-term debt was 4.98 percent for September 30, 2006, compared to 4.78 percent for the first nine months of 2005. Generally, funds for the payment of long-term debt come from operations and refinancings.

SHAREHOLDERS' EQUITY AND CAPITAL ADEQUACY

Shareholders' equity or capital, as a source of funds, enables Codorus Valley to maintain asset growth and absorb losses. Total shareholders' equity was approximately $42.1 million on September 30, 2006, an increase of $3.4 million or 9 percent above year-end 2005. The increase was attributable to profitable operations.

On October 10, 2006, the Board of Directors declared a quarterly cash dividend of $.135 per common share ($.129 adjusted), payable on or before November 14, 2006, to shareholders of record October 24, 2006. This follows three $.13 per share cash dividends paid in August ($.124 adjusted), May ($.118 adjusted) and February ($.118 adjusted). Total cash dividends for 2006 will total $.49 per share, as adjusted, for an increase of $.04 or 9 percent above 2005. In addition, on October 10, 2006, the Board of Directors declared a special 5 percent stock dividend payable on or before December 7, 2006, to shareholders of record October 24, 2006, which will result in the issuance of approximately 166,659 common shares. This follows a 5 percent stock dividend distributed in June 2006, which resulted in the issuance of 157,713 common shares.

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As described under the caption, short-term borrowings and long-term debt, Codorus Valley issued $7.2 million in trust preferred debt securities in June 2006 to support planned growth. The interest expense on trust preferred debt is tax deductible, while the amount borrowed is included in Tier 1 capital, subject to regulatory limitations, for regulatory capital purposes.

On October 14, 2004, the Corporation issued a press release, which was filed on Form 8-K, announcing that the Board of Directors authorized the purchase, in open market and privately negotiated transactions, of up to 4.9 percent or approximately 146,000 shares of its then outstanding common stock. As of September 30, 2006, the Corporation had not acquired any of its common stock under the authorization reported in October 2004.

Codorus Valley and PeoplesBank are subject to various regulatory capital requirements administered by banking regulators that involve quantitative guidelines and qualitative judgments. Quantitative measures established by regulators pertain to minimum capital ratios, as set forth in Note 5--Regulatory Matters, to the financial statements. Management believes that Codorus Valley and PeoplesBank were well capitalized on September 30, 2006, based on FDIC capital guidelines.

RISK MANAGEMENT

NONPERFORMING ASSETS

Table 3--Nonperforming Assets, provides a summary of nonperforming assets and related ratios. The paragraphs below provide information for selected categories for September 30, 2006, compared to December 31, 2005.

Table 3-Nonperforming Assets

(dollars in thousands)	September 30, 2006	December 31, 2005
Nonaccrual loans	$5,475	$1,034
Accruing loans that are contractually past due 90 days or more as to principal or interest	13	0
Foreclosed real estate, net of allowance	5	7
Total nonperforming assets	$5,493	$1,041

	======	======
Ratios:		
Nonaccrual loans as a % of total period-end loans	1.38%	0.28%
Nonperforming assets as a % of total period-end loans and net foreclosed real estate	1.38%	0.28%
Nonperforming assets as a % of total period-end stockholders' equity	13.04%	2.69%
Allowance for loan losses as a multiple of nonaccrual loans	0.5x	2.5x

On September 30, 2006, nonaccrual loans consisted of collateralized business and mortgage loans, and consumer loans. The Corporation recognizes interest income on a cash basis for nonaccrual loans. On

September 30, 2006, the $4,441,000 increase in nonaccrual loans was primarily attributable to the addition of three unrelated business loans in the amounts of $2,624,000, $686,000 and $526,000. The $2,624,000 loan, which has matured, has been making interest payments and management believes that the net realizable value of the real estate collateral, based on a recent independent appraisal, along with personal guarantees is adequate to ensure the ultimate recovery of interest and principal in full. In management's judgment the net realizable value of the real estate collateral for the $686,000 loan is insufficient. Accordingly, management established a $206,000 loss allowance for this account. During the third quarter of this year a credit worthy guarantor was added to the $526,000 account and brought all interest and principal current. Management plans to reclassify this loan to accrual status in the fourth quarter. On September 30, 2006, the nonaccrual loan portfolio was comprised of 21 unrelated accounts ranging in size from $2,000 to $2,624,000. Collection efforts including modification of contractual terms for individual accounts, based on prevailing market conditions, and liquidation of collateral assets are being employed to maximize recovery.

The level of loans contractually past due 90 days or more as to principal or interest was insignificant for September 30, 2006 and December 31, 2005.

ALLOWANCE FOR LOAN LOSSES

Table 4--Analysis of Allowance for Loan Losses, shows the allowance was $2,969,000 or .75 percent of total loans on September 30, 2006, compared to $2,277,000 or .68 percent of total loans, respectively, on September 30, 2005. The $692,000 or 30 percent increase in the allowance was based on management's estimate to bring the allowance to a level reflective of risk in the portfolio, loan growth, and macro-economic factors such as the relatively high level of energy costs and interest rates, and a downturn in the real estate market. Based on a recent evaluation of potential loan losses in the current portfolio, management believes that the allowance is adequate to support losses inherent in the loan portfolio on September 30, 2006.

Table 4-Analysis of Allowance for Loan Losses

(dollars in thousands)	2006	2005
Balance-January 1,	$2,538	$1,865
Provision charged to operating expense	500	525
Loans charged off:		
Commercial	104	34
Real estate-mortgage	17	99
Consumer	22	59
Total loans charged off	143	192
Recoveries:		
Commercial	45	57
Real estate-mortgage	2	1
Consumer	27	21
Total recoveries	74	79
Net charge-offs	69	113
Balance-September 30,	$2,969	$2,277
Ratios:		
Net annualized charge-offs to average total loans	0.02%	0.05%
Allowance for loan losses to total loans at period-end	0.75%	0.68%
Allowance for loan losses to nonaccrual loans and loans past due 90 days or more	54.1%	59.8%

LIQUIDITY

Codorus Valley's loan-to-deposit ratio, which is used as a broad measure of liquidity, was approximately 91.6 percent on September 30, 2006, compared to 95.6 percent on December 31, 2005. Liquidity for both periods was adequate based on availability from many sources, including the potential liquidation of a $64 million portfolio of available-for-sale securities, valued at September 30, 2006. Another important source of liquidity for PeoplesBank is available credit from the FHLBank Pittsburgh. On June 30, 2006, the latest available date, available funding from the FHLBank Pittsburgh was approximately $81 million. The successful promotion of deposit products and the addition of two financial centers in March 2005 have increased liquidity in the form of deposit growth. The issuance of $7.2 million in trust preferred debt securities by Codorus Valley in June 2006 also provided liquidity.

The Consolidated Statements of Cash Flows, included in this Form 10-Q report, present the changes in cash from operations, investing and financing activities.

Off-Balance Sheet Arrangements

Codorus Valley's financial statements do not reflect various commitments that are made in the normal course of business, which may involve some liquidity risk. These commitments consist primarily of commitments to grant new loans, unfunded commitments of existing loans, and letters of credit made under the same standards as on-balance sheet instruments. Unused commitments on September 30, 2006, totaled $131,406,000 and consisted of $82,174,000 in unfunded commitments of existing loans,

$41,762,000 to grant new loans and $7,470,000 in letters of credit. Due to fixed maturity dates and specified conditions within these instruments, many will expire without being drawn upon. Management believes that amounts actually drawn upon can be funded in the normal course of operations and therefore do not present a significant liquidity risk to Codorus Valley.

Contractual Obligations

Codorus Valley has various long-term contractual obligations outstanding at September 30, 2006, including long-term debt, time deposits and obligations under capital and operating leases, which were reported in Table 13 of the Annual Report on Form 10-K for the year ended 2005. A comparative schedule of deposits, which includes time deposits, is provided in Note 3 of this Form 10-Q report. A comparative schedule of long-term debt is provided in Note 4.

MARKET RISK MANAGEMENT

In the normal course of conducting business, Codorus Valley is exposed to market risk, principally interest rate risk, through the operations of its banking subsidiary. Interest rate risk arises from market driven fluctuations in interest rates, which may affect cash flows, income, expense and values of financial instruments. An asset-liability management committee comprised of members of management manages interest rate risk.

Codorus Valley performed a simulation on its balance sheet for September 30, 2006 and December 31, 2005. The results of the point-in-time analyses are shown in Table 3--Interest Rate Sensitivity. The most likely scenario for September 30, 2006, assumes that short-term market interest rates will remain stable through year-end 2006 and then decrease a total of 75-basis points (in 25-basis points increments) over the remaining nine months of the 12-month simulation period. Continued growth in interest rate sensitive liabilities, principally floating rate CDs and money market funds have gradually shifted the balance sheet to a liability sensitive position. Liability sensitivity means that deposits and debt will reprice to a greater and faster degree than the loans and investments that they fund. This suggests that earnings may increase if market interest rates decrease. Conversely, earnings may decrease if short-term market interest rates, which have been influenced by the Federal Reserve Bank, increase. Under the low rate scenario (down 200 basis points) for both periods, management presumed that trust preferred investment securities, which are callable at a premium, would be called due to the relatively high coupon rate and would result in a one time increase in interest income to the Corporation. A detailed discussion of market interest rate risk is provided in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2005.

Table 5-Interest Rate Sensitivity

Forecasted interest rate scenario	Change in interest rates ramped over 12 months (basis points)	Change in net income $000's	%
	AT SEPTEMBER 30, 2006		
Most likely	-75	(70)	(1.4)
High	+200	(246)	(5.0)
Flat (baseline)	0	0	0.0
Low	-200	265	5.4
	AT DECEMBER 31, 2005		
Most likely	+50	(1)	0.0
High	+200	2	0.0
Flat (baseline)	0	0	0.0
Low	-200	39	0.7

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Refer to the section entitled "Market risk management" within Management's Discussion and Analysis of Consolidated Financial Condition and Results of Operations on page 25 of this Form 10-Q.

ITEM 4. CONTROLS AND PROCEDURES

Codorus Valley maintains disclosure controls and procedures designed to ensure that information required to be disclosed in the reports that the Corporation files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission. Based upon their evaluation of those controls and procedures performed as of September 30, 2006, the chief executive and chief financial officers of Codorus Valley concluded that Codorus Valley's disclosure controls and procedures were adequate.

Codorus Valley made no changes in its internal controls or in other factors that has materially affected, or is reasonably likely to materially affect the Corporation's internal control over financial reporting, as evaluated by the chief executive and chief financial officers.

PART II--OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

There are no legal proceedings pending against Codorus Valley Bancorp, Inc. or any of its subsidiaries which are expected to have a material impact upon the financial position and/or operating results of the Corporation. Management is not aware of any proceedings known or contemplated by government authorities.

ITEM 1A. RISK FACTORS

Management is not aware of any material changes in the risk factors previously disclosed in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2005.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Codorus Valley made no sales or repurchases of equity securities during the quarter ended September 30, 2006.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Nothing to report.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

Nothing to report.

ITEM 5. OTHER INFORMATION

Nothing to report.

ITEM 6. EXHIBITS

Exhibit Number	Description of Exhibit
3(i)	Articles of Incorporation (Incorporated by reference to Exhibit 3(i) to the Registrant's Current Report on Form 8-K, filed with the Commission on October 14, 2005.)
3(ii)	By-laws (Incorporated by reference to Exhibit 3(ii) to the Registrant's Current Report on Form 8-K, filed with the Commission on October 14, 2005.)
4	Rights Agreement dated as of November 4, 2005 (Incorporated by reference to Exhibit 4 to the Registrant's Current Report on Form 8-K, filed with the Commission on November 8, 2005.)
10.1	1996 Stock Incentive Plan (Incorporated by reference to Exhibit 99 of Registration Statement No. 333-09277 on Form S-8, filed with the Commission on July 31, 1996.)
10.2	Employment Agreement between Codorus Valley Bancorp, Inc., PeoplesBank, A Codorus Valley Company and Larry J. Miller dated December 27, 2005. (Incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K, filed with the Commission on January 3, 2006.)
10.3	Change of Control Agreement by and among Codorus Valley Bancorp, Inc., PeoplesBank, A Codorus Valley Company and Jann A. Weaver, dated December 27, 2005. (Incorporated by reference to Exhibit 10.7 to the Registrant's Current Report on Form 8-K, filed with the Commission on January 3, 2006.)
10.4	Change of Control Agreement by and among Codorus Valley Bancorp, Inc., PeoplesBank, A Codorus Valley Company and Harry R. Swift, dated December 27, 2005. (Incorporated by reference to Exhibit 10.6 to the Registrant's Current Report on Form 8-K, filed with the Commission on January 3, 2006.)
10.5	1998 Independent Directors Stock Option Plan (Incorporated by reference to Exhibit 4.3 of Registrant Statement No. 333-61851 on Form S-8, filed with the Commission on August 19, 1998.)

10.6	2000 Stock Incentive Plan (Incorporated by reference to Exhibit 4.3 of Registration Statement No. 333-40532 on Form S-8, filed with the Commission on June 30, 2000.)
10.7	2001 Employee Stock Bonus Plan (Incorporated by reference to Exhibit 99.1 of Registration Statement No. 333-68410 on Form S-8, filed with the Commission on August 27, 2001.)
10.8	Dividend Reinvestment and Stock Purchase Plan (Incorporated by reference to Exhibit 4(a) Registration Statement no. 33-46171 on Amendment no. 4 to Form S-3, filed with the Commission on July 23, 2004.)
10.9	Amendment to Salary Continuation Agreement by and among PeoplesBank, A Codorus Valley Company, a wholly owned subsidiary of Codorus Valley Bancorp, Inc. and Larry J. Miller dated December 27, 2005. (Incorporated by reference to Exhibit 10.3 to the Registrant's Current Report on Form 8-K, filed with the Commission on January 3, 2006.)
10.10	Amendment to Salary Continuation Agreement by and among PeoplesBank, A Codorus Valley Company, a wholly owned subsidiary of Codorus Valley Bancorp, Inc. and Harry R. Swift dated December 27, 2005. (Incorporated by reference to Exhibit 10.4 to the Registrant's Current Report on Form 8-K, filed with the Commission on January 3, 2006.)
10.11	Amendment to Salary Continuation Agreement by and among PeoplesBank, A Codorus Valley Company, a wholly owned subsidiary of Codorus Valley Bancorp, Inc. and Jann A. Weaver dated December 27, 2005. (Incorporated by reference to Exhibit 10.5 to the Registrant's Current Report on Form 8-K, filed with the Commission on January 3, 2006.)
10.12	Form of Group Term Replacement Plan, dated December 1, 1998, as amended, including Split Dollar Policy Endorsements pertaining to senior officers of the Corporation's subsidiary, PeoplesBank, A Codorus Valley Company. (Incorporated by reference to Exhibit 10.12 to the Registrant's Annual Report on Form 10-K, filed on March 29, 2005.)
10.13	Sample form of Director Group Term Replacement Plan, dated December 1, 1998, including Split Dollar Policy Endorsements pertaining to non-employee directors of the Corporation's subsidiary, PeoplesBank, A Codorus Valley Company. (Incorporated by reference to Exhibit 10.13 to the Registrant's Annual Report on Form 10-K, filed on March 29, 2005.)
10.14	Long Term Nursing Care Agreement between Codorus Valley Bancorp, Inc., PeoplesBank, A Codorus Valley Company and Larry J. Miller, dated December 27, 2005. (Incorporated by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K, filed with the Commission on January 3, 2006.)
10.15	Codorus Valley Bancorp, Inc. Change in Control and Supplemental Benefit Trust Agreement between Codorus Valley Bancorp, Inc., PeoplesBank, A Codorus Valley Company and Hershey Trust Company, dated January 25, 2006. (Incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K, filed with the Commission on

January 27, 2006.)

10.16	Amended and Restated Declaration of Trust of CVB Statutory Trust No. 2, dated June 28, 2006. (Incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K, filed with the Commission on June 30, 2006.)
10.17	Indenture, dated as of June 28, 2006 between Codorus Valley Bancorp, Inc., as issuer, and the trustee named therein, relating to the Junior Subordinated Debt Securities due 2036. (Incorporated by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K, filed with the Commission on June 30, 2006.)
10.18	Guarantee Agreement, dated June 28, 2006, between Codorus Valley Bancorp, Inc. and the guarantee trustee named therein. (Incorporated by reference to Exhibit 10.3 to the Registrant's Current Report on Form 8-K, filed with the Commission on June 30, 2006.)
31a	Certification of Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31b	Certification of Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32	Certification of Principal Executive Officer and Principal Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

SIGNATURES

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

Codorus Valley Bancorp, Inc.
(Registrant)

November 9, 2006	/s/ Larry J. Miller
Date	Larry J. Miller President & CEO (Principal executive officer)
November 9, 2006	/s/ Jann A. Weaver
Date	Jann A. Weaver Treasurer & Assistant Secretary

(Principal financial and accounting officer)