

COSTAR GROUP INC
Form 10-Q
October 26, 2017

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, 2017

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 0-24531

CoStar Group, Inc.
(Exact name of registrant as specified in its charter)
Delaware 52-2091509
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

1331 L Street, NW
Washington, DC 20005
(Address of principal executive offices) (zip code)

(202) 346-6500
(Registrant's telephone number, including area code)

(877) 739-0486
(Registrant's facsimile number, including area code)

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 No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated

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filer,” “smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Securities Exchange Act of 1934.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a 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 Exchange Act). Yes
o No x

As of October 20, 2017, there were 36,145,490 shares of the registrant's common stock outstanding.

COSTAR GROUP, INC.

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PART I — FINANCIAL INFORMATION

Item 1. Financial Statements

COSTAR GROUP, INC.
 CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
 (in thousands, except per share data)
 (unaudited)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|-------------------------------------|-----------|------------------------------------|-----------|
| | 2017 | 2016 | 2017 | 2016 |
| Revenues | \$247,533 | \$212,711 | \$711,239 | \$619,319 |
| Cost of revenues | 55,483 | 42,222 | 162,102 | 127,801 |
| Gross margin | 192,050 | 170,489 | 549,137 | 491,518 |
| Operating expenses: | | | | |
| Selling and marketing | 72,705 | 75,414 | 240,833 | 231,086 |
| Software development | 21,536 | 19,357 | 67,054 | 56,539 |
| General and administrative | 35,998 | 30,572 | 104,550 | 88,275 |
| Customer base amortization | 4,298 | 5,550 | 13,642 | 17,602 |
| | 134,537 | 130,893 | 426,079 | 393,502 |
| Income from operations | 57,513 | 39,596 | 123,058 | 98,016 |
| Interest and other income | 555 | 344 | 1,589 | 587 |
| Interest and other expense | (2,901) | (2,498) | (8,280) | (7,462) |
| Income before income taxes | 55,167 | 37,442 | 116,367 | 91,141 |
| Income tax expense | 20,990 | 14,241 | 37,876 | 35,643 |
| Net income | \$34,177 | \$23,201 | \$78,491 | \$55,498 |
| Net income per share — basic | \$1.05 | \$0.72 | \$2.42 | \$1.73 |
| Net income per share — diluted | \$1.04 | \$0.72 | \$2.40 | \$1.71 |
| Weighted average outstanding shares — basic | 32,444 | 32,186 | 32,375 | 32,152 |
| Weighted average outstanding shares — diluted | 32,814 | 32,440 | 32,705 | 32,423 |

See accompanying notes.

COSTAR GROUP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands)

(unaudited)

| | Three Months Ended September 30, 2017 | | 2016 | | Nine Months Ended September 30, 2017 | | 2016 | |
|--|--|----------|----------|----------|---|--|------|--|
| Net income | \$34,177 | \$23,201 | \$78,491 | \$55,498 | | | | |
| Other comprehensive income (loss), net of tax | | | | | | | | |
| Foreign currency translation adjustment | 1,190 | (596) | 3,432 | (3,054) | | | | |
| Net decrease in unrealized loss on investments | — | 46 | — | 275 | | | | |
| Total other comprehensive income (loss) | 1,190 | (550) | 3,432 | (2,779) | | | | |
| Total comprehensive income | \$35,367 | \$22,651 | \$81,923 | \$52,719 | | | | |

See accompanying notes.

COSTAR GROUP, INC.
 CONDENSED CONSOLIDATED BALANCE SHEETS
 (in thousands)

| | September 30, 2017 | December 31, 2016 |
|--|-----------------------|----------------------|
| | (unaudited) | |
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 622,995 | \$ 567,223 |
| Accounts receivable, net of allowance for doubtful accounts of approximately \$6,370 and \$6,344 as of September 30, 2017 and December 31, 2016, respectively | 60,871 | 48,537 |
| Income tax receivable | — | 129 |
| Prepaid expenses and other current assets | 16,215 | 11,602 |
| Total current assets | 700,081 | 627,491 |
| Long-term investments | 9,952 | 9,952 |
| Deferred income taxes, net | 6,477 | 7,273 |
| Property and equipment, net | 84,326 | 87,568 |
| Goodwill | 1,283,190 | 1,254,866 |
| Intangible assets, net | 191,178 | 195,965 |
| Deposits and other assets | 5,392 | 1,948 |
| Total assets | \$ 2,280,596 | \$ 2,185,063 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Current portion of long-term debt | \$ 36,910 | \$ 31,866 |
| Accounts payable | 11,323 | 11,478 |
| Accrued wages and commissions | 34,661 | 33,803 |
| Accrued expenses | 33,073 | 31,092 |
| Deferred gain on the sale of building | 2,523 | 2,523 |
| Income taxes payable | 9,328 | 3,814 |
| Deferred rent | 3,201 | 1,206 |
| Deferred revenue | 45,568 | 39,164 |
| Total current liabilities | 176,587 | 154,946 |
| Long-term debt, less current portion | 268,586 | 306,473 |
| Deferred gain on the sale of building | 16,823 | 18,715 |
| Deferred rent | 30,090 | 31,589 |
| Deferred income taxes, net | 22,101 | 18,386 |
| Income taxes payable | 3,982 | 741 |
| Total liabilities | 518,169 | 530,850 |
| Total stockholders' equity | 1,762,427 | 1,654,213 |
| Total liabilities and stockholders' equity | \$ 2,280,596 | \$ 2,185,063 |
| See accompanying notes. | | |

COSTAR GROUP, INC.
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
 (in thousands)
 (unaudited)

| | Nine Months Ended September 30, | |
|---|------------------------------------|-----------|
| | 2017 | 2016 |
| Operating activities: | | |
| Net income | \$78,491 | \$55,498 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 48,277 | 53,041 |
| Amortization of debt issuance costs | 2,157 | 2,407 |
| Stock-based compensation expense | 29,203 | 26,981 |
| Deferred income tax expense, net | 6,087 | 5,554 |
| Provision for losses on accounts receivable | 3,992 | 6,462 |
| Changes in operating assets and liabilities, net of acquisitions: | | |
| Accounts receivable | (15,809) | (13,808) |
| Prepaid expenses and other current assets | (3,561) | (1,398) |
| Deposits and other assets | (3,387) | 473 |
| Accounts payable and other liabilities | 11,888 | 12,864 |
| Deferred revenue | 5,969 | 386 |
| Net cash provided by operating activities | 163,307 | 148,460 |
| Investing activities: | | |
| Proceeds from sale and settlement of investments | — | 4,700 |
| Purchases of property and equipment and other assets | (19,754) | (11,692) |
| Acquisitions, net of cash acquired | (47,767) | (10,443) |
| Net cash used in investing activities | (67,521) | (17,435) |
| Financing activities: | | |
| Payments of long-term debt | (35,000) | (20,000) |
| Payments of issuance costs | (643) | — |
| Repurchase of restricted stock to satisfy tax withholding obligations | (14,309) | (14,573) |
| Proceeds from exercise of stock options and employee stock purchase plan | 9,058 | 4,791 |
| Net cash used in financing activities | (40,894) | (29,782) |
| Effect of foreign currency exchange rates on cash and cash equivalents | 880 | (962) |
| Net increase in cash and cash equivalents | 55,772 | 100,281 |
| Cash and cash equivalents at the beginning of period | 567,223 | 421,818 |
| Cash and cash equivalents at the end of period | \$622,995 | \$522,099 |
| See accompanying notes. | | |

COSTAR GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

1. ORGANIZATION

CoStar Group, Inc. (the “Company” or “CoStar”) provides information, analytics and online marketplace services to the commercial real estate and related business community through its comprehensive, proprietary database of commercial real estate information covering the United States (“U.S.”), the United Kingdom (“U.K.”), and parts of Canada, Spain, Germany and France. The Company provides online marketplaces for commercial real estate, apartment rentals, lands for sale and businesses for sale. The Company operates within two operating segments, North America and International, and its services are typically distributed to its clients under subscription-based license agreements that renew automatically, a majority of which have a term of one year.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The condensed consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All intercompany balances and transactions have been eliminated in consolidation. Accounting policies are consistent for each operating segment.

Interim Financial Statements

The accompanying unaudited condensed consolidated financial statements of the Company have been prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) for interim financial information. In the opinion of the Company’s management, the financial statements reflect all adjustments necessary to present fairly the Company’s financial position at September 30, 2017 and December 31, 2016, the results of its operations for the three and nine months ended September 30, 2017 and 2016, its comprehensive income for the three and nine months ended September 30, 2017 and 2016, and its cash flows for the nine months ended September 30, 2017 and 2016. These adjustments are of a normal recurring nature.

Certain notes and other information have been condensed or omitted from the interim financial statements presented in this Quarterly Report on Form 10-Q. Therefore, these financial statements should be read in conjunction with the Company’s Annual Report on Form 10-K for the year ended December 31, 2016.

The results of operations for the three and nine months ended September 30, 2017 are not necessarily indicative of future financial results.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. On an ongoing basis, the Company evaluates its estimates and assumptions, including those related to revenue recognition, allowance for doubtful accounts, credit reserves, useful lives of property and equipment and intangible assets, recoverability of long-lived assets and intangible assets with definite lives, goodwill, income taxes, fair value of equity instruments, fair value of auction rate securities (“ARS”), accounting for business combinations and contingencies, among others. The Company bases these estimates on historical and anticipated results, trends, and various other assumptions that it believes are reasonable, including assumptions as to future events. These estimates form the basis for making judgments about the carrying values of assets and liabilities and recorded revenues and expenses. Actual results could

differ from these estimates.

Revenue Recognition

The Company primarily derives revenues by (i) providing access to its proprietary database of commercial real estate information, and (ii) providing an online marketplace for professional property management companies, property owners, brokers, and landlords. The Company generally charges a fixed monthly amount for its subscription-based services. The Company and its subsidiaries' subscription-based services consist primarily of information, analytics and online marketplace services offered over the internet to commercial real estate industry and related professionals. Subscription contract rates are based on the number of sites, number of users, organization size, the client's business focus, geography, the number and types of services to which a client subscribes, the number of properties a client advertises and the prominence and placement of a client's advertised properties in the search results, as applicable. A majority of the subscription-based service agreements have a term of one year and renew automatically.

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COSTAR GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited) — (CONTINUED)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES — (CONTINUED)

Revenue Recognition — (Continued)

Revenues are recognized when (1) there is persuasive evidence of an arrangement, (2) the fee is fixed and determinable, (3) services have been rendered and payment has been contractually earned and (4) collectability is reasonably assured. Revenues from subscription-based services are recognized on a straight-line basis over the term of the agreement. Deferred revenue results from advance cash receipts from customers or amounts billed in advance to customers from the sale of subscription services and is recognized over the term of the service agreement.

The Company analyzes contracts with multiple elements under the accounting guidance for multiple-element arrangements. The Company's multiple-element arrangements include information, analytics and/or online marketplace services that are generally provided to the customer over the same term. When identifying multiple-element arrangements, the Company considers multiple purchases made by the same customer within a short time frame and assesses whether the purchases were negotiated together as one overall arrangement. If a multiple-element arrangement is identified, then the arrangement consideration is allocated among the separate units of accounting based on their relative selling prices, which are estimated considering factors such as historical pricing, pricing strategy, market conditions and other factors. The Company accounts for each deliverable in the transaction separately. If the deliverables cannot be separated into multiple units of accounting, then the arrangement consideration is combined and recognition of revenue is determined for the combined unit of accounting. Multiple-element transactions require judgment to determine the selling price or fair value of the different elements. These judgments impact the amount of revenue recognized over the term of the contract, as well as the period in which they are recognized.

Concentration of Credit Risk and Financial Instruments

The Company maintains reserves for estimated inherent credit losses, and such losses have been within management's expectations. The large size and widespread nature of the Company's customer base and the Company's lack of dependence on any individual customer mitigates the risk of nonpayment of the Company's accounts receivable. The carrying amount of the accounts receivable approximates the net realizable value. The carrying value of the accounts receivable, accounts payable, accrued expenses and long-term debt approximates fair value.

The Company holds cash at major financial institutions in amounts that often exceed Federal Deposit Insurance Corporation insured limits. The Company manages its credit risk associated with cash concentrations by concentrating its cash deposits in high quality financial institutions and by periodically evaluating the credit quality of the primary financial institutions holding such deposits. The carrying value of cash approximates fair value. Historically, the Company has not experienced any losses due to such cash concentrations.

Advertising Costs

The Company expenses advertising costs as incurred. Advertising costs include e-commerce, television, radio, print and other media advertising. Advertising costs were approximately \$25 million and \$27 million for the three months ended September 30, 2017 and 2016, respectively. Advertising costs were approximately \$87 million and \$95 million for the nine months ended September 30, 2017 and 2016, respectively.

Foreign Currency Translation

The Company's functional currency of its foreign locations is the local currency. Assets and liabilities are translated into U.S. dollars using the exchange rates as of the balance sheet dates. Revenues, expenses, gains and losses are translated at the average exchange rates in effect during each period. Gains and losses resulting from translation are included in accumulated other comprehensive loss. Currency gains and losses on the translation of intercompany loans made to foreign subsidiaries that are of a long-term investment nature are also included in accumulated other comprehensive loss. Net gains or losses resulting from foreign currency exchange transactions are included in the condensed consolidated statements of operations. There were no material gains or losses from foreign currency exchange transactions for the three and nine months ended September 30, 2017 and 2016.

COSTAR GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited) — (CONTINUED)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES — (CONTINUED)

Accumulated Other Comprehensive Loss

The components of accumulated other comprehensive loss were as follows (in thousands):

| | September 30, 2017 | | December 31, 2016 | |
|--|--------------------|---|-------------------|---|
| Foreign currency translation adjustment | \$ (8,759 |) | \$ (12,191 |) |
| Accumulated net unrealized loss on investments, net of tax | (848 |) | (848 |) |
| Total accumulated other comprehensive loss | \$ (9,607 |) | \$ (13,039 |) |

There were no amounts reclassified out of accumulated other comprehensive loss to the condensed consolidated statements of operations for the three and nine months ended September 30, 2017 and 2016. The foreign currency translation adjustment includes intra-entity foreign currency transactions that are of a long-term investment nature.

Net Income Per Share

Net income per share is computed by dividing net income by the weighted average number of common shares outstanding during the period on a basic and diluted basis. The Company's potentially dilutive securities include stock options and unvested restricted stock. Diluted net income per share considers the impact of potentially dilutive securities except in periods in which there is a net loss, as the inclusion of the potentially dilutive common shares would have an anti-dilutive effect.

The following table sets forth the calculation of basic and diluted net income per share (in thousands, except per share data):

| | Three Months Ended September 30, 2017 | | Nine Months Ended September 30, 2016 | |
|--|---------------------------------------|----------|--------------------------------------|----------|
| Numerator: | | | | |
| Net income | \$34,177 | \$23,201 | \$78,491 | \$55,498 |
| Denominator: | | | | |
| Denominator for basic net income per share — weighted-average outstanding shares | 32,444 | 32,186 | 32,375 | 32,152 |
| Effect of dilutive securities: | | | | |
| Stock options and restricted stock | 370 | 254 | 330 | 271 |
| Denominator for diluted net income per share — weighted-average outstanding shares | 32,814 | 32,440 | 32,705 | 32,423 |
| Net income per share — basic | \$1.05 | \$0.72 | \$2.42 | \$1.73 |
| Net income per share — diluted | \$1.04 | \$0.72 | \$2.40 | \$1.71 |

COSTAR GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited) — (CONTINUED)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES — (CONTINUED)

Net Income Per Share — (Continued)

There were no anti-dilutive options for the three months ended September 30, 2017. Stock options to purchase approximately 89,000 shares that were outstanding for the three months ended September 30, 2016 were not included in the computation of diluted net income per share because the inclusion of such shares would have an anti-dilutive effect. Stock options to purchase approximately 116,000 and 184,000 shares that were outstanding for the nine months ended September 30, 2017 and 2016, respectively, were not included in the computation of diluted net income per share because the inclusion of the potentially dilutive common shares would have an anti-dilutive effect. Shares underlying restricted common stock awards that vest based on Company performance and service conditions that have not been achieved as of the end of the period are not included in the computation of basic or diluted earnings per share. Shares underlying restricted stock units that vest based on Company service conditions that have not been achieved as of the end of the period are not included in the computation of basic or diluted earnings per share. The following table summarizes the shares underlying the performance-based restricted stock awards and service-based restricted stock units excluded from the basic and diluted calculation (in thousands):

| | Three Months Ended September 30, 2017 | | Nine Months Ended September 30, 2016 | |
|---|--|----|---|----|
| Performance-based restricted stock awards | 85 | 72 | 85 | 72 |
| Service-based restricted stock units | 1 | 1 | 1 | 1 |
| Total shares excluded from computation | 86 | 73 | 86 | 73 |

Stock-Based Compensation

Equity instruments issued in exchange for services performed by officers, employees, directors and consultants of the Company are accounted for using a fair-value based method and the fair value of such equity instruments is recognized as expense in the condensed consolidated statements of operations.

Stock-based compensation expense is measured at the grant date of the stock-based awards that vest over set time periods based on their fair values, and is recognized on a straight line basis as expense over the vesting periods of the awards, net of an estimated forfeiture rate. For equity instruments that vest based on performance, the Company assesses the probability of the achievement of the performance conditions at the end of each reporting period, or more frequently based upon the occurrence of events that may change the probability of whether the performance conditions would be met. If the Company's initial estimates of the achievement of the performance conditions change, the related stock-based compensation expense and timing of recognition may fluctuate from period to period based on those estimates. For equity instruments that vest based on a performance condition and a market condition, the Company estimates the fair value of each equity instrument granted on the date of grant using a Monte-Carlo simulation model. This pricing model uses multiple simulations to evaluate the probability of achieving the market condition to calculate the fair value of the awards. Stock-based compensation expense is updated based on the expected achievement of the related performance conditions at the end of each reporting period. If the performance conditions are not met, no stock-based compensation expense will be recognized, and any previously recognized stock-based compensation expense will be reversed.

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Stock-based compensation expense for stock options, restricted stock, restricted stock units issued under equity incentive plans and stock purchases under the ESPP included in the Company's results of operations were as follows (in thousands):

| | Three Months | | Nine Months | |
|--------------------------------|---------------|---------|---------------|----------|
| | Ended | | Ended | |
| | September 30, | | September 30, | |
| | 2017 | 2016 | 2017 | 2016 |
| Cost of revenues | \$1,201 | \$1,396 | \$3,711 | \$4,209 |
| Selling and marketing | 1,862 | 1,676 | 5,401 | 4,920 |
| Software development | 1,665 | 1,684 | 5,315 | 4,902 |
| General and administrative | 5,015 | 4,555 | 14,776 | 12,950 |
| Total stock-based compensation | \$9,743 | \$9,311 | \$29,203 | \$26,981 |

COSTAR GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited) — (CONTINUED)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES — (CONTINUED)

Stock-Based Compensation — (Continued)

Options to purchase 3,532 and 3,367 shares were exercised during the three months ended September 30, 2017 and 2016, respectively. Options to purchase 81,815 and 24,078 shares were exercised during the nine months ended September 30, 2017 and 2016, respectively.

Debt Issuance Costs

Costs incurred in connection with the issuance of long-term debt are capitalized and amortized as interest expense over the term of the related debt using the effective interest method. These amounts are reflected in the consolidated balance sheets as direct deductions from a combination of the current and long-term portions of debt. Upon a refinancing, previously capitalized debt issuance costs are expensed and included in loss on extinguishment of debt if the Company determines that there has been a substantial modification of the related debt. If the Company determines that there has not been a substantial modification of the related debt, any previously capitalized debt issuance costs are amortized as interest expense over the term of the new debt instrument using the effective interest method. The Company had capitalized debt issuance costs, net of amortization, of approximately \$5 million and \$7 million as of September 30, 2017 and December 31, 2016, respectively. The debt issuance costs are associated with the financing commitment received from JPMorgan Chase Bank, N.A. (“J.P. Morgan Bank”) on April 27, 2011, the subsequent term loan facility and revolving credit facility established under a credit agreement dated February 16, 2012 (the “2012 Credit Agreement”), the financing commitment received from J.P. Morgan Bank, Bank of America, N.A., SunTrust Bank and Wells Fargo Bank, National Association on February 28, 2014, and the subsequent term loan facility and revolving credit facility established under a credit agreement dated April 1, 2014 (the “2014 Credit Agreement”). See Notes 7 and 11 for additional information regarding the term loan facility and revolving credit facility. The Company amortized debt issuance costs of approximately \$670,000 and \$797,000 for the three months ended September 30, 2017 and 2016, respectively. The Company amortized debt issuance costs of approximately \$2 million for each of the nine months ended September 30, 2017 and 2016, respectively.

Business Combinations

The Company allocates the purchase consideration to the tangible assets acquired, liabilities assumed and intangible assets acquired based on their estimated fair values. The excess of the fair value of purchase consideration over the fair values of these identifiable assets and liabilities is recorded as goodwill. Such valuations require management to make significant estimates and assumptions, especially with respect to intangible assets. Significant estimates in valuing certain intangible assets include, but are not limited to, future expected cash flows from acquired customer bases, acquired database technology, and acquired trade names from a market participant's perspective, useful lives and discount rates. During the measurement period, the Company may record adjustments to the assets acquired and liabilities assumed. Any adjustments to provisional amounts that are identified during the measurement period are recorded in the reporting period in which the adjustment amounts are determined. Upon the conclusion of the measurement period, any subsequent adjustments are recorded to earnings.

COSTAR GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited) — (CONTINUED)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES — (CONTINUED)

Recent Accounting Pronouncements

There have been no developments to the Recent Accounting Pronouncements discussion included in the Company's Annual Report on Form 10-K for the year ended December 31, 2016, including the expected dates of adoption and estimated effects on the Company's condensed consolidated financial statements, except for the following:

In May 2014, the Financial Accounting Standards Board ("FASB") and International Accounting Standards Board ("IASB") jointly issued a new revenue recognition standard that is designed to improve financial reporting by creating common recognition guidance for GAAP and International Financial Reporting Standards ("IFRS"). This guidance provides a robust framework for addressing revenue issues, improves the comparability of revenue recognition practices across industries, provides useful information to users of financial statements through improved disclosure requirements and simplifies the presentation of financial statements. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. From March to December 2016, amendments to the new revenue recognition standard were issued to clarify numerous accounting topics, including, but not limited to (i) the implementation guidance on principal versus agent considerations, (ii) the identification of performance obligations, (iii) the licensing implementation guidance, (iv) the objective of the collectability criterion, (v) the application of the variable consideration guidance and modified retrospective transition method, (vi) the way in which impairment testing is performed and (vii) the disclosure requirements for revenue recognized from performance obligations. This guidance permits the use of either a full retrospective method or a modified retrospective approach. The modified retrospective approach would be applied only to the most current period presented along with a cumulative-effect adjustment at the date of adoption. This guidance will be effective for annual reporting periods beginning after December 15, 2017, although companies may adopt the standard as early as annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. The Company is currently evaluating the potential impact of adopting this guidance and, although it expects significant changes to its financial statement disclosures, due to the nature of its services and current revenue recognition practices, it does not believe the new revenue recognition standard will have a material impact on its revenue recognition policies. The Company expects adoption of the new standard will change its current treatment of commissions paid to employees, which the Company currently expenses as incurred. Under the new standard, the Company expects to capitalize commission costs as an incremental cost of obtaining a contract, which may have a material impact on the Company's financial statements. The Company is currently evaluating the period over which the capitalized commission costs will be amortized. Once the amortization period is determined, the Company expects to be able to assess the impact of adopting this guidance. The Company expects to adopt the new standard on January 1, 2018 using the modified retrospective transition method.

In February 2016, the FASB issued authoritative guidance to increase transparency and comparability among organizations' accounting for leases. The guidance requires a company to recognize lease assets and lease liabilities on the balance sheet, as well as disclose key information about leasing arrangements. This guidance is effective on a modified retrospective basis for annual reporting periods beginning after December 15, 2018, including interim periods within that reporting period. Early application is permitted. The Company is currently evaluating the impact this guidance will have on its financial statements and related disclosures, and expects that the adoption of this standard may result in a material increase in assets and liabilities on its consolidated balance sheets.

COSTAR GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited) — (CONTINUED)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES — (CONTINUED)

Recent Accounting Pronouncements — (Continued)

In March 2016, the FASB issued authoritative guidance to simplify several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification of share-based payment transactions on the statement of cash flows. The guidance requires a company to (i) recognize all excess tax benefits and tax deficiencies as income tax expense or benefit in the statement of operations using a prospective transition method, (ii) recognize excess tax benefits in the current period regardless of whether the benefit reduces taxes payable using a modified retrospective transition method, and (iii) classify all excess tax benefits as operating activities within the statement of cash flows using either a prospective transition method or a retrospective transition method. The guidance also allows a company to (i) elect whether to estimate the number of share-based awards expected to vest or account for forfeitures when they occur, and (ii) withhold up to the maximum statutory tax rate in the applicable jurisdiction for awards, both of which should be applied using a modified retrospective transition method. Finally, the guidance requires a company to classify the cash paid by an employer when directly withholding shares for tax withholding purposes as a financing activity within the statement of cash flows using a retrospective transition method. This guidance is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period.

The adoption of the new standard resulted in a \$2 million cumulative-effect adjustment as of January 1, 2017 to record a deferred tax asset with the offset to retained earnings on the balance sheet, representing the amount of the Company's net operating loss carryforwards attributable to excess tax benefits that it was not able to record under the prior guidance. The Company elected to apply the presentation requirements for statement of cash flows related to excess tax benefits retrospectively to all periods presented, which resulted in an increase to both net cash provided by operating activities and net cash used in financing activities of approximately \$5 million for the nine months ended September 30, 2016. The presentation requirements related to employee taxes paid by withholding shares had no impact to any of the periods presented in the Company's condensed consolidated cash flows statements since such cash flows have historically been presented as a financing activity. In accordance with the new standard, the Company recognized an income tax benefit of \$1 million, resulting in a corresponding increase in net income and an increase of \$0.02 per basic and diluted share for the three months ended September 30, 2017. In addition, the Company recognized an income tax benefit of \$8 million, resulting in a corresponding increase in net income and an increase of \$0.23 per basic and diluted share for the nine months ended September 30, 2017. These income tax benefits related to the recognition of excess tax benefits from stock options that were exercised and restricted stock that vested during the period, that prior to the adoption of the new standard were recognized as an increase to additional paid-in capital.

In June 2016, the FASB issued authoritative guidance designed to provide financial statement users with more information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date. When determining such expected credit losses, the guidance requires companies to apply a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. This guidance is effective on a modified retrospective basis for annual reporting periods beginning after December 15, 2019, including interim periods within that reporting period. Companies may adopt the standard as early as annual reporting periods beginning after December 15, 2018. The Company is currently evaluating the impact this guidance will have on its financial statements and related disclosures.

In August 2016, the FASB issued authoritative guidance designed to reduce the existing diversity in how certain cash receipts and cash payments are presented and classified in the consolidated statements of cash flows. This guidance is effective on a retrospective basis for annual reporting periods beginning after December 15, 2017, including interim

periods within that reporting period. Early application is permitted. This guidance is not expected to have a material impact on the Company's consolidated statements of cash flows and related disclosures.

In January 2017, the FASB issued authoritative guidance designed to clarify the definition of a business to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The guidance indicates that when substantially all of the fair value of the gross assets acquired (or disposed of) is concentrated in a single identifiable asset or a group of similar identifiable assets, the set of assets is not a business. This guidance is effective on a prospective basis for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. Early application is permitted in certain situations. This guidance is not expected to have a material impact on the Company's consolidated financial statements and related disclosures.

COSTAR GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited) — (CONTINUED)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES — (CONTINUED)

Recent Accounting Pronouncements — (Continued)

In January 2017, the FASB issued authoritative guidance designed to simplify the measurement of goodwill by eliminating Step 2 from the goodwill impairment test. The guidance indicates that an entity should recognize an impairment charge for the amount by which the carrying amount of a reporting unit exceeds the reporting unit's fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. This guidance is effective on a prospective basis for annual reporting periods beginning after December 15, 2019, including interim periods within that reporting period. Early application is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The Company early adopted this guidance during the first quarter of 2017 and the early adoption did not have a material impact on the Company's consolidated financial statements and related disclosures.

In May 2017, the FASB issued authoritative guidance designed to reduce the existing diversity and complexity in the accounting for changes to terms or conditions of a share-based payment award. This guidance clarifies that an entity will not apply modification accounting to a share-based payment award if all of the following are the same immediately before and after the change: (i) the fair value of the award, (ii) the vesting conditions of the award, and (iii) the classification of the award as an equity instrument or liability instrument. This guidance is effective on a prospective basis for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. Early application is permitted. This guidance is not expected to have a material impact on the Company's consolidated financial statements and related disclosures.

3. INVESTMENTS

The Company determines the appropriate classification of debt and equity investments at the time of purchase and re-evaluates such designation as of each balance sheet date. The Company considers all of its investments to be available-for-sale. The Company's investments consist of long-term variable rate debt instruments with an auction reset feature, referred to as ARS. Investments are carried at fair value.

Scheduled maturities of investments classified as available-for-sale as of September 30, 2017 are as follows (in thousands):

| Maturity | Fair Value |
|--------------------------------|------------|
| Due: | |
| July 1, 2017 — June 30, 2018 | \$— |
| July 1, 2018 — June 30, 2022 | — |
| July 1, 2022 — June 30, 2027 | — |
| After June 30, 2027 | 9,952 |
| Available-for-sale investments | \$9,952 |

The Company had no realized gains on its investments for each of the three and nine months ended September 30, 2017 and 2016, respectively. The Company had no realized losses on its investments for each of the three and nine months ended September 30, 2017 and 2016, respectively. Realized gains and losses from the sale of available-for-sale securities are determined on a specific-identification basis.

Changes in unrealized holding gains and losses, net of the related tax effect, on available-for-sale securities are excluded from earnings and are reported as a separate component of accumulated other comprehensive loss in

stockholders' equity until realized. A decline in market value of any available-for-sale security below cost that is deemed to be other-than-temporary results in a reduction in carrying amount to fair value. The impairment is charged to earnings and a new cost basis for the security is established. Dividend and interest income are recognized when earned.

COSTAR GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited) — (CONTINUED)

3. INVESTMENTS — (CONTINUED)

As of September 30, 2017, the amortized cost basis and fair value of investments classified as available-for-sale were as follows (in thousands):

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|--------------------------------|-------------------|------------------------------|-------------------------------|---------------|
| Auction rate securities | \$ 10,800 | \$ | —\$ (848) | \$9,952 |
| Available-for-sale investments | \$ 10,800 | \$ | —\$ (848) | \$9,952 |

As of December 31, 2016, the amortized cost basis and fair value of investments classified as available-for-sale were as follows (in thousands):

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|--------------------------------|-------------------|------------------------------|-------------------------------|---------------|
| Auction rate securities | \$ 10,800 | \$ | —\$ (848) | \$9,952 |
| Available-for-sale investments | \$ 10,800 | \$ | —\$ (848) | \$9,952 |

The unrealized losses on the Company's investments as of September 30, 2017 and December 31, 2016 were generated primarily from changes in interest rates and ARS that failed to settle at auction, due to adverse conditions in the global credit markets. The losses are considered temporary, as the contractual terms of these investments do not permit the issuer to settle the security at a price less than the amortized cost of the investment. Because the Company does not intend to sell these instruments and it is not more likely than not that the Company will be required to sell these instruments prior to anticipated recovery, which may be at maturity, the Company does not consider these investments to be other-than-temporarily impaired as of September 30, 2017 and December 31, 2016. See Note 4 for further discussion of the fair value of the Company's financial assets.

The components of the Company's investments in an unrealized loss position for twelve months or longer were as follows (in thousands):

| | September 30, 2017 | | December 31, 2016 | |
|--|----------------------------|-------------------------------|----------------------------|-------------------------------|
| | Aggregate Fair Value | Gross Unrealized Losses | Aggregate Fair Value | Gross Unrealized Losses |
| Auction rate securities | \$9,952 | \$ (848) | \$9,952 | \$ (848) |
| Investments in an unrealized loss position | \$9,952 | \$ (848) | \$9,952 | \$ (848) |

The Company did not have any investments in an unrealized loss position for less than twelve months as of September 30, 2017 and December 31, 2016.

4. FAIR VALUE

Fair value is defined as the price that would be received in the sale of an asset or paid to transfer a liability in an orderly transaction between market participants. There is a three-tier fair value hierarchy, which categorizes the inputs used in measuring fair value. These tiers include: Level 1, defined as observable inputs such as quoted prices in active markets for identical assets or liabilities; Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and Level 3, defined as unobservable inputs for which little or no market data exists, therefore requiring an entity to develop its own assumptions.

COSTAR GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited) — (CONTINUED)

4. FAIR VALUE — (CONTINUED)

The following table represents the Company's fair value hierarchy for its financial assets (cash equivalents and investments) measured at fair value on a recurring basis as of September 30, 2017 (in thousands):

| | Level 1 | Level 2 | Level 3 | Total |
|-------------------------------------|-----------|---------|----------|-----------|
| Assets: | | | | |
| Money market funds | \$336,265 | \$— | \$— | \$336,265 |
| Commercial paper | 8,970 | — | — | 8,970 |
| Auction rate securities | — | — | 9,952 | 9,952 |
| Total assets measured at fair value | \$345,235 | \$— | -\$9,952 | \$355,187 |

The following table represents the Company's fair value hierarchy for its financial assets (cash equivalents and investments) measured at fair value on a recurring basis as of December 31, 2016 (in thousands):

| | Level 1 | Level 2 | Level 3 | Total |
|-------------------------------------|-----------|---------|----------|-----------|
| Assets: | | | | |
| Money market funds | \$175,344 | \$— | \$— | \$175,344 |
| Commercial paper | 6,383 | — | — | 6,383 |
| Auction rate securities | — | — | 9,952 | 9,952 |
| Total assets measured at fair value | \$181,727 | \$— | -\$9,952 | \$191,679 |

The Company's Level 3 assets consist of ARS, whose underlying assets are primarily student loan securities supported by guarantees from the Federal Family Education Loan Program ("FFELP") of the U.S. Department of Education.

The following tables summarize changes in fair value of the Company's Level 3 assets for the three and nine months ended September 30, 2017 and 2016 (in thousands):

| | Three Months Ended September 30, 2017 | | Nine Months Ended September 30, 2016 | |
|--|---------------------------------------|----------|--------------------------------------|----------|
| Balance at beginning of period | \$9,952 | \$11,036 | \$9,952 | \$15,507 |
| Decrease in unrealized loss included in accumulated other comprehensive loss | — | 46 | — | 275 |
| Settlements | — | — | — | (4,700) |
| Balance at end of period | \$9,952 | \$11,082 | \$9,952 | \$11,082 |

The following table summarizes changes in fair value of the Company's Level 3 assets from December 31, 2015 to September 30, 2017 (in thousands):

| | |
|--|-------------------------------------|
| Balance at December 31, 2015 | Auction Rate Securities \$15,507 |
| Decrease in unrealized loss included in accumulated other comprehensive loss | 395 |
| Settlements | (5,950) |
| Balance at December 31, 2016 | 9,952 |
| Decrease in unrealized loss included in accumulated other comprehensive loss | — |

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| | |
|-------------------------------|---------|
| Settlements | — |
| Balance at September 30, 2017 | \$9,952 |

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COSTAR GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited) — (CONTINUED)

4. FAIR VALUE — (CONTINUED)

ARS are variable rate debt instruments whose interest rates are reset approximately every 28 days. The majority of the underlying securities have contractual maturities greater than twenty years. The ARS are recorded at fair value.

As of September 30, 2017, the Company held ARS with \$11 million par value, all of which failed to settle at auction. The majority of these investments are of high credit quality with AAA credit ratings and are primarily student loan securities supported by guarantees from the FFELP of the U.S. Department of Education. The Company may not be able to liquidate and fully recover the carrying value of the ARS in the near term. As a result, these securities are classified as long-term investments in the Company's condensed consolidated balance sheet as of September 30, 2017. See Note 3 for further discussion of the scheduled maturities of investments classified as available-for-sale.

While the Company continues to earn interest on its ARS investments at the contractual rate, these investments are not currently actively trading and therefore do not currently have a readily determinable market value. The estimated fair value of the ARS no longer approximates par value. The Company used a discounted cash flow model to determine the estimated fair value of its investment in ARS as of September 30, 2017. The assumptions used in preparing the discounted cash flow model include estimates for interest rates, credit spreads, timing and amount of contractual cash flows, liquidity risk premiums, expected holding periods and default risk. The Company updates the discounted cash flow model on a quarterly basis to reflect any changes in the assumptions used in the model and settlements of ARS investments that occurred during the period.

The only significant unobservable input in the discounted cash flow model is the discount rate. The discount rate used represents the Company's estimate of the yield expected by a market participant from the ARS investments. The weighted average discount rate used in the discounted cash flow model as of September 30, 2017 and December 31, 2016 was approximately 5%. Selecting another discount rate within the range used in the discounted cash flow model would not result in a significant change to the fair value of the ARS.

Based on this assessment of fair value, as of September 30, 2017, the Company determined there was a decline in the fair value of its ARS investments of approximately \$848,000. The decline was deemed to be a temporary impairment and recorded as an unrealized loss in accumulated other comprehensive loss in stockholders' equity. In addition, while a majority of the ARS are currently rated AAA, if the issuers are unable to successfully close future auctions and/or their credit ratings deteriorate, then the Company may be required to record additional unrealized losses in accumulated other comprehensive loss or an other-than-temporary impairment charge to earnings on these investments.

5. GOODWILL

The changes in the carrying amount of goodwill by operating segment consist of the following (in thousands):

| | North America | International | Total |
|--|------------------|---------------|--------------|
| Goodwill, December 31, 2015 | \$ 1,227,310 | \$ 25,635 | \$ 1,252,945 |
| Acquisition | 467 | 5,933 | 6,400 |
| Effect of foreign currency translation | — | (4,479) | (4,479) |
| Goodwill, December 31, 2016 | 1,227,777 | 27,089 | 1,254,866 |
| Acquisitions | 25,717 | — | 25,717 |
| Effect of foreign currency translation | — | 2,607 | 2,607 |
| Goodwill, September 30, 2017 | \$ 1,253,494 | \$ 29,696 | \$ 1,283,190 |

COSTAR GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited) — (CONTINUED)

5. GOODWILL — (CONTINUED)

The Company recorded goodwill of approximately \$467,000 during the year ended December 31, 2016 in connection with the acquisition of certain assets related to the business operations of Apartment Finder's independent distributors within various markets. The Company also recorded goodwill of approximately \$6 million in connection with the May 3, 2016 acquisition of Thomas Daily GmbH ("Thomas Daily"), a commercial real estate news and information provider operating in Freiburg, Germany. The Company recorded goodwill of approximately \$8 million in connection with the January 31, 2017 acquisition of Koa Lei, Inc. (doing business as Westside Rentals and now known as Westside Rentals, LLC), an online marketplace specializing in Southern California real estate rentals, and its affiliated entity Westside Credit Services, LLC, a provider of credit checks and tenant screening for landlords in the Southern California real estate rental market. The Company recorded goodwill of approximately \$15 million in connection with the May 10, 2017 acquisition of certain assets and assumption of certain liabilities from Datasphere Technologies, Inc., in each case, related to the LandWatch.com® business (collectively referred to as "LandWatch"), a leading listing site dedicated to land and rural properties. The Company recorded goodwill of approximately \$2 million in connection with the July 18, 2017 acquisition of The Screening Pros, LLC, an online apartment leasing platform that includes tenant screening services, rental applications and payments processing and lease renewals. The purchase accounting for the acquisitions of Westside Rentals®, LandWatch®, and The Screening Pros™ is preliminary, subject to the completion of the accounting for certain tax related items and working capital adjustments.

6. INTANGIBLE ASSETS

Intangible assets consist of the following (in thousands, except amortization period data):

| | September 30, 2017 | December 31, 2016 | Weighted- Average Amortization Period (in years) |
|---|-----------------------|----------------------|---|
| Capitalized product development cost | \$ 2,275 | \$ 2,275 | 4 |
| Accumulated amortization | (2,250) | (2,217) |) |
| Capitalized product development cost, net | 25 | 58 | |
| Building photography | 18,723 | 17,271 | 4 |
| Accumulated amortization | (17,777) | (16,351) |) |
| Building photography, net | 946 | 920 | |
| Acquired database technology | 83,424 | 78,151 | 5 |
| Accumulated amortization | (78,313) | (72,691) |) |
| Acquired database technology, net | 5,111 | 5,460 | |
| Acquired customer base | 225,776 | 220,749 | 10 |
| Accumulated amortization | (165,041) | (150,445) |) |
| Acquired customer base, net | 60,735 | 70,304 | |
| Acquired trade names and other intangible assets | 167,683 | 153,607 | 13 |
| Accumulated amortization | (43,322) | (34,384) |) |
| Acquired trade names and other intangible assets, net | 124,361 | 119,223 | |
| Intangible assets, net | \$ 191,178 | \$ 195,965 | |

COSTAR GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited) — (CONTINUED)

7. LONG-TERM DEBT

On April 1, 2014 (the “Closing Date”), the Company entered into the 2014 Credit Agreement by and among the Company, as Borrower, CoStar Realty Information, Inc., as Co-Borrower, the Lenders from time to time party thereto and JPMorgan Chase Bank, N.A., as Administrative Agent. The 2014 Credit Agreement provides for a \$400 million term loan facility and a \$225 million revolving credit facility, each with a term of five years. The Company can make principal prepayments on the term loan facility and revolving credit facility at any time without penalty. In addition to regularly scheduled principal payments on the term loan made during the first quarter of 2017, the Company made a principal prepayment of \$30 million. The carrying value of the term loan facility approximates fair value and can be estimated through Level 3 unobservable inputs using a valuation technique based on expected cash flows discounted using the current credit-adjusted risk-free rate, which approximates the rate of interest on the term loan facility at origination.

The revolving credit facility includes a subfacility for swingline loans of up to \$10 million, and up to \$10 million of the revolving credit facility is available for the issuance of letters of credit. The Company has an irrevocable standby letter of credit outstanding totaling \$0.2 million as of September 30, 2017 and December 31, 2016, respectively, which was required to secure its San Francisco office lease. The letter of credit was established in 2014 related to the San Francisco office lease, and automatically renews through January 31, 2025.

The term loan facility will amortize in quarterly installments in amounts resulting in an annual amortization of 5% during each of the first, second and third years, 10% during the fourth year and 15% during the fifth year after the Closing Date, with the remainder payable at final maturity. The loans under the 2014 Credit Agreement bear interest, at the Company's option, either (i) during any interest period selected by the Company, at the London interbank offered rate for deposits in U.S. dollars with a maturity comparable to such interest period, adjusted for statutory reserves (“LIBOR”), plus an initial spread of 2% per annum, subject to adjustment based on the First Lien Secured Leverage Ratio (as defined in the 2014 Credit Agreement) of the Company, or (ii) at the greatest of (x) the prime rate from time to time announced by JPMorgan Chase Bank, N.A., (y) the federal funds effective rate plus 0.5% and (z) LIBOR for a one-month interest period plus 1%, plus an initial spread of 1% per annum, subject to adjustment based on the First Lien Secured Leverage Ratio of the Company. If an event of default occurs under the 2014 Credit Agreement, the interest rate on overdue amounts will increase by 2% per annum. The obligations under the 2014 Credit Agreement are guaranteed by all material subsidiaries of the Company and are secured by a lien on substantially all of the assets of the Company and those of its material subsidiaries, in each case subject to certain exceptions, pursuant to security and guarantee documents entered into on the Closing Date.

The 2014 Credit Agreement requires the Company to maintain certain leverage ratios from the Closing Date through the term of the 2014 Credit Agreement. Currently, the 2014 Credit Agreement requires the Company to maintain (i) a First Lien Secured Leverage Ratio (as defined in the 2014 Credit Agreement) not exceeding 3.5 to 1.0 during the three months ended September 30, 2017, and each full fiscal quarter thereafter and (ii) after the incurrence of additional indebtedness under certain specified exceptions in the 2014 Credit Agreement, a Total Leverage Ratio (as defined in the 2014 Credit Agreement) not exceeding 4.5 to 1.0 during the three months ended September 30, 2017, and each full fiscal quarter thereafter. The 2014 Credit Agreement also includes other covenants, including covenants that, subject to certain exceptions, restrict the ability of the Company and its subsidiaries to (i) incur additional indebtedness, (ii) create, incur, assume or permit to exist any liens, (iii) enter into mergers, consolidations or similar transactions, (iv) make investments and acquisitions, (v) make certain dispositions of assets, (vi) make dividends, distributions and prepayments of certain indebtedness, and (vii) enter into certain transactions with affiliates. The Company was in compliance with the covenants in the 2014 Credit Agreement as of September 30, 2017.

In connection with obtaining the term loan facility and revolving credit facility pursuant to the 2014 Credit Agreement, the Company incurred approximately \$10 million in debt issuance costs as of April 1, 2014, which along with the unamortized debt issuance cost from the 2012 Credit Agreement, were capitalized and are amortized as interest expense over the term of the 2014 Credit Agreement using the effective interest method.

As of September 30, 2017 and December 31, 2016, no amounts were outstanding under the revolving credit facility. Total interest expense for the term loan facility and revolving credit facility was approximately \$3 million and \$2 million for the three months ended September 30, 2017 and 2016, respectively. Total interest expense for the term loan facility and revolving credit facility was approximately \$8 million and \$7 million for the nine months ended September 30, 2017 and 2016, respectively. Interest expense included amortized debt issuance costs of approximately \$670,000 and \$797,000 for the three months ended September 30, 2017 and 2016, respectively. Interest expense included amortized debt issuance costs of approximately \$2 million for each of the nine months ended September 30, 2017 and 2016. Total interest paid for the term loan facility and revolving credit facility was approximately \$2 million for each of the three months ended September 30, 2017 and 2016. Total interest paid for the term loan

COSTAR GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited) — (CONTINUED)

7. LONG-TERM DEBT — (CONTINUED)

facility and revolving credit facility was approximately \$5 million for each of the nine months ended September 30, 2017 and 2016.

The following table represents the Company's long-term debt (in thousands):

| | September 30, 2017 | December 31, 2016 |
|--|-----------------------|----------------------|
| Term loan facility | \$ 310,000 | \$ 345,000 |
| Debt issuance costs, net | (4,504) | (6,661) |
| Total debt | 305,496 | 338,339 |
| Current maturities of long-term debt | (40,000) | (35,000) |
| Current debt issuance costs, net | 3,090 | 3,134 |
| Total long-term debt, less current portion | \$ 268,586 | \$ 306,473 |

8. INCOME TAXES

The income tax provision for the nine months ended September 30, 2017 and 2016 reflects an effective tax rate of approximately 33% and 39%, respectively. The decrease in the effective tax rate for the nine months ended September 30, 2017 compared to the nine months ended September 30, 2016 was primarily due to the adoption of FASB issued authoritative guidance to simplify several aspects of the accounting for share-based payment transactions, which requires the recognition of excess tax benefits in income tax expense that were previously recognized as an increase to additional paid-in capital.

9. COMMITMENTS AND CONTINGENCIES

The Company leases office facilities and office equipment under various non-cancelable operating leases. The leases contain various renewal options.

On April 1, 2014, the Company entered into the 2014 Credit Agreement. The 2014 Credit Agreement provides for a \$400 million term loan facility and a \$225 million revolving credit facility, each with a term of five years. See Notes 7 and 11 for additional information regarding the term loan facility and revolving credit facility.

On September 11, 2017, the Company and our wholly-owned subsidiary CoStar Realty Information, Inc., (“CRI”) entered into a Securities Purchase Agreement (the “ForRent Agreement”) with LTM Company Dominion, LLC (“LTM”), Dominion Enterprises (“Dominion”), and Landmark Media Enterprises, LLC (“Landmark” and, together with LTM and Dominion, the “Sellers”), pursuant to which CRI will acquire all of the issued and outstanding shares of common stock, no par value per share, of DE Holdings, Inc. (the “Acquisition”) for an aggregate purchase price of \$385 million, payable \$350 million in cash and \$35 million in shares of Company common stock, subject to a customary working capital adjustment. The ForRent Agreement may be terminated by each of CRI and LTM under certain circumstances, including if the expiration or termination of the applicable waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended (“HSR Clearance”) has not been obtained prior to September 11, 2018 and further provides that, upon the termination of the ForRent Agreement under specified circumstances in which certain antitrust approvals are not obtained, CRI will be required to pay to LTM a cash termination fee of \$40 million.

Currently, and from time to time, the Company is involved in litigation incidental to the conduct of its business. In accordance with GAAP, the Company records a provision for a liability when it is both probable that a liability has

been incurred and the amount can be reasonably estimated. At the present time, while it is reasonably possible that an unfavorable outcome may occur as a result of one or more of the Company's current litigation matters, management has concluded that it is not probable that a loss has been incurred in connection with the Company's current litigation. In addition, the Company is unable to estimate the possible loss or range of loss that could result from an unfavorable outcome in the Company's current litigation and accordingly, the Company has not recognized any liability in the condensed consolidated financial statements for unfavorable results, if any. Legal defense costs are expensed as incurred.

COSTAR GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited) — (CONTINUED)

10. SEGMENT REPORTING

Segment Information

The Company manages its business geographically in two operating segments, with the primary areas of measurement and decision-making being North America, which includes the U.S. and Canada, and International, which includes the U.K., Spain, Germany and France. The Company and its subsidiaries' subscription-based services consist primarily of information, analytics and online marketplace services offered over the internet to commercial real estate industry and related professionals. CoStar Suite® is the Company's primary service offering in the North America and International operating segments. Management relies on an internal management reporting process that provides revenue and operating segment net income before interest, income taxes, depreciation and amortization ("EBITDA"). Management believes that operating segment EBITDA is an appropriate measure for evaluating the operational performance of the Company's operating segments. EBITDA is used by management to internally measure operating and management performance and to evaluate the performance of the business. However, this measure should be considered in addition to, not as a substitute for or superior to, income from operations or other measures of financial performance prepared in accordance with GAAP.

COSTAR GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited) — (CONTINUED)

10. SEGMENT REPORTING — (CONTINUED)

Segment Information — (Continued)

Summarized information by operating segment consists of the following (in thousands):

| | Three Months Ended | | Nine Months Ended | |
|------------------------------|--------------------|-----------|-------------------|-----------|
| | September 30, | | September 30, | |
| | 2017 | 2016 | 2017 | 2016 |
| Revenues | | | | |
| North America | \$239,537 | \$205,637 | \$688,704 | \$598,757 |
| International | | | | |
| External customers | 7,996 | 7,074 | 22,535 | 20,562 |
| Intersegment revenues | 5 | 3 | 27 | 24 |
| Total International revenues | 8,001 | 7,077 | 22,562 | 20,586 |
| Intersegment eliminations | (5) | (3) | (27) | (24) |
| Total revenues | \$247,533 | \$212,711 | \$711,239 | \$619,319 |
| EBITDA | | | | |
| North America | \$72,267 | \$56,305 | \$170,064 | \$148,296 |
| International | 365 | 1,371 | 1,271 | 2,761 |
| Total EBITDA | \$72,632 | \$57,676 | \$171,335 | \$151,057 |

The reconciliation of net income to EBITDA consists of the following (in thousands):

| | Three Months | | Nine Months Ended | |
|--|---------------|----------|-------------------|-----------|
| | Ended | | September 30, | |
| | September 30, | | September 30, | |
| | 2017 | 2016 | 2017 | 2016 |
| Net income | \$34,177 | \$23,201 | \$78,491 | \$55,498 |
| Amortization of acquired intangible assets in cost of revenues | 4,200 | 5,736 | 15,089 | 17,119 |
| Amortization of acquired intangible assets in operating expenses | 4,298 | 5,550 | 13,642 | 17,602 |
| Depreciation and other amortization | 6,621 | 6,794 | 19,546 | 18,320 |
| Interest and other income | (555) | (344) | (1,589) | (587) |
| Interest and other expense | 2,901 | 2,498 | 8,280 | 7,462 |
| Income tax expense | 20,990 | 14,241 | 37,876 | 35,643 |
| EBITDA | \$72,632 | \$57,676 | \$171,335 | \$151,057 |

Intersegment revenues recorded were attributable to services performed for the Company's wholly owned subsidiary, CoStar Portfolio Strategy, by Grecom S.A.S. ("Grecom"), a wholly owned subsidiary of CoStar Limited, the Company's wholly owned U.K. holding company. Intersegment revenues are recorded at an amount the Company believes approximates fair value. North America EBITDA includes a corresponding cost for the services performed by Grecom for CoStar Portfolio Strategy.

COSTAR GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited) — (CONTINUED)

10. SEGMENT REPORTING — (CONTINUED)

Segment Information — (Continued)

Summarized information by operating segment consists of the following (in thousands):

| | September 30, 2017 | December 31, 2016 |
|--|-----------------------|----------------------|
| Property and equipment, net | | |
| North America | \$ 81,220 | \$ 84,727 |
| International | 3,106 | 2,841 |
| Total property and equipment, net | \$ 84,326 | \$ 87,568 |
| Goodwill | | |
| North America | \$ 1,253,494 | \$ 1,227,777 |
| International | 29,696 | 27,089 |
| Total goodwill | \$ 1,283,190 | \$ 1,254,866 |
| Assets | | |
| North America | \$ 2,331,852 | \$ 2,239,587 |
| International | 49,952 | 45,167 |
| Total operating segment assets | \$ 2,381,804 | \$ 2,284,754 |
| Reconciliation of operating segment assets to total assets | | |
| Total operating segment assets | \$ 2,381,804 | \$ 2,284,754 |
| Investment in subsidiaries | (57,065) | (57,065) |
| Intersegment receivables | (44,143) | (42,626) |
| Total assets | \$ 2,280,596 | \$ 2,185,063 |
| Liabilities | | |
| North America | \$ 507,088 | \$ 520,833 |
| International | 53,490 | 50,057 |
| Total operating segment liabilities | \$ 560,578 | \$ 570,890 |
| Reconciliation of operating segment liabilities to total liabilities | | |
| Total operating segment liabilities | \$ 560,578 | \$ 570,890 |
| Intersegment payables | (42,409) | (40,040) |
| Total liabilities | \$ 518,169 | \$ 530,850 |

COSTAR GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited) — (CONTINUED)

10. SEGMENT REPORTING — (CONTINUED)

Revenues by Services

The Company provides information, analytics and online marketplaces to the commercial real estate industry and related professionals. The revenues by type of service consist of the following (in thousands):

| | Three Months Ended | | Nine Months Ended | |
|---|--------------------|------------|-------------------|------------|
| | September 30, | | September 30, | |
| | 2017 | 2016 | 2017 | 2016 |
| Information and analytics | | | | |
| CoStar Suite ⁽¹⁾ | \$ 117,314 | \$ 103,261 | \$ 341,087 | \$ 301,969 |
| Information services ⁽²⁾ | 18,716 | 19,486 | 55,364 | 58,336 |
| Online marketplaces | | | | |
| Multifamily ⁽³⁾ | 72,257 | 57,654 | 204,324 | 164,752 |
| Commercial property and land ⁽⁴⁾ | 39,246 | 32,310 | 110,464 | 94,262 |
| Total revenues | \$ 247,533 | \$ 212,711 | \$ 711,239 | \$ 619,319 |

⁽¹⁾ CoStar Suite is comprised of CoStar Property Professional; CoStar COMPS Professional; CoStar Tenant; CoStar Market Analytics; and CoStar Portfolio Strategy.

⁽²⁾ Information services is comprised of LoopNet Premium Searcher; CoStar Real Estate Manager; CoStar Risk Analytics COMPASS; CoStar Investment Analysis Portfolio Maximizer; CoStar Investment Analysis Request; CoStar Brokerage Applications; PROPEX; Grecam; Belbex; and Thomas Daily.

⁽³⁾ Multifamily is comprised of Apartments.com; ApartmentFinder.com; ApartmentHomeLiving.com; WestsideRentals.com; Apartamentos.com; and The Screening Pros.

⁽⁴⁾ Commercial property and land is comprised of LoopNet Premium Lister; LoopLink; CoStar Advertising; BizBuySell and BizQuest; LandsofAmerica, LandAndFarm and LandWatch; and CoStar Private Sale Network.

COSTAR GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited) — (CONTINUED)

11. SUBSEQUENT EVENTS

On October 3, 2017, the Company completed a public equity offering of 3,317,308 shares of common stock for \$260.00 per share. Net proceeds from the public equity offering were approximately \$833.2 million, after deducting approximately \$29.3 million of underwriting discounts and commissions. The Company intends to use the net proceeds from the sale of the securities to fund all or a portion of the costs of any strategic acquisitions it determines to pursue in the future, to finance the growth of its business and for working capital and other general corporate purposes. General corporate purposes may include additions to working capital, capital expenditures, repayment of debt, investments in the Company's subsidiaries, possible acquisitions and the repurchase, redemption or retirement of securities, including the Company's common stock.

On October 19, 2017, the Company entered into an amended and restated credit agreement (the "2017 Credit Agreement"), which amended and restated in its entirety the existing 2014 Credit Agreement. The 2017 Credit Agreement provides for a \$750 million revolving credit facility with a term of five years from a syndicate of financial institutions as lenders and issuing banks. The Company also repaid the remaining balance of \$310 million and interest on its existing \$400 million term loan under the 2014 Credit Agreement on October 19, 2017 from existing cash balances. The proceeds of the 2017 revolving credit facility may be used for working capital and other general corporate purposes of the Company and its subsidiaries. In connection with refinancing the revolving credit facility, the Company incurred approximately \$3.4 million in debt issuance costs as of October 19, 2017. The Company is currently evaluating the transaction and will finalize the related accounting treatment in the fourth quarter.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following Management's Discussion and Analysis of Financial Condition and Results of Operations contains "forward-looking statements," including statements about our beliefs and expectations. There are many risks and uncertainties that could cause actual results to differ materially from those discussed in the forward-looking statements. Potential factors that could cause actual results to differ materially from those discussed in any forward-looking statements include, but are not limited to, those discussed in "Cautionary Statement Concerning Forward-Looking Statements" at the end of this Item 2 and see "Risk Factors" in Item 1A of Part II of this Quarterly Report on Form 10-Q for a discussion of certain risk factors applicable to our business, financial condition and results of operations.

All forward-looking statements are based on information available to us on the date of this filing and we assume no obligation to update such statements, whether as a result of new information, future events or otherwise. The following discussion should be read in conjunction with our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and other filings with the Securities and Exchange Commission and the condensed consolidated financial statements and related notes included in this Quarterly Report on Form 10-Q.

Overview

CoStar Group, Inc. (the "Company" or "CoStar") is the number one provider of information, analytics and online marketplaces to the commercial real estate industry in the United States ("U.S.") and the United Kingdom ("U.K.") based on the fact that we offer the most comprehensive commercial real estate database available; have the largest research department in the industry; own and operate leading online marketplaces for commercial real estate and apartment listings in the U.S. based on the numbers of unique visitors and site visits per month; provide more information, analytics and marketing services than any of our competitors and believe that we generate more revenues than any of our commercial real estate information competitors. We created and compiled our standardized platform of

information, analytics and online marketplace services where industry professionals and consumers of commercial real estate, including apartments, and the related business communities can continuously interact and facilitate transactions by efficiently accessing and exchanging accurate and standardized real estate-related information.

Subscription-Based Services

Our subscription-based services consist primarily of information, analytics and online marketplace services offered over the internet to commercial real estate industry and related professionals. Our services are typically distributed to our clients under subscription-based license agreements that renew automatically, a majority of which have a term of one year. Upon renewal, subscription contract rates may change in accordance with contract provisions or as a result of contract renegotiations. To encourage clients to use our services regularly, we generally charge a fixed monthly amount for our subscription-based services rather than charging fees based on actual system usage or number of paid clicks. Our service offerings span all commercial property types, including office, retail, industrial, multifamily, commercial land, mixed-use and hospitality. Depending on the type of service, contract rates are generally based on the number of sites, number of users, organization size, the client's business focus, geography, the number and types of services to which a client subscribes, the number of properties a client advertises and the prominence and

placement of a client's advertised properties in the search results, as applicable. Our subscription clients generally pay contract fees in advance on a monthly basis, but in some cases may pay us in advance on a quarterly or annual basis.

Revenues by services and a description of what is included in those line items can be found in Note 10 in the Notes to Condensed Consolidated Financial Statements included in Part I of this Quarterly Report on Form 10-Q. Our principal information, analytics and online marketplace services are described in the following paragraphs by type of service:

Information and Analytics

CoStar Suite®. Our subscription-based information services consist primarily of CoStar Suite services. CoStar Suite is sold as a platform of service offerings consisting of CoStar Property Professional®, CoStar COMPS Professional® and CoStar Tenant® and through our mobile application, CoStar Go®. Our integrated suite of online service offerings includes information about space available for lease, comparable sales information, information about properties for sale, tenant information, internet marketing services, analytical capabilities, information for clients' websites, information about industry professionals and their business relationships, data integration and industry news. We provide market research, consulting and analysis for commercial real estate investors and lenders via our CoStar Portfolio Strategy and CoStar Market Analytics service offerings. The 2017 revenue growth rates for our CoStar Suite services are expected to be consistent with historical rates.

Information services. We provide portfolio and debt analysis, management and reporting capabilities through our CoStar Investment Analysis and CoStar Risk Analytics service offerings; and, real estate and lease management solutions, including lease administration and abstraction services, through our CoStar Real Estate Manager service offerings. We also provide information services internationally, through our Grecam, Belbex and Thomas Daily businesses in France, Spain and Germany, respectively. The revenue growth rate for our information services is expected to decline for the remainder of 2017 resulting from the elimination or phase out of the LoopNet information services as we seek to convert LoopNet information customers to higher value, more profitable annual subscription CoStar Suite information services.

Online Marketplaces

Multifamily. Apartments.comTM is part of our network of apartment marketing sites, which also includes ApartmentFinder.comTM, ApartmentHomeLiving.comTM, WestsideRentals.com®, and Apartamentos.comTM, our apartment-listing site offered exclusively in Spanish. Our apartment marketing network of subscription-based services offers renters a searchable database of apartment listings and provides professional property management companies and landlords with an advertising destination. On July 18, 2017, we acquired The Screening ProsTM, an online apartment leasing platform that includes tenant screening services, rental applications and payments processing and lease renewals. Multifamily revenue increased in 2016 and is expected to continue to increase in 2017, although at lower growth rates than in 2016 given the impact of the Apartment Finder acquisition on 2016 growth rates.

Commercial property and land. Our LoopNet subscription-based online marketplace services enable commercial property owners, landlords and real estate agents working on their behalf to list properties for sale or for lease and to submit detailed information about property listings. Commercial real estate agents, buyers and tenants also use LoopNet's online marketplace services to search for available property listings that meet their criteria. Our BizBuySell services, which include BizQuest®, provide an online marketplace for businesses for sale. Our Land.com network of sites, which provide online marketplaces for rural lands for sale, includes LandsofAmerica, LandAndFarm and LandWatch®. The 2017 revenue growth rates for our commercial property and land services are expected to increase during the remainder of 2017 as compared to historical rates primarily as a result of the acquisition of the LandWatch.com® business on May 10, 2017.

As of September 30, 2017 and September 30, 2016, our annualized net bookings of subscription-based services on all contracts were approximately \$34 million and \$26 million, respectively, calculated based on the annualized amount of change in our sales resulting from all new subscription-based contracts or upsales on all existing subscription-based contracts, less write downs and cancellations, for the period reported. We recognize subscription revenues on a straight-line basis over the life of the contract. Our net bookings is a quantitative measurement that is typically closely correlated with our subscription revenue results. Net bookings is considered a key indicator of future subscription revenue growth and also serves as a metric of salesforce productivity by management and investors.

For each of the twelve months ended September 30, 2017 and 2016, our contract renewal rate for existing CoStar subscription-based services on annual contracts was approximately 91%, and therefore our cancellation rate for those services was approximately 9% for the same time periods. We expect our contract renewal rate for existing CoStar subscription-based services on annual contracts to decrease slightly in future periods due to the increased scale of our Multifamily services, which currently have a lower renewal rate as compared to our CoStar Suite services. Our contract renewal rate is a quantitative measurement that is typically closely correlated with our revenue results. As a result, management also believes that the rate may be a reliable indicator of short-term and long-term performance. Our trailing twelve-month contract renewal rate may decline if, among other reasons, negative economic conditions lead to greater business failures and/or consolidations among our clients, reductions in customer spending, or decreases in our customer base.

Development and Expansion

We expect to continue our software development efforts to improve existing services, introduce new services, integrate and cross-sell services, and expand and develop supporting technologies for our research, sales and marketing organizations. We are committed to supporting, improving and enhancing our information, news, analytics and online marketplace solutions, including expansion and improvement of our offerings for property managers and renters. We have been, and plan to continue, integrating, further developing and cross-selling our services including Apartments.com, ApartmentFinder.com, and CoStar Market Analytics. To generate brand awareness and site traffic for our listing sites, we utilize a variety of marketing campaigns, including television and radio advertising, online/digital advertising, social media and out-of-home ads, and Search Engine Marketing. We expect to continue to invest in sales and marketing for the remainder of 2017. As we continue to assess the success and effectiveness of our marketing campaign, we will continue to work to determine the optimal level of marketing investment for our services for future periods.

Our key priorities and developments include:

We are transitioning the LoopNet marketplace to a pure pay-to-list/free-to-search marketing site for commercial real estate, and converting LoopNet information customers to higher value CoStar Suite information services. We recently completed integrating the backend systems of the LoopNet and CoStar databases; the two services now share a unified database of information, creating operating efficiencies and improving the data available to our customers. We also introduced new enhancements on the CoStar homepage, including a Listing Manager feature that we believe will increase the quantity and quality of the listing information available by enabling brokers and other industry participants to load information directly into the integrated system. This in turn will reduce the time and costs associated with researching and maintaining our comprehensive database of commercial real estate information.

On September 11, 2017, together with our wholly owned subsidiary, CoStar Realty Information, Inc. ("CRI"), we signed a definitive agreement to acquire ForRent, a division of Dominion Enterprises, for an aggregate purchase price of \$385 million, payable \$350 million in cash and \$35 million in shares of CoStar Group common stock, subject to a customary working capital adjustment. ForRent's primary service is digital advertising through a network of four multifamily websites - which includes ForRent.com, AFTER55.com, CorporateHousing.com and ForRentUniversity.com. The completion of the transaction is subject to customary closing conditions, including antitrust clearance. On October 23, 2017, we voluntarily withdrew our premerger notification and report form under the Hart-Scott Rodino Antitrust Improvements Act of 1976, as amended, and refiled it on October 25, 2017, to provide the FTC with additional time to complete its review of the acquisition. The ForRent purchase agreement may be terminated by the parties thereto under certain circumstances, including if antitrust clearance has not been obtained prior to September 11, 2018 and further provides that, upon the termination of the ForRent purchase agreement under specified circumstances in which certain antitrust approvals are not obtained, we will be required to pay the seller a cash termination fee of \$40 million. We expect the acquisition to close during the fourth quarter of 2017, subject to satisfaction or waiver of all closing conditions.

We continue to invest in our research operations to support continued growth of our information and analytics offerings. We established our research operations headquarters in Richmond, Virginia, in December 2016, which is developing into a technology innovation hub, powering the software development necessary to support the content within our information, analytics and marketing services. In connection with the opening of the Richmond research headquarters, we have expanded our research team to continue to meet the growing content needs of our clients. In addition, we expect to continue to invest in our International research operations in Madrid, Spain and the U.K.

In the first quarter of 2017, we acquired Westside Rentals®, and in the third quarter of 2017 we acquired The Screening Pros. The purpose of these acquisitions is to increase the rental property content and to enhance the marketing effectiveness of our Apartments.com network of sites.

On May 10, 2017, we added LandWatch.com to our network of land-dedicated sites through our acquisition of LandWatch. We will continue to make investments to improve the experience for sellers and buyers of land who use our land-dedicated sites. Recent enhancements include adding a custom mapping tool to make property listings more dynamic and consolidating listing management for Lands of America and LandAndFarm into a single account management interface, enabling sellers to purchase advertising on both sites through a single transaction, and making other enhancements to the overall experience.

In support of our continued expansion and development, in October 2017, we completed a public equity offering of 3,317,308 shares of common stock for \$260.00 per share. Net proceeds from the public equity offering were approximately \$833.2 million, after deducting approximately \$29.3 million of underwriting discounts and commissions. We expect to use the net proceeds from the public equity offering to fund all or a portion of the costs of any strategic acquisitions we determine to pursue in the future, to finance the growth of our business and for working

capital and other general corporate purposes. General corporate purposes may include additions to working capital, capital expenditures, repayment of debt, investments in the Company's subsidiaries, possible acquisitions and the repurchase, redemption or retirement of securities, including the Company's common stock.

On October 19, 2017, the Company entered into an amended and restated credit agreement (the "2017 Credit Agreement"), which amended and restated in its entirety the existing 2014 Credit Agreement. The 2017 Credit Agreement provides for a \$750 million revolving credit facility with a term of five years from a syndicate of financial institutions as lenders and issuing banks. The Company also paid off the remaining balance of \$310 million and interest on its existing \$400 million term loan under the 2014 Credit Agreement on October 19, 2017 from existing cash balances. The proceeds of the 2017 revolving credit facility may be used for working capital and other general corporate purposes of the Company and its subsidiaries. In connection with refinancing the revolving credit facility, the Company incurred approximately \$3.4 million in debt issuance costs as of October 19, 2017. The

restructured credit facility, along with the proceeds from the October equity offering and cash generated by the Company's business are expected to support the Company's continued growth and give the Company flexibility to act on strategic acquisition opportunities that may arise.

We also intend to continue to assess the need for additional investments in our business, in addition to the investments discussed above, in order to develop and distribute new services within our current platform or expand the reach of our current service offerings. Any future product development or expansion of services, combination and coordination of services or elimination of services or corporate expansion, development or restructuring efforts could reduce our profitability and increase our capital expenditures. Any new investments, changes to our service offerings or other unforeseen events could cause us to generate reduced revenues or losses and negative cash flow from operations in the future. Any development efforts must comply with our credit facility, which contains restrictive covenants that restrict our operations and use of our cash flow and may prevent us from taking certain actions that we believe could increase our profitability or otherwise enhance our business.

Property Developments

As we have done in the past, we expect to continue to identify new facilities and consolidate existing facilities to better accommodate the changing demands of our business operations and employees. As a result, we may incur additional lease restructuring charges for the abandonment of certain lease space and the impairment of leasehold improvements.

Non-GAAP Financial Measures

We prepare and publicly release quarterly unaudited financial statements prepared in accordance with generally accepted accounting principles (“GAAP”). We also disclose and discuss certain non-GAAP financial measures in our public releases, investor conference calls and filings with the Securities and Exchange Commission. The non-GAAP financial measures that we may disclose include net income before interest and other income (expense), income taxes, depreciation and amortization (“EBITDA”), adjusted EBITDA, non-GAAP net income and non-GAAP net income per diluted share (also referred to as “non-GAAP EPS”). EBITDA is our net income before interest, income taxes, depreciation and amortization. We typically disclose EBITDA on a consolidated and an operating segment basis in our earnings releases, investor conference calls and filings with the Securities and Exchange Commission. Adjusted EBITDA is different from EBITDA because we further adjust EBITDA for stock-based compensation expense, acquisition- and integration-related costs, restructuring costs and settlements and impairments incurred outside our ordinary course of business. Non-GAAP net income and non-GAAP net income per diluted share are similarly adjusted for stock-based compensation expense, acquisition- and integration-related costs, restructuring costs, settlement and impairment costs incurred outside our ordinary course of business as well as amortization of acquired intangible assets and other related costs. We may disclose adjusted EBITDA, non-GAAP net income and non-GAAP net income per diluted share on a consolidated basis in our earnings releases, investor conference calls and filings with the Securities and Exchange Commission. The non-GAAP financial measures that we use may not be comparable to similarly titled measures reported by other companies. Also, in the future, we may disclose different non-GAAP financial measures in order to help our investors meaningfully evaluate and compare our results of operations to our previously reported results of operations or to those of other companies in our industry.

We view EBITDA, adjusted EBITDA, non-GAAP net income and non-GAAP net income per diluted share as operating performance measures and as such we believe that the most directly comparable GAAP financial measure is net income. In calculating EBITDA, adjusted EBITDA, non-GAAP net income and non-GAAP net income per diluted share, we exclude from net income the financial items that we believe should be separately identified to provide additional analysis of the financial components of the day-to-day operation of our business. We have outlined below the type and scope of these exclusions and the material limitations on the use of these non-GAAP financial measures as a result of these exclusions. EBITDA, adjusted EBITDA, non-GAAP net income and non-GAAP net income per diluted share are not measurements of financial performance under GAAP and should not be considered as a measure of liquidity, as an alternative to net income or as an indicator of any other measure of performance derived in accordance with GAAP. Investors and potential investors in our securities should not rely on EBITDA, adjusted EBITDA, non-GAAP net income and non-GAAP net income per diluted share as a substitute for any GAAP financial measure, including net income. In addition, we urge investors and potential investors in our securities to carefully review the GAAP financial information included as part of our Annual Reports on Form 10-K and Quarterly Reports on Form 10-Q that are filed with the Securities and Exchange Commission, as well as our quarterly earnings releases, and compare the GAAP financial information with our EBITDA, adjusted EBITDA, non-GAAP net income and non-GAAP net income per diluted share.

EBITDA, adjusted EBITDA, non-GAAP net income and non-GAAP net income per diluted share may be used by management to internally measure our operating and management performance and may be used by investors as supplemental financial measures to evaluate the performance of our business. We believe that these non-GAAP measures, when viewed with our GAAP results and the accompanying reconciliation, provide additional information that is useful to understand the factors and trends affecting our business. We have spent more than 29 years building our database of commercial real estate information and expanding our markets and services partially through acquisitions of complementary businesses. Due to the expansion of our information, analytics and online marketplace services, which has included acquisitions, our net income has included significant charges for amortization of acquired intangible assets, depreciation and other amortization, acquisition- and integration-related costs and restructuring costs. Adjusted EBITDA, non-GAAP net income and non-GAAP net income per diluted share exclude these charges

and provide meaningful information about the operating performance of our business, apart from charges for amortization of acquired intangible assets, depreciation and other amortization, acquisition- and integration-related costs, restructuring costs and settlement and impairment costs incurred outside our ordinary course of business. We believe the disclosure of non-GAAP measures can help investors meaningfully evaluate and compare our performance from quarter to quarter and from year to year. We also believe the non-GAAP measures we disclose are measures of our ongoing operating performance because the isolation of non-cash charges, such as amortization and depreciation, and other items, such as interest, income taxes, stock-based compensation expenses, acquisition- and integration-related costs, restructuring costs and settlement and impairment costs incurred outside our ordinary course of business, provides additional information about our cost structure, and, over time, helps track our operating progress. In addition, investors, securities analysts and others have regularly relied on EBITDA and may rely on adjusted EBITDA, non-GAAP net income or non-GAAP net income per diluted share to provide a financial measure by which to compare our operating performance against that of other companies in our industry.

Set forth below are descriptions of financial items that have been excluded from net income to calculate EBITDA and the material limitations associated with using this non-GAAP financial measure as compared to net income:

Amortization of acquired intangible assets in cost of revenues may be useful for investors to consider because it represents the diminishing value of any acquired trade names and other intangible assets and the use of our acquired database technology, which is one of the sources of information for our database of commercial real estate information. We do not believe these charges necessarily reflect the current and ongoing cash charges related to our operating cost structure.

Amortization of acquired intangible assets in operating expenses may be useful for investors to consider because it represents the estimated attrition of our acquired customer base. We do not believe these charges necessarily reflect the current and ongoing cash charges related to our operating cost structure.

Depreciation and other amortization may be useful for investors to consider because they generally represent the wear and tear on our property and equipment used in our operations. We do not believe these charges necessarily reflect the current and ongoing cash charges related to our operating cost structure.

The amount of interest and other income we generate may be useful for investors to consider and may result in current cash inflows. However, we do not consider the amount of interest and other income to be a representative component of the day-to-day operating performance of our business.

The amount of interest and other expense we incur may be useful for investors to consider and may result in current cash outflows. However, we do not consider the amount of interest and other expense to be a representative component of the day-to-day operating performance of our business.

Income tax expense may be useful for investors to consider because it generally represents the taxes which may be payable for the period and the change in deferred income taxes during the period and may reduce the amount of funds otherwise available for use in our business. However, we do not consider the amount of income tax expense to be a representative component of the day-to-day operating performance of our business.

Set forth below are descriptions of additional financial items that have been excluded from EBITDA to calculate adjusted EBITDA and the material limitations associated with using this non-GAAP financial measure as compared to net income:

Stock-based compensation expense may be useful for investors to consider because it represents a portion of the compensation of our employees and executives. Determining the fair value of the stock-based instruments involves a high degree of judgment and estimation and the expenses recorded may bear little resemblance to the actual value realized upon the future exercise or termination of the related stock-based awards. Therefore, we believe it is useful to exclude stock-based compensation in order to better understand the long-term performance of our core business.

The amount of acquisition- and integration-related costs incurred may be useful for investors to consider because they generally represent professional service fees and direct expenses related to acquisitions. Because we do not acquire businesses on a predictable cycle we do not consider the amount of acquisition- and integration-related costs to be a representative component of the day-to-day operating performance of our business.

The amount of restructuring costs incurred may be useful for investors to consider because they generally represent costs incurred in connection with a change in a contract or a change in the makeup of our properties or personnel. We do not consider the amount of restructuring related costs to be a representative component of the day-to-day operating performance of our business.

- The amount of material settlement and impairment costs incurred outside of our ordinary course of business may be useful for investors to consider because they generally represent gains or losses from the settlement of litigation matters or impairments on acquired intangible assets. We do not believe these charges necessarily reflect the current and ongoing cash charges related to our operating cost structure.

The financial items that have been excluded from our net income to calculate non-GAAP net income and non-GAAP net income per diluted share are amortization of acquired intangible assets and other related costs, stock-based compensation, acquisition- and integration-related costs, restructuring costs and settlement and impairment costs incurred outside our ordinary course of business. These items are discussed above with respect to the calculation of adjusted EBITDA together with the material limitations associated with using this non-GAAP financial measure as compared to net income. We subtract an assumed provision for income taxes to calculate non-GAAP net income. In 2016 and 2017, we assumed a 38% tax rate, which approximates our long-term effective corporate tax rate, excluding the impact of discrete items.

Non-GAAP net income per diluted share is a non-GAAP financial measure that represents non-GAAP net income divided by the number of diluted shares outstanding for the period used in the calculation of GAAP net income per diluted share.

Management compensates for the above-described limitations of using non-GAAP measures by using a non-GAAP measure only to supplement our GAAP results and to provide additional information that is useful to understand the factors and trends affecting our business.

The following table shows our net income reconciled to our EBITDA and our net cash flows from operating, investing and financing activities for the indicated periods (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|-------------------------------------|----------|------------------------------------|-----------|
| | 2017 | 2016 | 2017 | 2016 |
| Net income | \$34,177 | \$23,201 | \$78,491 | \$55,498 |
| Amortization of acquired intangible assets in cost of revenues | 4,200 | 5,736 | 15,089 | 17,119 |
| Amortization of acquired intangible assets in operating expenses | 4,298 | 5,550 | 13,642 | 17,602 |
| Depreciation and other amortization | 6,621 | 6,794 | 19,546 | 18,320 |
| Interest and other income | (555) | (344) | (1,589) | (587) |
| Interest and other expense | 2,901 | 2,498 | 8,280 | 7,462 |
| Income tax expense | 20,990 | 14,241 | 37,876 | 35,643 |
| EBITDA | \$72,632 | \$57,676 | \$171,335 | \$151,057 |
| Net cash flows provided by (used in) | | | | |
| Operating activities | \$67,944 | \$61,766 | \$163,307 | \$148,460 |
| Investing activities | (9,779) | (3,946) | (67,521) | (17,435) |
| Financing activities | (121) | 348 | (40,894) | (29,782) |

Comparison of Three Months Ended September 30, 2017 and Three Months Ended September 30, 2016

The following table provides a comparison of our selected condensed consolidated results of operations for the three months ended September 30, 2017 and 2016 (in thousands of dollars):

| | Three Months Ended September 30, | | Increase (Decrease) (\$) | Increase (Decrease) (%) |
|------------------------------|-------------------------------------|------------|--------------------------------|-------------------------------|
| | 2017 | 2016 | | |
| Revenues: | | | | |
| CoStar Suite | \$ 117,314 | \$ 103,261 | \$ 14,053 | 14 % |
| Information services | 18,716 | 19,486 | (770) | (4) |
| Multifamily | 72,257 | 57,654 | 14,603 | 25 |
| Commercial property and land | 39,246 | 32,310 | 6,936 | 21 |
| Total revenues | 247,533 | 212,711 | 34,822 | 16 |
| Cost of revenues | 55,483 | 42,222 | 13,261 | 31 |
| Gross margin | 192,050 | 170,489 | 21,561 | 13 |
| Operating expenses: | | | | |
| Selling and marketing | 72,705 | 75,414 | (2,709) | (4) |
| Software development | 21,536 | 19,357 | 2,179 | 11 |
| General and administrative | 35,998 | 30,572 | 5,426 | 18 |
| Customer base amortization | 4,298 | 5,550 | (1,252) | (23) |
| Total operating expenses | 134,537 | 130,893 | 3,644 | 3 |
| Income from operations | 57,513 | 39,596 | 17,917 | 45 |
| Interest and other income | 555 | 344 | 211 | 61 |
| Interest and other expense | (2,901) | (2,498) | 403 | 16 |
| Income before income taxes | 55,167 | 37,442 | 17,725 | 47 |
| Income tax expense | 20,990 | 14,241 | 6,749 | 47 |
| Net income | 34,177 | 23,201 | 10,976 | 47 |

NM - Not meaningful

Revenues. Revenues increased to \$248 million for the three months ended September 30, 2017, from \$213 million for the three months ended September 30, 2016. The \$35 million increase was primarily attributable to continued organic growth in Multifamily and CoStar Suite revenues. Revenues by services can be found in Note 10 in the Notes to Condensed Consolidated Financial Statements included in Part I of this Quarterly Report on Form 10-Q. The 2017 revenue growth rate for our CoStar Suite services is expected to be consistent with historical rates. The revenue growth rate for our information services is expected to decline for the remainder of 2017 resulting from the elimination or phase out of the LoopNet information services as we seek to convert LoopNet information customers to higher value, more profitable CoStar subscription information services. Multifamily revenue is expected to continue to increase during the remainder of 2017 consistent with the growth rate during the nine months ended September 30, 2017, although at a lower growth rate than in 2016 given the impact of the Apartment Finder acquisition on the growth rate in 2016. The revenue growth rate for our commercial property and land services is expected to increase for the remainder of 2017 as a result of the May 10, 2017 acquisition of LandWatch.

Gross Margin. Gross margin increased to \$192 million for the three months ended September 30, 2017, from \$170 million for the three months ended September 30, 2016. The gross margin percentage decreased to 78% for the three

months ended September 30, 2017, from 80% for the three months ended September 30, 2016. The increase in the gross margin amount was principally due to an increase in revenues offset by an increase in cost of revenues of \$13 million. The increase in cost of revenues was primarily due to an \$11 million increase in personnel costs and a \$1 million increase in occupancy costs, due in part to costs associated with our new research operations headquarters in Richmond, Virginia, and the expansion of our research team. The

gross margin percentage is expected to remain relatively consistent for the remainder of 2017 as compared to 2016 as a result of our continued investment in research operations.

Selling and Marketing Expenses. Selling and marketing expenses decreased to \$73 million for the three months ended September 30, 2017, from \$75 million for the three months ended September 30, 2016, and decreased as a percentage of revenues to 29% for the three months ended September 30, 2017 compared to 35% for the three months ended September 30, 2016. The decrease in the amount of selling and marketing expenses was primarily due to a decrease in marketing costs during the third quarter of 2017 related to the Apartments.com wide-scale marketing campaign compared to the third quarter of 2016.

Software Development Expenses. Software development expenses increased to \$22 million for the three months ended September 30, 2017, from \$19 million for the three months ended September 30, 2016, and remained flat as a percentage of revenues at 9% for each of the three months ended September 30, 2017 and 2016. The increase in the amount of software development expenses was primarily due to an increase in personnel costs to support the expansion of our research capabilities in Richmond, Virginia, as well as ongoing product maintenance.

General and Administrative Expenses. General and administrative expenses increased to \$36 million for the three months ended September 30, 2017, from \$31 million for the three months ended September 30, 2016, and remained relatively consistent as a percentage of revenues at 15% and 14% for the three months ended September 30, 2017 and 2016, respectively. The increase in the amount of general and administrative expenses was primarily related to litigation and acquisitions. We expect to continue to incur legal costs related to a legal matter that we initiated in 2016 that is expected to continue throughout 2017.

Customer Base Amortization Expense. Customer base amortization expense decreased to \$4 million for the three months ended September 30, 2017, compared to \$6 million for the three months ended September 30, 2016, and decreased as a percentage of revenues to 2% for the three months ended September 30, 2017, compared to 3% for the three months ended September 30, 2016. The decrease in the amount and percentage of purchase amortization expense was primarily due to the accelerated amortization of acquired customer bases for the three months ended September 30, 2016, compared to the three months ended September 30, 2017.

Interest and Other Income. Interest and other income increased to approximately \$555,000 for the three months ended September 30, 2017, from approximately \$344,000 for the three months ended September 30, 2016. The increase was primarily due to our higher average cash and cash equivalent balances during the three months ended September 30, 2017 compared to the three months ended September 30, 2016.

Interest and Other Expense. Interest and other expense increased slightly to approximately \$3 million for the three months ended September 30, 2017 from approximately \$2 million for the three months ended September 30, 2016.

Income Tax Expense. Income tax expense increased to \$21 million for the three months ended September 30, 2017, from \$14 million for the three months ended September 30, 2016. This increase was primarily due to higher income before income taxes for the three months ended September 30, 2017 as a result of our increased revenues. The effective tax rate was 38% for each of the three months ended September 30, 2017 and 2016. The income tax rate may continue to fluctuate during 2017 due to excess tax benefits as well as potential tax credits that we may claim for tax years that remain open.

Comparison of Business Segment Results for Three Months Ended September 30, 2017 and Three Months Ended September 30, 2016

We manage our business geographically in two operating segments, with our primary areas of measurement and decision-making being North America, which includes the U.S. and Canada, and International, which includes the U.K., Spain, Germany and France. Management relies on an internal management reporting process that provides revenues and operating segment EBITDA, which is our net income before interest, income taxes, depreciation and amortization. Management believes that operating segment EBITDA is an appropriate measure for evaluating the operational performance of our operating segments. EBITDA is used by management to internally measure our operating and management performance and to evaluate the performance of our business. However, this measure should be considered in addition to, not as a substitute for or superior to, income from operations or other measures of financial performance prepared in accordance with GAAP.

Segment Revenues. North America revenues increased to \$240 million for the three months ended September 30, 2017, from \$206 million for the three months ended September 30, 2016. This increase in North America revenues was primarily due to continued organic growth in Multifamily and CoStar Suite revenues. International revenues remained relatively consistent at approximately \$8 million for the three months ended September 30, 2017 and approximately \$7 million for the three months ended September 30, 2016, primarily due to an increase in revenues from further penetration of our subscription-based services, offset by the negative impact of foreign currency fluctuations.

Segment EBITDA. North America EBITDA increased to \$72 million for the three months ended September 30, 2017 from \$56 million for the three months ended September 30, 2016. The increase in North America EBITDA was primarily due to an increase in revenues. International EBITDA decreased to \$365,000 for the three months ended September 30, 2017 compared to \$1 million for the three months ended September 30, 2016. The decrease in International EBITDA was primarily due to the continued investment in our International research operations in Madrid, Spain and the U.K.

Comparison of Nine Months Ended September 30, 2017 and Nine Months Ended September 30, 2016

The following table provides a comparison of our selected condensed consolidated results of operations for the nine months ended September 30, 2017 and 2016 (in thousands of dollars):

| | Nine Months Ended September 30, | | Increase (Decrease) (\$) | Increase (Decrease) (%) | |
|-------------------------------|------------------------------------|-----------|--------------------------------|-------------------------------|---|
| | 2017 | 2016 | | | |
| Revenues: | | | | | |
| CoStar Suite | \$341,087 | \$301,969 | \$39,118 | 13 | % |
| Information services | 55,364 | 58,336 | (2,972) | (5) |) |
| Multifamily | 204,324 | 164,752 | 39,572 | 24 | |
| Commercial property and land | 110,464 | 94,262 | 16,202 | 17 | |
| Total revenues | 711,239 | 619,319 | 91,920 | 15 | |
| Cost of revenues | 162,102 | 127,801 | 34,301 | 27 | |
| Gross margin | 549,137 | 491,518 | 57,619 | 12 | |
| Operating expenses: | | | | | |
| Selling and marketing | 240,833 | 231,086 | 9,747 | 4 | |
| Software development | 67,054 | 56,539 | 10,515 | 19 | |
| General and administrative | 104,550 | 88,275 | 16,275 | 18 | |
| Customer base amortization | 13,642 | 17,602 | (3,960) | (22) |) |
| Total operating expenses | 426,079 | 393,502 | 32,577 | 8 | |
| Income from operations | 123,058 | 98,016 | 25,042 | 26 | |
| Interest and other income | 1,589 | 587 | 1,002 | NM | |
| Interest and other expense | (8,280) | (7,462) | 818 | 11 | |
| Income before income taxes | 116,367 | 91,141 | 25,226 | 28 | |
| Income tax expense | 37,876 | 35,643 | 2,233 | 6 | |
| Net income | \$78,491 | \$55,498 | \$22,993 | 41 | % |

NM - Not meaningful

Revenues. Revenues increased to \$711 million for the nine months ended September 30, 2017, from \$619 million for the nine months ended September 30, 2016. The \$92 million increase was primarily attributable to continued organic growth in CoStar Suite and Multifamily revenues. Revenues by services can be found in Note 10 in the Notes to Condensed Consolidated Financial Statements included in Part I of this Quarterly Report on Form 10-Q.

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Gross Margin. Gross margin increased to \$549 million for the nine months ended September 30, 2017, from \$492 million for the nine months ended September 30, 2016. The gross margin percentage decreased to 77% for the nine months ended September 30, 2017, from 79% for the nine months ended September 30, 2016. The increase in the gross margin amount was principally due to an increase in revenues partially offset by an increase in cost of revenues of \$34 million. The increase in cost of revenues was primarily due to a \$24 million increase in personnel costs, a \$2 million increase in related technology costs and a \$3 million increase in occupancy costs, due in part to costs associated with our new research operations headquarters in Richmond, Virginia, and the expansion of our research team. Additionally, we incurred approximately \$600,000 in costs associated with translation services for our Apartamentos.com website, while similar amounts were not incurred during the nine months ended September 30, 2016.

Selling and Marketing Expenses. Selling and marketing expenses increased to \$241 million for the nine months ended September 30, 2017, compared to \$231 million for the nine months ended September 30, 2016, and decreased as a percentage of revenues to 34% for the nine months ended September 30, 2017, compared to 37% for the nine months ended September 30, 2016. The increase in the amount of selling and marketing expenses was primarily due to a \$16 million increase in sales personnel costs driven by higher headcount and commissions related to increased sales. The increase in sales personnel costs was partially offset by a \$4 million decrease in marketing costs, primarily related to a decrease in costs for the Apartments.com wide-scale marketing campaign.

Software Development Expenses. Software development expenses increased to \$67 million for the nine months ended September 30, 2017, from \$57 million for the nine months ended September 30, 2016, and as a percentage of revenue, remained relatively consistent at approximately 9% for each of the nine months ended September 30, 2017 and 2016. The increase in the amount of software development expenses was primarily due to an increase in personnel costs to support the expansion of our research capabilities in Richmond, Virginia, as well as ongoing product maintenance.

General and Administrative Expenses. General and administrative expenses increased to \$105 million for the nine months ended September 30, 2017, from \$88 million for the nine months ended September 30, 2016, and increased as a percentage of revenues to 15% for the nine months ended September 30, 2017, compared to 14% for the nine months ended September 30, 2016. The increase in the amount and percentage of general and administrative expenses was primarily due to approximately \$9 million in legal costs primarily related to litigation and acquisitions, as well as approximately \$4 million in personnel-related costs.

Customer Base Amortization Expense. Customer base amortization expense decreased to \$14 million for the nine months ended September 30, 2017, compared to \$18 million for the nine months ended September 30, 2016, and decreased as a percentage of revenues to 2% for the nine months ended September 30, 2017, compared to 3% for the nine months ended September 30, 2016. The decrease in the amount and percentage of purchase amortization expense was primarily due to the accelerated amortization of acquired customer bases for the nine months ended September 30, 2016, compared to the nine months ended September 30, 2017.

Interest and Other Income. Interest and other income increased to approximately \$2 million for the nine months ended September 30, 2017, compared to approximately \$587,000 for the nine months ended September 30, 2016. The increase was primarily due to our higher average cash and cash equivalent balances during the nine months ended September 30, 2017, compared to the nine months ended September 30, 2016.

Interest and Other Expense. Interest and other expense remained relatively consistent at approximately \$8 million for the nine months ended September 30, 2017 and September 30, 2016.

Income Tax Expense. Income tax expense increased to a \$38 million income tax expense for the nine months ended September 30, 2017, from \$36 million for the nine months ended September 30, 2016. This increase was primarily

due to higher income before income taxes for the nine months ended September 30, 2017 as a result of our increased revenues, offset by a decrease in the effective tax rate from 39% to 33%. The decrease in the effective tax rate was primarily due to the adoption of guidance issued by the FASB that simplifies several aspects of the accounting for share-based payment transactions. The new FASB guidance requires the recognition of excess tax benefits in income tax expense that were previously recorded as an adjustment to additional paid-in-capital. In accordance with the new standard, the Company recognized an income tax benefit of \$8 million, resulting in a corresponding decrease in income tax expense for the nine months ended September 30, 2017. The income tax rate may continue to fluctuate during 2017 due to these excess tax benefits as well as potential tax credits that we may claim for tax years that remain open.

Comparison of Business Segment Results for Nine Months Ended September 30, 2017 and Nine Months Ended September 30, 2016

Segment Revenues. North America revenues increased to \$689 million for the nine months ended September 30, 2017, from \$599 million for the nine months ended September 30, 2016. This increase in North America revenue was primarily a result of continued organic growth in CoStar Suite and Multifamily revenues. International revenues increased to \$23 million for the nine months ended September 30, 2017, compared to \$21 million for the nine months ended September 30, 2016. This increase was primarily due to an increase in CoStar Suite revenues as well as revenue associated with the May 3, 2016 acquisition of Thomas Daily. These increases were partially offset by the negative impact of foreign currency fluctuations.

Segment EBITDA. North America EBITDA increased to \$170 million for the nine months ended September 30, 2017, from \$148 million for the nine months ended September 30, 2016. The increase in North America EBITDA was primarily due to an increase in revenues. International EBITDA decreased to \$1 million for the nine months ended September 30, 2017, from \$3 million for the nine months ended September 30, 2016. The decrease in International EBITDA was primarily due to the continued investment in our International research operations in Madrid, Spain and the U.K.

Liquidity and Capital Resources

Our principal sources of liquidity are cash and cash equivalents, debt from our revolving credit facility and cash from operations. Total cash and cash equivalents increased to \$623 million as of September 30, 2017, compared to cash and cash equivalents of \$567 million as of December 31, 2016. The increase in cash and cash equivalents for the nine months ended September 30, 2017 was primarily due to net cash provided by operating activities of approximately \$163 million. Offsetting the cash generated from operations were payments made for acquisitions including LandWatch, Westside Rentals and The Screening Pros totaling approximately \$48 million as well as payments of long-term debt of \$35 million, cash paid for purchases of property and equipment of \$20 million and repurchase of restricted stock to satisfy tax withholding obligations of approximately \$14 million.

Net cash provided by operating activities for the nine months ended September 30, 2017 was approximately \$163 million compared to approximately \$148 million for the nine months ended September 30, 2016. This \$15 million increase was due to an increase of \$18 million in net income plus non-cash items, partially offset by a net decrease of \$3 million in changes in operating assets and liabilities. The \$3 million net decrease in changes in operating assets and liabilities was primarily due to differences in timing of collection of receipts and payments of disbursements.

Net cash used in investing activities for the nine months ended September 30, 2017 was approximately \$68 million compared to approximately \$17 million for the nine months ended September 30, 2016. This \$51 million increase in cash used in investing activities was primarily due to \$48 million of payments for acquisitions including LandWatch, Westside Rentals and The Screening Pros for the nine months ended September 30, 2017. These increases in cash used in investing activities were partially offset by the \$10 million of cash used for the acquisition of Thomas Daily and certain assets related to the business operations of Apartment Finder's independent distributors during the nine months ended September 30, 2016. During the nine months ended September 30, 2017, we incurred capital expenditures of approximately \$20 million. We expect capital expenditures to increase for the remainder of 2017 as compared to 2016 as we incur capital expenditures to build out leased office space, including the Richmond research headquarters, as well as to invest in technology.

Net cash used in financing activities was approximately \$41 million for the nine months ended September 30, 2017, compared to approximately \$30 million for the nine months ended September 30, 2016. This \$11 million increase in net cash used in financing activities was primarily due to an increase in the payments of long-term debt resulting from a \$30 million prepayment made on March 1, 2017 of the principal payments for our term loan facility due over the remaining quarters in 2017.

Our future capital requirements will depend on many factors, including, among others, our operating results, our expansion and integration efforts, and our level of acquisition activity or other strategic transactions. To date, we have grown in part by acquiring other companies, and we expect to continue to make acquisitions. On July 18, 2017, we acquired The Screening Pros. On September 11, 2017, we entered into a definitive agreement to acquire ForRent, a division of Dominion Enterprises, for \$350 million in cash and \$35 million in CoStar Group stock, subject to customary closing conditions including antitrust approval. The ForRent purchase agreement contains certain termination rights for both buyer and seller, including if the expiration or termination of the applicable waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, has not been obtained prior to

September 11, 2018, and further provides that, upon the termination of the ForRent Agreement under specified circumstances in which certain antitrust approvals are not obtained, we will be required to pay to the seller a cash termination fee of \$40 million. Our future acquisitions may vary in size and could be material to our current operations. We may use cash, stock, debt or other means of funding to make these acquisitions.

In October 2017, we completed a public equity offering of 3,317,308 shares of common stock for \$260.00 per share. Net

proceeds from the public equity offering were approximately \$833.2 million after deducting underwriting discounts and commissions. We intend to use the net proceeds from the public equity offering to fund all or a portion of the costs of any strategic acquisitions we determine to pursue in the future, to finance the growth of our business and for working capital and other general corporate purposes.

On October 19, 2017, the Company entered into the 2017 Credit Agreement, which amended and restated in its entirety the existing 2014 Credit Agreement. The 2017 Credit Agreement provides for a \$750 million revolving credit facility with a term of five years from a syndicate of financial institutions as lenders and issuing banks. The Company also repaid the remaining balance of \$310 million and interest on its existing \$400 million term loan under the 2014 Credit Agreement on October 19, 2017 from

existing cash balances. The proceeds of the 2017 revolving credit facility may be used for working capital and other general corporate purposes of the Company and its subsidiaries. In connection with refinancing the revolving credit facility, the Company incurred approximately \$3.4 million in debt issuance costs as of October 19, 2017.

Based on current plans, we believe that our available cash combined with positive cash flow provided by operating activities should be sufficient to fund our operations for at least the next 12 months.

Critical Accounting Policies

The preparation of financial statements and related disclosures in conformity with U.S. generally accepted accounting principles (“GAAP”) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and revenues and expenses during the period reported. The following accounting policies involve a “critical accounting estimate” because they are particularly dependent on estimates and assumptions made by management about matters that are highly uncertain at the time the accounting estimates are made. In addition, while we have used our best estimates based on facts and circumstances available to us at the time, different acceptable assumptions would yield different results. Changes in the accounting estimates are reasonably likely to occur from period to period, which may have a material impact on the presentation of our financial condition and results of operations. We review these estimates and assumptions periodically and reflect the effects of revisions in the period that they are determined to be necessary.

Valuation of Long-Lived and Intangible Assets and Goodwill

We assess the impairment of long-lived assets, identifiable intangibles and goodwill whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Judgments made by management relate to the expected useful lives of long-lived assets and our ability to recover the carrying value of such assets. The accuracy of these judgments may be adversely affected by several factors, including the factors listed below:

- ⊘ Significant underperformance relative to historical or projected future operating results;
- ⊘ Significant changes in the manner of our use of the acquired assets or the strategy for our overall business;
- ⊘ Significant negative industry or economic trends; or
- ⊘ Significant decline in our market capitalization relative to net book value for a sustained period.

When we determine that the carrying value of long-lived and identifiable intangible assets may not be recovered based upon the existence of one or more of the above indicators, we test for impairment.

Goodwill and identifiable intangible assets that are not subject to amortization are tested annually for impairment by each reporting unit on October 1 of each year and are also tested for impairment more frequently based upon the existence of one or more of the above indicators.

To determine whether it is necessary to perform the two-step goodwill impairment test, we may first assess qualitative factors to evaluate whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If we conclude that it is more likely than not that the fair value of a reporting unit is less than its carrying amount or if we elect not to assess qualitative factors, then we perform the two-step process. The first step is to determine the fair value of each reporting unit. We estimate the fair value of each reporting unit based on a projected discounted cash flow model that includes significant assumptions and estimates including our discount rate, growth rate and future financial performance. Assumptions about the discount rate are based on a weighted average cost of capital for comparable companies. Assumptions about the growth rate and future financial performance of a reporting unit are based on our forecasts, business plans, economic projections and anticipated future cash flows. Our assumptions regarding the future financial performance of the International reporting unit reflect our expectation as of October 1, 2016, that revenues will continue to increase as a result of further penetration of our international subscription-based services, including into Madrid, Spain, and Freiburg, Germany, and the successful cross-selling of our services to our customers in existing markets due to the release of our upgraded international platform and expansion of coverage of our international service offerings. These assumptions are subject to change from period to period and could be adversely impacted by the uncertainty surrounding global market conditions, commercial real estate conditions, and the competitive environment in which we operate. Changes in these or other factors could negatively affect our reporting units' fair value and potentially result in impairment charges. Such impairment charges

could have an adverse effect on our results of operations.

The fair value of each reporting unit is compared to the carrying amount of the reporting unit. If the carrying value of the reporting unit exceeds the fair value, then the second step of the process is performed to measure the impairment loss. We estimate the fair value of our reporting units based on a projected discounted cash flow method using a discount rate determined by our management to be commensurate with the risk in our current business model. As of October 1, 2016, the date of our most recent impairment analysis, the estimated fair value of each of our reporting units substantially exceeded the carrying value of our reporting units. There have been no events or changes in circumstances since the date of our impairment analysis on October 1, 2016 that would indicate that the carrying value of each reporting unit may not be recoverable.

Revenue Recognition

We recognize revenues when (1) there is persuasive evidence of an arrangement, (2) the fee is fixed and determinable, (3) services have been rendered and payment has been contractually earned and (4) collectability is reasonably assured. Revenues from subscription-based services are recognized on a straight-line basis over the term of the agreement. We evaluate our allowance for doubtful accounts and estimate collectability of accounts receivable based on our analysis of historical collection experience, changes in customer payment profiles and the aging of receivable balances, as well as current economic conditions, all of which may affect a customer's ability to pay. A credit reserve has also been established based on historical experience of credits issued to customers to ensure that revenue is recognized appropriately in the current period. Deferred revenue results from advance cash receipts from customers or amounts billed in advance to customers from the sale of subscription services and is recognized over the term of the service agreement.

We derive revenues by providing access to our proprietary database of commercial real estate information. We generally charge a fixed monthly amount for our subscription-based services. Our subscription-based services consist primarily of information, analytics and online marketplace services offered over the internet to commercial real estate industry and related professionals. Subscription contract rates are based on the number of sites, number of users, organization size, the client's business focus, geography, the number and types of services to which a client subscribes, the number of properties a client advertises and the prominence and placement of a client's advertised properties in the search results, as applicable. A majority of the subscription-based service agreements have a term of one year and renew automatically.

We analyze contracts with multiple elements under the accounting guidance for multiple-element arrangements. Our multiple-element arrangements include information, analytics and/or online marketplace services that are generally provided to the customer over the same term. When identifying multiple-element arrangements, we consider multiple purchases made by the same customer within a short time frame and assess whether the purchases were negotiated together as one overall arrangement. If a multiple-element arrangement is identified, then the arrangement consideration is allocated among the separate units of accounting based on their relative selling prices, which is estimated considering factors such as historical pricing, pricing strategy, market conditions and other factors. We account for each deliverable in the transaction separately. If the deliverables cannot be separated into multiple units of accounting, then the arrangement consideration is combined and recognition of revenues is determined for the combined unit of accounting. Multiple-element transactions require judgment to determine the selling price or fair value of the different elements. The judgments impact the amount of revenues recognized over the term of the contract, as well as the period in which they are recognized.

Accounting for Income Taxes

As part of the process of preparing our condensed consolidated financial statements, we are required to estimate our income taxes in each of the jurisdictions in which we operate. This process requires us to estimate our current tax exposure and assess the temporary differences resulting from differing treatment of items, such as deductibility of certain intangible assets, for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within our condensed consolidated balance sheets. We must then also assess the likelihood that our deferred tax assets will be recovered from future taxable income, and, to the extent we believe that it is more likely than not that some portion or all of our deferred tax assets will not be realized, we must establish a valuation allowance. To the extent we establish a valuation allowance or change the allowance in a period, we must reflect the corresponding increase or decrease within the tax provision in the condensed consolidated statements of operations.

Stock-Based Compensation

We account for equity instruments issued in exchange for employee services using a fair-value based method, and we recognize the fair value of such equity instruments as an expense in the condensed consolidated statements of operations. We estimate the fair value of each option granted on the date of grant using the Black-Scholes option-pricing model, which requires us to estimate the dividend yield, expected volatility, risk-free interest rate and expected life of the stock option. For equity instruments that vest based on a market condition, we estimate the fair value of each equity instrument granted on the date of grant using a Monte-Carlo simulation model, which also requires us to estimate the dividend yield, expected volatility, risk-free interest rate and expected life of the equity instruments. These assumptions and the estimation of expected forfeitures are based on multiple factors, including historical employee behavior patterns of exercising options and post-employment termination behavior, expected future employee option exercise patterns, and the historical volatility of our stock price. For equity instruments that vest based on performance, we assess the probability of the achievement of the performance conditions at the end of each reporting period, or more frequently based upon the occurrence of events that may change the probability of whether the performance conditions would be met. If our initial estimates of the achievement of the performance conditions change, the related stock-based compensation expense and

timing of recognition may fluctuate from period to period based on those estimates. If the performance conditions are not met, no stock-based compensation expense will be recognized, and any previously recognized stock-based compensation expense will be reversed.

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We do not expect any material changes in the near term to the underlying assumptions used to calculate stock-based compensation expense for the nine months ended September 30, 2017. However, if changes in these assumptions occur, and, should those changes be significant, they could have a material impact on our stock-based compensation expense.

Business Combinations

We allocate the purchase consideration to the tangible assets acquired, liabilities assumed and intangible assets acquired based on their estimated fair values. The excess of the fair value of purchase consideration over the fair values of these identifiable assets and liabilities is recorded as goodwill. Such valuations require management to make significant estimates and assumptions, especially with respect to intangible assets. Significant estimates in valuing certain intangible assets include, but are not limited to, future expected cash flows from acquired customer bases, acquired database technology, and acquired trade names from a market participant's perspective, useful lives and discount rates. During the measurement period, we may record adjustments to the assets acquired and liabilities assumed. Any adjustments to provisional amounts that are identified during the measurement period are recorded in the reporting period in which the adjustment amounts are determined. Upon the conclusion of the measurement period, any subsequent adjustments are recorded to earnings.

Fair Value of Auction Rate Securities

Fair value is defined as the price that would be received in the sale of an asset or paid to transfer a liability in an orderly transaction between market participants. There is a three-tier fair value hierarchy, which categorizes assets and liabilities by the inputs used in measuring fair value. These tiers include: Level 1, defined as observable inputs such as quoted prices in active markets; Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and Level 3, defined as unobservable inputs for which little or no market data exists, therefore requiring an entity to develop its own assumptions. Our Level 3 assets consist of auction rate securities ("ARS"), whose underlying assets are primarily student loan securities supported by guarantees from the Federal Family Education Loan Program ("FFELP") of the U.S. Department of Education.

Our ARS investments are not currently actively trading and therefore do not currently have a readily determinable market value. The estimated fair value of the ARS no longer approximates par value. We have used a discounted cash flow model to determine the estimated fair value of our investment in ARS as of September 30, 2017. The assumptions used in preparing the discounted cash flow model include estimates for interest rates, credit spreads, timing and amount of contractual cash flows, liquidity risk premiums, expected holding periods and default risk of the ARS. We update the discounted cash flow model on a quarterly basis to reflect any changes in the assumptions used in the model and settlements of ARS investments that occurred during the period.

The only significant unobservable input in the discounted cash flow model is the discount rate. The discount rate used represents our estimate of the yield expected by a market participant from the ARS investments. The weighted average discount rate used in the discounted cash flow model as of September 30, 2017 and December 31, 2016 was approximately 5%. Selecting another discount rate within the range used in the discounted cash flow model would not result in a significant change to the fair value of the ARS.

Based on this assessment of fair value, as of September 30, 2017, we determined there was a net decline in the fair value of our ARS investments of approximately \$848,000. The decline was deemed to be a temporary impairment and recorded as an unrealized loss in accumulated other comprehensive loss in stockholders' equity. If the issuers of these ARS are unable to successfully close future auctions and/or their credit ratings deteriorate, we may be required to record additional unrealized losses in accumulated other comprehensive loss or an other-than-temporary impairment charge to earnings on these investments, which would reduce our profitability and adversely affect our financial

position.

We have not made any material changes in the accounting methodology used to determine the fair value of the ARS. We do not expect any material changes in the near term to the underlying assumptions used to determine the unobservable inputs used to calculate the fair value of the ARS as of September 30, 2017. However, if changes in these assumptions occur, and, should those changes be significant, we may be exposed to additional unrealized losses in accumulated other comprehensive loss or an other-than-temporary impairment charge to earnings on these investments.

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Recent Accounting Pronouncements

In March 2016, the FASB issued authoritative guidance to simplify several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification of share-based payment transactions on the statement of cash flows. Effective the first quarter of 2017, the Company adopted the standard, which will continue to impact our 2017 net income because excess tax benefits, which were previously reflected in additional paid in capital, are now reflected in income tax expense. The significance of the impact will depend on the intrinsic value at the time of vesting or exercise of equity instruments.

See Note 2 to the Notes to Condensed Consolidated Financial Statements included in Part I of this Quarterly Report on Form 10-Q for additional information on recent accounting pronouncements, including the expected dates of adoption and estimated effects, if any, on our condensed consolidated financial statements and related disclosures.

Cautionary Statement Concerning Forward-Looking Statements

We have made forward-looking statements in this Report and make forward-looking statements in our press releases, conference calls, annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and other filings with the Securities and Exchange Commission that are subject to risks and uncertainties. Forward-looking statements include information that is not purely historic fact and include, without limitation, statements concerning our financial outlook for 2017 and beyond, our possible or assumed future results of operations generally, and other statements and information regarding assumptions about our revenues, revenue growth rates, gross margin percentage, net income, net income per share, fully diluted net income per share, EBITDA, adjusted EBITDA, non-GAAP net income, non-GAAP net income per share, weighted-average outstanding shares, taxable income, cash flow from operating activities, available cash, use of proceeds from equity offerings, operating costs, amortization expense, intangible asset recovery, capital and other expenditures, legal proceedings and claims, legal costs, effective tax rate, equity compensation charges, future taxable income, pending acquisitions, timing of closing of pending acquisitions, the anticipated benefits of completed or proposed acquisitions, the anticipated benefits of cross-selling efforts, product development and release, sales and marketing campaigns, product integrations, elimination and de-emphasizing of services, contract renewal rates, expectations regarding our compliance with financial and restrictive covenants in the 2017 Credit Agreement, financing plans, geographic expansion, capital structure, contractual obligations, our database, database growth, services and facilities, employee relations, future economic performance, our ability to liquidate or realize our long-term investments, management's plans, goals and objectives for future operations, and growth and markets for our stock. Sections of this Report which contain forward-looking statements include the Financial Statements and related Notes, "Management's Discussion and Analysis of Financial Condition and Results of Operations," "Quantitative and Qualitative Disclosures About Market Risk," "Controls and Procedures," "Legal Proceedings" and "Risk Factors."

Our forward-looking statements are also identified by words such as “hope,” “anticipate,” “may,” “believe,” “expect,” “intend,” “will,” “should,” “plan,” “estimate,” “predict,” “continue” and “potential” or the negative of these terms or other comparable terminology. You should understand that these forward-looking statements are estimates reflecting our judgment, beliefs and expectations, not guarantees of future performance. They are subject to a number of assumptions, risks and uncertainties that could cause actual results to differ materially from those expressed or implied in the forward-looking statements. The following important factors, in addition to those discussed or referred to under the heading “Risk Factors,” and other unforeseen events or circumstances, could affect our future results and could cause those results or other outcomes to differ materially from those expressed or implied in our forward-looking statements: commercial real estate market conditions; general economic conditions, both domestic and international; our ability to identify, acquire and integrate acquisition candidates; our ability to realize the expected benefits, cost savings or other synergies from acquisitions, including the acquisitions of Thomas Daily, Westside Rentals, The Screening Pros, and the assets of Belbex and LandWatch, and the pending acquisition of ForRent, on a timely basis or at all; our ability to combine acquired businesses successfully or in a timely and cost-efficient manner; business disruption relating to integration of acquired businesses or other business initiatives; the businesses of CoStar, Apartments.com and ForRent may not be combined successfully or in a timely and cost-efficient manner; the possibility that the ForRent merger does not close, including as a result of failure to obtain governmental approval; conditions, divestitures or changes relating to the operations or assets of ForRent or CoStar may be required to obtain required governmental clearances or approvals; business disruption relating to the ForRent acquisition may be greater than expected; our ability to transition acquired service platforms to our model in a timely manner or at all; changes and developments in business plans; theft of any personally identifiable information we maintain or process; any actual or perceived failure to comply with privacy or data protection laws, regulations or standards; the amount of investment for sales and marketing and our ability to realize a return on investments in sales and marketing; our ability to effectively and strategically combine, eliminate or de-emphasize service offerings; reductions in revenues as a result of service changes; the time and resources required to develop upgraded or new services and to expand service offerings; changes or consolidations within the commercial real estate industry; customer retention; our ability to attract new clients; our ability to sell additional services to existing clients; our ability to integrate our North America and International product offerings; our ability to create operating efficiencies and provide improved data to our customers as a result of the integration of the CoStar and LoopNet systems; our ability to successfully transition LoopNet to a pure marketing site, where all listings are paid and searches are free, in a timely manner, and minimize the impact of that transition on revenue; our ability to successfully develop, introduce and cross-sell new products or upgraded services in U.S. and foreign markets; our ability to attract consumers to our online marketplaces; our ability to increase traffic on our network of sites; the success of our marketing campaigns in generating brand awareness and site traffic; competition; foreign currency fluctuations; global credit market conditions affecting investments; our ability to continue to expand successfully, timely and in a cost-efficient manner, including internationally; our ability to effectively penetrate and gain acceptance in new sectors and geographies; our ability to control costs; our ability to establish our research operations headquarters in Richmond, Virginia as a technology innovation hub; litigation or government investigations in which we become involved; changes in accounting policies or practices; release of new and upgraded services or entry into new markets by us or our competitors; data quality; expansion, growth, development or reorganization of our sales force; employee retention; technical problems with our services; managerial execution; changes in relationships with real estate brokers, property managers and other strategic partners; legal and regulatory issues; and successful adoption of and training on our services.

Accordingly, you should not place undue reliance on forward-looking statements, which speak only as of, and are based on information available to us on, the date of this Report. All subsequent written and oral forward-looking statements attributable to us or any person acting on our behalf are expressly qualified in their entirety by the cautionary statements contained or referred to in this section. We do not undertake any obligation to update any such statements or release publicly any revisions to these forward-looking statements to reflect new information or events or circumstances after the date of this Report or to reflect the occurrence of unanticipated events.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We provide information, analytics and online marketplace services to the commercial real estate and related business community in the U.S., the U.K., and parts of Canada, Spain, Germany and France. Our functional currency for our operations in the U.K., Canada, Spain, Germany, and France is the local currency. As such, fluctuations in the British Pound, Canadian dollar and Euro may have an impact on our business, results of operations and financial position. We currently do not use financial instruments to hedge our exposure to exchange rate fluctuations with respect to our foreign subsidiaries. We may seek to enter into hedging transactions in the future to reduce our exposure to exchange rate fluctuations, but we may be unable to enter into hedging transactions successfully, on acceptable terms or at all. As of September 30, 2017, accumulated other comprehensive loss included a loss from foreign currency translation adjustments of approximately \$9 million.

We do not have material exposure to market risks associated with changes in interest rates related to cash equivalent securities held as of September 30, 2017. As of September 30, 2017, we had \$623 million of cash, cash equivalents and short-term investments. If there is an increase or decrease in interest rates, there will be a corresponding increase or decrease in the amount of interest earned on our cash and cash equivalents.

As of September 30, 2017, we had \$310 million of long-term debt bearing interest at a variable rate of LIBOR plus 2%, subject to adjustment based on our First Lien Secured Leverage Ratio (as defined in the 2014 Credit Agreement). If there is an increase or decrease in interest rates, there will be a corresponding increase or decrease in the amount of interest expense on our long-term debt. Based on our outstanding borrowings as of September 30, 2017, an increase in the interest rate by 25 basis points would result in an increase of approximately \$800,000 in interest expense annually. Conversely, a decrease in the interest rate by 25 basis points would result in a decrease of approximately \$800,000 in interest expense annually. Based on our ability to access our cash and cash equivalents, and our expected operating cash flows, we do not believe that increases or decreases in interest rates will impact our ability to operate our business in the foreseeable future.

Included within our short-term and long-term investments are investments in mostly AAA-rated student loan ARS. These securities are primarily securities supported by guarantees from the FFELP of the U.S. Department of Education. As of September 30, 2017, \$11 million of our investments in ARS failed to settle at auction. As a result, we may not be able to sell these investments at par value until a future auction on these investments is successful. In the event we need to immediately liquidate these investments, we may have to locate a buyer outside the auction process, who may be unwilling to purchase the investments at par, resulting in a loss. Based on an assessment of fair value of these investments in ARS as of September 30, 2017, we determined that there was a net decline in the fair value of our ARS investments of approximately \$848,000, which was deemed to be a temporary impairment and recorded as an unrealized loss in accumulated other comprehensive loss in stockholders' equity. If the issuers are unable to successfully close future auctions and/or their credit ratings deteriorate, we may be required to adjust the carrying value of these investments as a temporary impairment and recognize a greater unrealized loss in accumulated other comprehensive loss or as an other-than-temporary impairment charge to earnings. Based on our ability to access our cash and cash equivalents, and our expected operating cash flows, we do not anticipate having to sell these securities below par value in order to operate our business in the foreseeable future. See Notes 3 and 4 to the Notes to Condensed Consolidated Financial Statements included in Part I of this Quarterly Report on Form 10-Q for further discussion.

We had approximately \$1 billion in intangible assets as of September 30, 2017. As of September 30, 2017, we believe our intangible assets will be recoverable, however, changes in the economy, the business in which we operate and our own relative performance could change the assumptions used to evaluate intangible asset recoverability. In the event that we determine that an asset has been impaired, we would recognize an impairment charge equal to the amount by which the carrying amount of the assets exceeds the fair value of the asset. We continue to monitor these assumptions

and their effect on the estimated recoverability of our intangible assets.

Item 4. Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

As of September 30, 2017, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based on the foregoing, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective and were operating at a reasonable assurance level.

There have been no changes in our internal control over financial reporting during our most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II — OTHER INFORMATION

Item 1. Legal Proceedings

Currently, and from time to time, we are involved in litigation incidental to the conduct of our business. We are not a party to any lawsuit or proceeding that, in the opinion of our management based on consultations with legal counsel, is likely to have a material adverse effect on our financial position or results of operations.

Item 1A. Risk Factors

In addition to the other information set forth in this Quarterly Report on Form 10-Q, you should carefully consider the factors discussed in Part I, “Item 1A Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2016 (the “2016 Form 10-K”), which could materially affect our business, financial condition or future results. The risks described in our 2016 Form 10-K are not the only risks facing our company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or results of operations. There have been no material changes to the Risk Factors as previously disclosed in Part I, “Item 1A Risk Factors” in our 2016 Form 10-K.

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

The following table is a summary of our repurchases of common stock during each of the three months in the quarter ended September 30, 2017:

ISSUER PURCHASES OF EQUITY SECURITIES

| Month, 2017 | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs |
|----------------------------------|--|--|---|---|
| July 1 through July 31 | 190 | \$272.14 | — | — |
| August 1 through August 31 | — | — | — | — |
| September 1 through September 30 | 2,854 | 279.12 | — | — |
| Total | 3,044 | (1) \$278.68 | — | — |

(1) The number of shares purchased consists of shares of common stock tendered by employees to the Company to satisfy the employees' minimum tax withholding obligations arising as a result of vesting of restricted stock grants under the Company's 2007 Stock Incentive Plan, as amended, and the Company's 2016 Stock Incentive Plan, as amended, which shares were purchased by the Company based on their fair market value on the vesting date. None of these share purchases were part of a publicly announced program to purchase common stock of the Company.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

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Item 6. Exhibits

| Exhibit No. | Description |
|-------------|---|
| <u>3.1</u> | Third Amended and Restated Certificate of Incorporation (Incorporated by reference to Exhibit 3.1 to the Registrant's Current Report on Form 8-K filed with the Commission on June 6, 2013). |
| <u>3.2</u> | Third Amended and Restated By-Laws (Incorporated by reference to Exhibit 3.1 to the Registrant's Current Report on Form 8-K filed with the Commission on September 24, 2013). |
| <u>10.1</u> | Securities Purchase Agreement, dated as of September 11, 2017, among CoStar Realty Information, Inc., CoStar Group, Inc., LTM Company Dominion, LLC, Dominion Enterprises, and Landmark Media Enterprises, LLC (Incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed with the Commission on September 13, 2017). |
| <u>10.2</u> | Amendment and Restatement Agreement, dated as of October 19, 2017, by and among CoStar Group, Inc., CoStar Realty Information, Inc., the Lenders party thereto and JPMorgan Chase Bank, N.A., as Administrative Agent (Incorporated by referenced to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed with the Commission on October 25, 2017). ¹ |
| <u>31.1</u> | Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith). |
| <u>31.2</u> | Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith). |
| <u>32.1</u> | Certification of Principal Executive Officer pursuant to 18 U.S.C. Sec. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (filed herewith). |
| <u>32.2</u> | Certification of Principal Financial Officer pursuant to 18 U.S.C. Sec. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (filed herewith). |
| <u>99.1</u> | CoStar Group, Inc. Press Release Dated October 25, 2017 (Incorporated by referenced to Exhibit 99.1 to the Registrant's Current Report on Form 8-K filed with the Commission on October 25, 2017) ² |
| 101 | The following materials from CoStar Group, Inc.'s Quarterly Report on Form 10-Q for the quarter ended September 30, 2017, formatted in XBRL (eXtensible Business Reporting Language): (i) Unaudited Condensed Consolidated Statement of Operations for the three and nine months ended September 30, 2017 and 2016, respectively; (ii) Unaudited Condensed Consolidated Statements of Comprehensive Income for the three and nine months ended September 30, 2017 and 2016, respectively; (iii) Unaudited Condensed Consolidated Balance Sheets at September 30, 2017 and December 31, 2016, respectively; (iv) Unaudited Condensed Consolidated Statements of Cash Flows for the nine months ended September 30, 2017 and 2016, respectively; and (v) Notes to the Unaudited Condensed Consolidated Financial Statements that have been detail tagged. |

¹ Registrant previously filed Exhibit 10.2 with its Current Report on Form 8-K filed with the Commission on October 25, 2017, as Exhibit 10.1. The listing of that exhibit with this Quarterly Report on Form 10-Q as Exhibit 10.2 fixes a non-functioning hyperlink in the October 25, 2017 Form 8-K.

² Registrant previously filed Exhibit 99.1 with its Current Report on Form 8-K filed with the Commission on October 25, 2017, as Exhibit 99.1. Registrant is including that exhibit with this Quarterly Report on Form 10-Q as Exhibit 99.1 to fix a non-functioning hyperlink in the October 25, 2017 Form 8-K. Exhibit 99.1 and the information contained in that Exhibit shall be considered "furnished" and shall not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liabilities of that Section or Sections 11 and 12(a)(2) of the Securities Act of 1933, as amended, nor shall it be deemed incorporated by reference into any of the Registrant's reports or filings with the Securities and Exchange Commission, whether made before or after the date hereof, except as expressly set forth by specific reference in such a filing.

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.

COSTAR GROUP, INC.

Date: October 26, 2017 By: /s/ Scott T. Wheeler
Scott T. Wheeler
Chief Financial Officer
(Principal Financial and Accounting Officer and Duly Authorized Officer)