

COSTAR GROUP INC
Form 10-Q
May 08, 2009

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 March 31, 2009

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
(State or other jurisdiction of
incorporation or organization)

52-2091509
(I.R.S. Employer Identification No.)

2 Bethesda Metro Center, 10th Floor
Bethesda, Maryland 20814
(Address of principal executive offices) (zip code)

(301) 215-8300
(Registrant's telephone 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

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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, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Securities Exchange Act of 1934.

Large accelerated filer Accelerated filer
Non-accelerated filer Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes No

As of May 1, 2009, there were 19,874,371 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 March 31, | |
|---|---------------------------------|-----------|
| | 2009 | 2008 |
| Revenues | \$ 51,370 | \$ 52,264 |
| Cost of revenues | 16,894 | 19,721 |
| Gross margin | 34,476 | 32,543 |
| Operating expenses: | | |
| Selling and marketing | 9,161 | 10,873 |
| Software development | 3,178 | 3,414 |
| General and administrative | 10,450 | 9,805 |
| Purchase amortization | 946 | 1,221 |
| | 23,735 | 25,313 |
| Income from operations | 10,741 | 7,230 |
| Interest and other income, net | 442 | 1,938 |
| Income before income taxes | 11,183 | 9,168 |
| Income tax expense, net | 5,077 | 4,126 |
| Net income | \$ 6,106 | \$ 5,042 |
| Net income per share ³ / ₄ basic | \$ 0.31 | \$ 0.26 |
| Net income per share ³ / ₄ diluted | \$ 0.31 | \$ 0.26 |
| Weighted average outstanding shares ³ / ₄ basic | 19,468 | 19,217 |
| Weighted average outstanding shares ³ / ₄ diluted | 19,562 | 19,369 |

See accompanying notes.

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

| ASSETS | March 31, 2009 (unaudited) | December 31, 2008 |
|---|----------------------------------|-------------------------|
| Current assets: | | |
| Cash and cash equivalents | \$ 170,624 | \$ 159,982 |
| Short-term investments | 33,508 | 35,268 |
| Accounts receivable, less allowance for doubtful accounts of approximately \$3,665 and \$3,213 as of March 31, 2009 and December 31, 2008, respectively | 14,236 | 12,294 |
| Deferred income taxes, net | 2,164 | 2,036 |
| Prepaid expenses and other current assets | 3,013 | 2,903 |
| Total current assets | 223,545 | 212,483 |
| Long-term investments | 29,340 | 29,340 |
| Deferred income taxes, net | 3,269 | 3,392 |
| Property and equipment, net | 15,801 | 16,876 |
| Goodwill | 53,911 | 54,328 |
| Intangibles and other assets, net | 14,646 | 16,421 |
| Deposits and other assets | 1,470 | 1,544 |
| Total assets | \$ 341,982 | \$ 334,384 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$ 1,976 | \$ 1,636 |
| Accrued wages and commissions | 6,412 | 7,217 |
| Accrued expenses and deferred rent | 9,858 | 8,934 |
| Deferred revenue | 9,760 | 9,442 |
| Income taxes payable | 963 | 1,907 |
| Total current liabilities | 28,969 | 29,136 |
| Deferred income taxes, net | 103 | 132 |
| Income taxes payable | 1,745 | 1,695 |
| Total stockholders' equity | 311,165 | 303,421 |
| Total liabilities and stockholders' equity | \$ 341,982 | \$ 334,384 |

See accompanying notes.

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

| | Three Months Ended March 31, | |
|---|---------------------------------|-----------|
| | 2009 | 2008 |
| Operating activities: | | |
| Net income | \$ 6,106 | \$ 5,042 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation | 1,936 | 2,163 |
| Amortization | 1,740 | 2,119 |
| Stock-based compensation expense | 1,587 | 1,243 |
| Deferred income tax expense, net | 34 | 1,195 |
| Provision for losses on accounts receivable | 1,502 | 946 |
| Changes in operating assets and liabilities, net of acquisitions: | | |
| Accounts receivable | (3,484) | (1,777) |
| Prepaid expenses and other current assets | (96) | 1,282 |
| Deposits | 42 | 828 |
| Accounts payable and accrued expenses | (431) | (5,319) |
| Deferred revenue | 385 | 360 |
| Net cash provided by operating activities | 9,321 | 8,082 |
| Investing activities: | | |
| Purchases of investments | ¾ | (1,490) |
| Sales of investments | 2,629 | 31,172 |
| Purchases of property and equipment and other assets | (1,037) | (1,189) |
| Net cash provided by investing activities | 1,592 | 28,493 |
| Financing activities: | | |
| Repurchase of restricted stock to satisfy tax withholding obligations | (215) | (133) |
| Proceeds from exercise of stock options | 81 | 545 |
| Net cash (used in) provided by financing activities | (134) | 412 |
| Effect of foreign currency exchange rates on cash and cash equivalents | (137) | (66) |
| Net increase in cash and cash equivalents | 10,642 | 36,921 |
| Cash and cash equivalents at the beginning of period | 159,982 | 57,785 |
| Cash and cash equivalents at the end of period | \$ 170,624 | \$ 94,706 |

See accompanying notes.

COSTAR GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

1. ORGANIZATION

CoStar Group, Inc. (the “Company”) has created a comprehensive, proprietary database of commercial real estate information covering the United States, as well as parts of the United Kingdom and France. Based on its unique database, the Company provides information/marketing services to the commercial real estate and related business community and operates within two operating segments, U.S. and International. The Company’s information/marketing services are typically distributed to its clients under subscription-based license agreements, which typically have a minimum term of one year and renew automatically.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All significant 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 generally accepted accounting principles (“GAAP”) in the United States of America 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 March 31, 2009, and the results of its operations and its cash flows for the three months ended March 31, 2009 and 2008. 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, 2008.

The results of operations for the three months ended March 31, 2009 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. Actual results could differ from those estimates.

Reclassifications

Certain previously reported amounts on the condensed consolidated statements of cash flows have been reclassified to conform to the Company’s current presentation.

Foreign Currency Translation

The Company’s functional currency in its foreign locations is the local currency. Assets and liabilities are translated into U.S. dollars as of the balance sheet date. 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 income. Net gains or losses resulting from foreign currency exchange transactions are included in the consolidated statements of operations. There were no material gains or losses from foreign currency exchange transactions for the three months ended March 31, 2009 and 2008.

COSTAR GROUP, INC.

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES — (CONTINUED)

Comprehensive Income

The components of total comprehensive income were as follows (in thousands):

| | Three Months Ended | |
|---|--------------------|----------|
| | March 31, 2009 | 2008 |
| | (unaudited) | |
| Net income | \$ 6,106 | \$ 5,042 |
| Foreign currency translation adjustment | (684) | (64) |
| Net unrealized gain (loss) on investments, net of tax | 869 | (1,570) |
| Total comprehensive income | \$ 6,291 | \$ 3,408 |

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

| | March 31, | December |
|--|-------------|-------------|
| | 2009 | 31, 2008 |
| | (unaudited) | |
| Foreign currency translation adjustment | \$ (9,205) | \$ (8,521) |
| Accumulated net unrealized loss on investments, net of tax | (4,406) | (5,275) |
| Total accumulated other comprehensive loss | \$ (13,611) | \$ (13,796) |

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 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.

COSTAR GROUP, INC.

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES — (CONTINUED)

Net Income Per Share — (Continued)

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

| | Three Months Ended March 31, 2009 2008 (unaudited) | |
|--|--|----------|
| Numerator: | | |
| Net income | \$ 6,106 | \$ 5,042 |
| Denominator: | | |
| Denominator for basic net income per share $\frac{3}{4}$ weighted-average outstanding shares | 19,468 | 19,217 |
| Effect of dilutive securities: | | |
| Stock options and restricted stock | 94 | 152 |
| Denominator for diluted net income per share $\frac{3}{4}$ weighted-average outstanding shares | 19,562 | 19,369 |
| Net income per share $\frac{3}{4}$ basic | \$ 0.31 | \$ 0.26 |
| Net income per share $\frac{3}{4}$ diluted | \$ 0.31 | \$ 0.26 |

Stock-Based Compensation

The Company accounts for stock-based compensation in accordance with Statement of Financial Accounting Standards (“SFAS”) No. 123R “Share Based Payment” (“SFAS 123R”), which addresses the accounting for share based payment transactions in which the Company receives employee services in exchange for equity instruments. The statement generally requires that equity instruments issued in such transactions be accounted for using a fair value based method and the fair value of such equity instruments be recognized as expenses in the consolidated statements of operations.

Stock-based compensation expense for stock options and restricted stock included in the Company’s results of operations for the three months ended March 31, 2009 and 2008, was as follows (in thousands):

| | Three Months Ended March 31, 2009 2008 (unaudited) | |
|--------------------------------|--|----------|
| Cost of revenues | \$ 193 | \$ 162 |
| Selling and marketing | 258 | 180 |
| Software development | 150 | 124 |
| General and administrative | 986 | 777 |
| Total stock-based compensation | \$ 1,587 | \$ 1,243 |

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 1,500 and 15,113 shares were exercised during the three months ended March 31, 2009 and 2008, respectively.

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, 2008, including the expected dates of adoption and estimated effects on the Company's consolidated financial statements, except for the following:

In April 2009, the FASB issued FASB Staff Position ("FSP") No. FAS 141(R)-1, Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies ("FSP 141(R)-1"), to amend SFAS 141 (revised 2007) Business Combinations. FSP 141(R)-1 addresses the initial recognition, measurement and subsequent accounting for assets and liabilities arising from contingencies in a business combination. It requires that such assets acquired or liabilities assumed be initially recognized at fair value at the acquisition date if fair value can be determined during the measurement period. When fair value cannot be determined, companies should typically account for the acquired contingencies using existing guidance. FSP 141(R)-1 also requires that a systematic and rational basis for subsequently measuring and accounting for the assets or liabilities be developed depending on their nature. FSP 141(R)-1 is effective for contingent assets or liabilities arising from business combinations with an acquisition date on or after January 1, 2009. The adoption of FSP 141(R)-1 will change the accounting treatment and disclosure for certain specific items in a business combination, but the effect on the Company's results of operations or financial position will depend upon the specifics of any business combination with an acquisition date subsequent to December 31, 2008.

In April 2009, the FASB issued FASB Staff Position No. 157-4, Determining Fair Value When the Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly ("FSP 157-4"). FSP 157-4 provides additional guidance for determining whether a market is active or inactive, and whether a transaction is distressed. FSP 157-4 is applicable to all assets and liabilities (financial and non-financial) and will require enhanced disclosures. The provisions of FSP 157-4 are effective for the Company's interim period ending June 30, 2009. The adoption of FSP 157-4 is not expected to have a material impact on the Company's result of operations or financial position, but may require additional disclosures in the Company's interim financial statements.

In April 2009, the FASB issued FASB Staff Position No. 107-1 and APB 28-1, Interim Disclosures about Fair Value of Financial Instruments ("FSP 107-1"). FSP 107-1 requires disclosures in interim reporting periods concerning the fair value of financial instruments that were previously only required in the annual financial statements. The provisions of FSP 107-1 are effective for the Company's interim period ending June 30, 2009. The adoption of FSP 107-1 is not expected to have a material impact on the Company's results of operations or financial position, but may require additional disclosures in the interim financial statements.

COSTAR GROUP, INC.

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES — (CONTINUED)

Recent Accounting Pronouncements — (Continued)

In April 2009, the FASB issued FASB Staff Position No. 115-2 and 124-2, Recognition and Presentation of Other-Than-Temporary Impairments (“FSP 115-2”). FSP 115-2 applies to debt securities. FSP 115-2 redefines what constitutes an other-than-temporary impairment, defines credit and non-credit components of an other-than-temporary impairment, prescribes their financial statement treatment, and requires enhanced disclosures relating to such impairments. The provisions of FSP 115-2 are effective for the Company’s interim period ending June 30, 2009. The Company is currently evaluating the effect that the provisions of FSP 115-2 may have on the Company’s financial statements.

3. ACQUISITION

On April 1, 2008, the Company acquired certain assets of First CLS, Inc. (doing business as the Dorey Companies and DoreyPRO), an Atlanta-based provider of local commercial real estate information for \$3.0 million in initial cash consideration and deferred consideration payable within approximately six months after the one-year anniversary of closing. The First CLS, Inc. acquisition was accounted for using the purchase method of accounting. The purchase price for the acquisition was primarily allocated to customer base. The acquired customer base, which consists of one distinct intangible asset and is composed of acquired customer contracts and the related customer relationships, is being amortized on a 125% declining balance method over ten years. The results of operations of First CLS, Inc. have been consolidated with those of the Company since the date of the acquisition and are not considered material to the consolidated financial statements of the Company. Accordingly, pro forma financial information has not been presented for the acquisition.

4. FAIR VALUE

In September 2006, the FASB issued SFAS No. 157, “Fair Value Measurements” (“SFAS 157”), which defines fair value, establishes a framework for measuring fair value in accordance with GAAP and expands disclosures about fair value measurements. The Company adopted the provisions of SFAS 157 as of January 1, 2008 for financial instruments. Although the adoption of SFAS 157 did not materially impact its financial position, results of operations, or cash flow, the Company is now required to provide additional disclosures as part of its financial statements.

SFAS 157 establishes 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; 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 in 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)

In accordance with SFAS 157, the following table represents the Company's fair value hierarchy for its financial assets (cash, cash equivalents and investments) measured at fair value on a recurring basis as of March 31, 2009 (in thousands):

| | Level 1 | Level 2 | Level 3 | Total |
|--|------------|-----------|-----------|------------|
| Cash | \$ 74,969 | \$ ¾ | \$ ¾ | \$ 74,969 |
| Money market funds | 95,655 | ¾ | ¾ | 95,655 |
| Corporate debt securities | ¾ | 33,399 | ¾ | 33,399 |
| Government-sponsored enterprise obligations | ¾ | 109 | ¾ | 109 |
| Auction rate securities | ¾ | ¾ | 29,340 | 29,340 |
| Total cash, cash equivalents and investments | \$ 170,624 | \$ 33,508 | \$ 29,340 | \$ 233,472 |

The Company's Level 2 assets consist of corporate debt securities and government-sponsored enterprise obligations, which do not have directly observable quoted prices in active markets. The Company's corporate debt securities are valued using matrix pricing, which is an acceptable practical expedient under SFAS 157 for inputs.

The Company's Level 3 assets consist of variable rate debt instruments with an auction-reset feature ("auction rate securities" or "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 table presents the Company's Level 3 assets measured at fair value on a recurring basis using significant unobservable inputs as defined in SFAS 157, as of March 31, 2009 (in thousands):

| | Auction Rate Securities |
|--|-------------------------|
| Balance at December 31, 2007 | \$ 53,975 |
| Unrealized loss included in other comprehensive income | (3,710) |
| Net settlements | (20,925) |
| Balance at December 31, 2008 | \$ 29,340 |
| Unrealized loss included in other comprehensive income | ¾ |
| Net settlements | ¾ |
| Balance at March 31, 2009 (unaudited) | \$ 29,340 |

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

As of March 31, 2009, the Company held ARS with \$33.1 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 March 31, 2009.

COSTAR GROUP, INC.

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

4. FAIR VALUE — (CONTINUED)

While the Company continues to earn interest on its ARS investments at the contractual rate, these investments are not currently trading and therefore do not currently have a readily determinable market value. Accordingly, the estimated fair value of the ARS no longer approximates par value. The Company has used a discounted cash flow model to determine the estimated fair value of its investment in ARS as of March 31, 2009. The assumptions used in preparing the discounted cash flow model include estimates for interest rates, credit spreads, timing and amount of cash flows, liquidity risk premiums, expected holding periods and default risk. Based on this assessment of fair value, as of March 31, 2009, the Company determined there was a total decline in the fair value of its ARS investments of approximately \$3.7 million compared to its par value. The decline was deemed to be a temporary impairment and recorded as an unrealized loss in other comprehensive income 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 their credit ratings deteriorate, the Company may be required to record additional unrealized losses in other comprehensive income 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):

| | United States | International | Total |
|--|------------------|---------------|-----------|
| Goodwill, December 31, 2007 | \$ 30,428 | \$ 31,426 | \$ 61,854 |
| Acquisitions | 1,119 | ¾ | 1,119 |
| Effect of foreign currency translation | ¾ | (8,645) | (8,645) |
| Goodwill, December 31, 2008 | 31,547 | 22,781 | 54,328 |
| Effect of foreign currency translation | ¾ | (417) | (417) |
| Goodwill, March 31, 2009 (unaudited) | \$ 31,547 | \$ 22,364 | \$ 53,911 |

The Company recorded goodwill of approximately \$1.1 million in connection with the First CLS, Inc. acquisition in April 2008.

COSTAR GROUP, INC.

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

6. INTANGIBLES AND OTHER ASSETS

Intangibles and other assets consist of the following (in thousands, except amortization period data):

| | March 31, 2009 (unaudited) | December 31, 2008 | Weighted- Average Amortization Period (in years) |
|-------------------------------------|----------------------------------|-------------------------|--|
| Building photography | \$ 11,103 | \$ 11,011 | 5 |
| Accumulated amortization | (8,010) | (7,711) | |
| Building photography, net | 3,093 | 3,300 | |
| Acquired database technology | 20,678 | 20,711 | 4 |
| Accumulated amortization | (20,413) | (20,361) | |
| Acquired database technology, net | 265 | 350 | |
| Acquired customer base | 47,971 | 48,198 | 10 |
| Accumulated amortization | (38,029) | (37,192) | |
| Acquired customer base, net | 9,942 | 11,006 | |
| Acquired trade names and other | 7,679 | 7,744 | 6 |
| Accumulated amortization | (6,333) | (5,979) | |
| Acquired trade names and other, net | 1,346 | 1,765 | |
| Intangibles and other assets, net | \$ 14,646 | \$ 16,421 | |

7. INCOME TAXES

The income tax provision for the three months ended March 31, 2009 and 2008 reflects an effective tax rate of approximately 45%.

8. COMMITMENTS AND CONTINGENCIES

Currently, and from time to time, the Company is involved in litigation incidental to the conduct of its business. The Company is not a party to any lawsuit or proceeding that, in the opinion of management, is likely to have a material adverse effect on its financial position or results of operations.

COSTAR GROUP, INC.

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

9. SEGMENT REPORTING

Due to the increased size, complexity, and funding requirements associated with the Company's international expansion, in 2007 the Company began to manage the business geographically in two operating segments, with the primary areas of measurement and decision-making being the U.S. and International, which includes the U.K. and France. The Company's subscription-based information services, consisting primarily of CoStar Property Professional®, CoStar Tenant®, CoStar COMPS Professional®, and FOCUS™ services, currently generate more than 90% of the Company's total revenues. CoStar Property Professional, CoStar Tenant, and CoStar COMPS Professional are generally sold as a suite of similar services and comprise the Company's primary service offering in the U.S. operating segment. FOCUS is the Company's primary service offering in the International operating segment. Management relies on an internal management reporting process that provides revenue and operating segment EBITDA, which is the Company's 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 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.

Summarized information by operating segment was as follows (in thousands):

| | Three Months Ended March 31, 2009 2008 (unaudited) | |
|---|--|-----------|
| Revenues | | |
| United States | \$ 47,132 | \$ 46,403 |
| International | 4,238 | 5,861 |
| Total revenues | \$ 51,370 | \$ 52,264 |
| EBITDA | | |
| United States | \$ 14,586 | \$ 12,570 |
| International | (169) | (1,058) |
| Total EBITDA | \$ 14,417 | \$ 11,512 |
| Reconciliation of EBITDA to net income | | |
| EBITDA | \$ 14,417 | \$ 11,512 |
| Purchase amortization in cost of revenues | (479) | (583) |
| Purchase amortization in operating expenses | (946) | (1,221) |
| Depreciation and other amortization | (2,251) | (2,478) |
| Interest income, net | 442 | 1,938 |
| Income tax expense, net | (5,077) | (4,126) |
| Net income | \$ 6,106 | \$ 5,042 |

International EBITDA includes a corporate allocation of approximately \$100,000 and \$325,000 for the three months ended March 31, 2009 and 2008, respectively. The corporate allocation represents costs incurred for U.S. employees involved in management and expansion activities of the Company's International operating segment.

COSTAR GROUP, INC.

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

9. SEGMENT REPORTING — (CONTINUED)

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

| | March 31, 2009 (unaudited) | December 31, 2008 |
|--|----------------------------------|----------------------|
| Property and equipment, net | | |
| United States | \$ 13,166 | \$ 13,927 |
| International | 2,635 | 2,949 |
| Total property and equipment, net | \$ 15,801 | \$ 16,876 |
| Goodwill | | |
| United States | \$ 31,547 | \$ 31,547 |
| International | 22,364 | 22,781 |
| Total goodwill | \$ 53,911 | \$ 54,328 |
| Assets | | |
| United States | \$ 362,581 | \$ 353,084 |
| International | 42,188 | 43,474 |
| Total operating segment assets | \$ 404,769 | \$ 396,558 |
| Reconciliation of operating segment assets to total assets | | |
| Total operating segment assets | \$ 404,769 | \$ 396,558 |
| Investment in subsidiaries | (18,343) | (18,343) |
| Intercompany receivables | (44,444) | (43,831) |
| Total assets | \$ 341,982 | \$ 334,384 |
| Liabilities | | |
| United States | \$ 23,973 | \$ 24,180 |
| International | 40,114 | 40,053 |
| Total operating segment liabilities | \$ 64,087 | \$ 64,233 |
| Reconciliation of operating segment liabilities to total liabilities | | |
| Total operating segment liabilities | \$ 64,087 | \$ 64,233 |
| Intercompany payables | (33,270) | (33,270) |
| Total liabilities | \$ 30,817 | \$ 30,963 |

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. See "Cautionary Statement Concerning Forward-Looking Statements" at the end of this Item 2. for additional factors relating to such statements, 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.

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. ("CoStar") is the number one provider of information/marketing services to the commercial real estate industry in the U.S. and the 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, provide more information/marketing services than any of our competitors and believe we generate more revenues than any of our competitors. We have created a standardized information/marketing platform where members of the commercial real estate and related business community can continuously interact and facilitate transactions by efficiently exchanging accurate and standardized commercial real estate information. Our integrated suite of online service offerings includes information about space available for lease, comparable sales information, tenant information, information about properties for sale, internet marketing services, information for clients' websites, information about industry professionals and their business relationships, analytic information, data integration, and industry news. Our service offerings span all commercial property types, including office, industrial, retail, land, mixed-use, hospitality and multifamily.

Since 1994, we have expanded the geographical coverage of our existing information/marketing services and developed new information/marketing services. In addition to internal growth, this expansion included the acquisitions of Chicago ReSource, Inc. in Chicago in 1996 and New Market Systems, Inc. in San Francisco in 1997. In August 1998, we expanded into the Houston region through the acquisition of Houston-based real estate information provider C Data Services, Inc. In January 1999, we expanded further into the Midwest and Florida by acquiring LeaseTrend, Inc. and into Atlanta and Dallas/Fort Worth by acquiring Jamison Research, Inc. In February 2000, we acquired COMPS.COM, Inc., a San Diego-based provider of commercial real estate information. In November 2000, we acquired First Image Technologies, Inc., a California-based provider of commercial real estate software. In September 2002, we expanded further into Portland, Oregon through the acquisition of certain assets of Napier Realty Advisors (doing business as REAL-NET). In January 2003, we established a base in the U.K. with our acquisition of London-based FOCUS Information Limited. In May 2004, we expanded into Tennessee through the acquisition of Peer Market Research, Inc., and in September 2004, we extended our coverage of the U.K. through the acquisition of Scottish Property Network ("SPN"). In September 2004, we strengthened our position in Denver, Colorado through the acquisition of substantially all of the assets of RealComp, Inc., a local comparable sales information provider.

In January 2005, we acquired National Research Bureau, a Connecticut-based leading provider of U.S. shopping center information. In December 2006, our U.K. subsidiary, CoStar Limited, acquired Grecam S.A.S. ("Grecam"), a provider of commercial property information and market-level surveys, studies and consulting services located in Paris, France. In February 2007, CoStar Limited also acquired Property Investment Exchange Limited ("Propex"), a provider of commercial property information and operator of an electronic platform that facilitates the exchange of investment property located in London, England. In April 2008, we acquired the assets of First CLS, Inc. (doing business as the Dorey Companies and DoreyPRO), an Atlanta-based provider of local commercial real estate

information. The First CLS, Inc. acquisition is discussed later in this section under the heading “Recent Acquisition.”

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In 2004, we began our expansion into 21 new metropolitan markets throughout the U.S., and began expanding the geographical coverage of many of our existing U.S. and U.K. markets. We completed our expansion into the 21 new markets in the first quarter of 2006. In early 2005, in conjunction with the acquisition of National Research Bureau, we launched a major effort to expand our coverage of retail real estate information. The retail component of our flagship product, CoStar Property Professional, was unveiled in May 2006 at the International Council of Shopping Centers' convention in Las Vegas.

During the second half of 2006, in order to expand the geographical coverage of our service offerings, we began actively researching commercial properties in 81 new Core Based Statistical Areas ("CBSAs") in the U.S., we increased our U.S. field research fleet by adding 89 vehicles and we hired researchers to staff these vehicles. We released our CoStar Property Professional service in the 81 new CBSAs across the U.S. in the fourth quarter of 2007. Throughout our recent expansion efforts, we have remained focused on ensuring that CoStar continues to provide the quality of information our customers expect. As such, we have grown our research operations and plan to continue to grow our research operations slightly in 2009 in order to continue to meet customer expectations.

In connection with our acquisitions of Propex and Grecam, we intend to expand the coverage of our service offerings within the U.K. and integrate our international operations more fully with those in the U.S. We have gained operational efficiencies as a result of consolidating a majority of our U.K. research operations in one location in Glasgow and combining the majority of our remaining U.K. operations in one central location in London.

We intend to eventually introduce a consistent international platform of service offerings. In 2007, we introduced the "CoStar Group" as the brand encompassing our international operations. We believe that our recent U.S. and international expansion and integration efforts have created a platform for continued earnings growth. In fact, our results for 2008 reflected growth in earnings as a result of these investments in our business.

Our financial reporting currency is the U.S. dollar. Changes in exchange rates can significantly affect our reported results and consolidated trends. We believe that our increasing diversification beyond the U.S. economy through our international businesses benefits our shareholders over the long term. We also believe it is important to evaluate our operating results before and after the effect of currency changes, as it may provide a more accurate comparison of our results of operations over historical periods. Currency volatility may continue, which may impact (either positively or negatively) our reported financial results and consolidated trends and comparisons.

We expect to continue to develop and distribute new services, expand existing services within our current platform, consider strategic acquisitions and expand and develop our sales and marketing organization. For instance, in May 2008, we released CoStar Showcase®, an internet marketing service that provides commercial real estate professionals the opportunity to make their listings accessible to all visitors to our public website, www.CoStar.com. In addition, in April 2008, as described above we acquired the online commercial real estate information assets of First CLS, Inc. (doing business as the Dorey Companies and DoreyPRO). Any future expansion could reduce our profitability and increase our capital expenditures. Therefore, while we expect current service offerings to remain profitable, driving overall earnings throughout 2009 and providing substantial cash flow for our business, it is possible that any new investments could cause us to generate losses and negative cash flow from operations in the future.

Current general economic conditions in the U.S. and the world are negatively affecting business operations for our clients and are resulting in more business consolidations and, in certain circumstances, failures. As a result of these economic conditions, we continue to see increased levels of customer cancellations, reductions of services and failures to pay amounts due to us. If cancellations, reductions of services and failures to pay continue at the current rate or increase, and we are unable to offset the resulting decrease in revenue by increasing sales to new or existing customers, our revenues may decline or grow at reduced rates. Additionally, current economic conditions may cause customers to reduce expenses, and customers may be forced to purchase fewer services or cancel all services. We compete against many other commercial real estate information and marketing service providers for business. If

customers choose to cancel our services for cost-cutting or other reasons, our revenue could decline. The extent and duration of any future continued weakening of the economy is unknown and there can be no assurance that any of the governmental or private sector initiatives designed to strengthen the economy will be successful. Because of these uncertainties in the current economic environment, we may not be able to accurately forecast our revenue. However, we continue to believe that the Company is positioned to generate continued, sustained earnings in 2009.

We currently issue stock options and/or restricted stock to our officers, directors and employees, and as a result we record additional compensation expense in our consolidated statements of operations. We plan to continue the use of alternative stock-based compensation for our officers, directors and employees, which may include, among other things, restricted stock or stock option grants that typically will require us to record additional compensation expense in our consolidated statements of operations and reduce our net income.

Our subscription-based information/marketing services, consisting primarily of CoStar Property Professional, CoStar Tenant, CoStar COMPS Professional, and FOCUS services currently generate more than 90% of our total revenues. CoStar Property Professional, CoStar Tenant, and CoStar COMPS Professional are generally sold as a suite of similar services and comprise our primary service offering in our U.S. operating segment. FOCUS is our primary service offering in our International operating segment. Our contracts for our subscription-based information/marketing services typically have a minimum term of one year and renew automatically. Upon renewal, many of the 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 fees based on actual system usage. Contract rates are generally based on the number of sites, number of users, organization size, the client's business focus, geography and the number of services to which a client subscribes. Our subscription clients generally pay contract fees on a monthly basis, but in some cases may pay us on a quarterly or annual basis. We recognize this revenue on a straight-line basis over the life of the contract. Annual and quarterly advance payments result in deferred revenue, substantially reducing the working capital requirements generated by accounts receivable.

For the twelve months ended March 31, 2009, our contract renewal rate was approximately 87%. For the twelve months ended March 31, 2008, our contract renewal rate was over 90%. As discussed above, our contract renewal rate may continue to decline if continuing negative economic conditions lead to greater business failures and/or consolidations, further reductions in customer spending or decreases in the customer base.

Application of Critical Accounting Policies and Estimates

The preparation of financial statements and related disclosures in conformity with generally accepted accounting principles ("GAAP") in the United States of America 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 estimates reasonably could have been used in the current period. Changes in the accounting estimates we use 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 realize any undiscounted cash flows of the carrying amounts 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.

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Goodwill and identifiable intangible assets not subject to amortization are tested annually by each reporting unit on October 1st of each year for impairment and are tested for impairment more frequently based upon the existence of one or more of the above indicators. We consider our operating segments, U.S. and International, as our reporting units under Statement of Financial Accounting Standards (“SFAS”) No. 142 for consideration of potential impairment of goodwill.

The goodwill impairment test is a 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 future financial performance and a weighted average cost of capital. 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 measure impairment loss 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.

Accounting for Income Taxes

As part of the process of preparing our 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 actual current tax exposure and assess the temporary differences resulting from differing treatment of items, such as deferred revenue or deductibility of certain intangible assets, for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within our 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 statements of operations.

Non-GAAP Financial Measures

We prepare and publicly release quarterly unaudited financial statements prepared in accordance with GAAP. We also disclose and discuss certain non-GAAP financial measures in our public releases. Currently, the non-GAAP financial measure that we disclose is EBITDA, which is our net income (loss) before interest, income taxes, depreciation and amortization. We 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. 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 more meaningfully evaluate and compare our future results of operations to our previously reported results of operations.

We view EBITDA as an operating performance measure and as such we believe that the GAAP financial measure most directly comparable to it is net income (loss). In calculating EBITDA, we exclude from net income (loss) 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 is not a measurement of financial performance under GAAP and should not be considered as a measure of liquidity, as an alternative to net income (loss) 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 as a substitute for any GAAP financial measure, including net income (loss). In addition, we urge investors and potential investors in our securities to carefully review the reconciliation of EBITDA to net income (loss) set forth below, in our earnings releases and in other filings with the Securities and Exchange Commission and to carefully review the GAAP financial information included as part of our Quarterly Reports on Form 10-Q and our Annual Reports on Form 10-K 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.

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EBITDA is used by management to internally measure our operating and management performance and by investors as a supplemental financial measure to evaluate the performance of our business that, when viewed with our GAAP results and the accompanying reconciliation, we believe provides additional information that is useful to gain an understanding of the factors and trends affecting our business. We have spent more than 21 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/marketing services, which included acquisitions, our net income (loss) has included significant charges for purchase amortization, depreciation and other amortization. EBITDA excludes these charges and provides meaningful information about the operating performance of our business, apart from charges for purchase amortization, depreciation and other amortization. We believe the disclosure of EBITDA helps investors meaningfully evaluate and compare our performance from quarter to quarter and from year to year. We also believe EBITDA is a measure of our ongoing operating performance because the isolation of non-cash charges, such as amortization and depreciation, and non-operating items, such as interest and income taxes, 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 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 the financial items that have been excluded from our net income (loss) to calculate EBITDA and the material limitations associated with using this non-GAAP financial measure as compared to net income (loss):

- Purchase amortization in cost of revenues may be useful for investors to consider because it represents 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.
- Purchase amortization in operating expenses may be useful for investors to consider because it represents the estimated attrition of our acquired customer base and the diminishing value of any acquired trade names. 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 net interest income we generate may be useful for investors to consider and may result in current cash inflows or outflows. However, we do not consider the amount of net interest income to be a representative component of the day-to-day operating performance of our business.
- Income tax expense (benefit) 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 (benefit) to be a representative component of the day-to-day operating performance of our business.

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 gain an understanding of the factors and trends affecting our business.

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

| | Three Months Ended March 31, | |
|---|---------------------------------|-----------|
| | 2009 | 2008 |
| | (unaudited) | |
| Net income | \$ 6,106 | \$ 5,042 |
| Purchase amortization in cost of revenues | 479 | 583 |
| Purchase amortization in operating expenses | 946 | 1,221 |
| Depreciation and other amortization | 2,251 | 2,478 |
| Interest income, net | (442) | (1,938) |
| Income tax expense, net | 5,077 | 4,126 |
| EBITDA | \$ 14,417 | \$ 11,512 |
| Cash flows provided by (used in) | | |
| Operating activities | \$ 9,321 | \$ 8,082 |
| Investing activities | 1,592 | 28,493 |
| Financing activities | (134) | 412 |

Comparison of Three Months Ended March 31, 2009 and Three Months Ended March 31, 2008

Revenues. Revenues decreased to \$51.4 million in the first quarter of 2009 from \$52.3 million in the first quarter of 2008. Approximately \$1.6 million of the decrease in revenue is due to decreased revenue from our International operations as a result of a decrease in foreign currency exchange rates. The decrease was partially offset by an increase in U.S. revenue of approximately \$700,000. The increase in U.S. revenue is attributable to further penetration of our subscription-based information services, and successful cross-selling of our services to our customers in existing markets, combined with continued high renewal rates. Our subscription-based information services, consisting primarily of CoStar Property Professional, CoStar Tenant, CoStar COMPS Professional and FOCUS, currently generate more than 90% of our total revenues.

Gross Margin. Gross margin increased to \$34.5 million in the first quarter of 2009 from \$32.5 million in the first quarter of 2008. The gross margin percentage increased to 67.1% in the first quarter of 2009 from 62.3% in the first quarter of 2008. The increase in gross margin amount and percentage was principally due to a decrease in the cost of revenues. Cost of revenues decreased to \$16.9 million for the first quarter of 2009 from \$19.7 million for the first quarter of 2008. The decrease in the cost of revenues was principally due to our reduction of approximately \$1.2 million in research personnel costs, a decrease of approximately \$1.1 million due to a decrease in foreign currency exchange rates, and a decrease of approximately \$200,000 in data costs.

Selling and Marketing Expenses. Selling and marketing expenses decreased to \$9.2 million in the first quarter of 2009 from \$10.9 million in the first quarter of 2008, and decreased as a percentage of revenues to 17.8% in the first quarter of 2009 from 20.8% in the first quarter of 2008. The decrease in the amount of selling and marketing expenses was primarily due to a decrease in personnel expense of approximately \$1.3 million and a decrease of approximately \$400,000 due to a decrease in foreign currency exchange rates.

Software Development Expenses. Software development expenses remained relatively consistent at \$3.2 million in the first quarter of 2009 compared to \$3.4 million in the first quarter of 2008, and remained relatively consistent as a percentage of revenues at 6.2% in the first quarter of 2009 compared to 6.5% in the first quarter of 2008.

General and Administrative Expenses. General and administrative expenses increased to \$10.5 million in the first quarter of 2009 from \$9.8 million in the first quarter of 2008, and increased as a percentage of revenues to 20.3% in the first quarter of 2009 compared to 18.8% in the first quarter of 2008. The increase in the amount of general and administrative expenses was primarily due to increased bad debt expense of approximately \$500,000 and increased legal fees of approximately \$400,000.

Purchase Amortization. Purchase amortization remained relatively consistent at \$0.9 million in the first quarter of 2009 compared to \$1.2 million in the first quarter of 2008, and was slightly lower as a percentage of revenues at 1.8% in the first quarter of 2009 compared to 2.3% in the first quarter of 2008.

Interest and Other Income, net. Interest and other income, net decreased to \$442,000 in the first quarter of 2009 from \$1.9 million in the first quarter of 2008. Although, cash and cash equivalents, short-term and long-term investments were higher in the first quarter of 2009 than in the first quarter of 2008, our interest and other income decreased due to lower average interest rates in the first quarter of 2009 compared to the first quarter of 2008.

Income Tax Expense, net. Income tax expense, net increased to \$5.1 million in the first quarter of 2009 from \$4.1 million in the first quarter of 2008. This increase was due to higher income before income taxes as a result of our growth in profitability.

Comparison of Business Segment Results for Three Months Ended March 31, 2009 and Three Months Ended March 31, 2008

We manage our business geographically in two operating segments, with our primary areas of measurement and decision-making being the U.S. and International, which includes the U.K. and France. Management relies on an internal management reporting process that provides revenue 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. CoStar Property Professional, CoStar Tenant, and CoStar COMPS Professional are generally sold as a suite of similar services and comprise our primary service offering in our U.S. operating segment. U.S. revenues increased to \$47.1 million in the first quarter of 2009 from \$46.4 million in the first quarter of 2008. This increase in U.S. revenue was due to further penetration of our U.S. subscription-based information/marketing services and the successful cross-selling of our services to our customers in existing markets, combined with a continued high renewal rate. FOCUS is our primary service offering in our International operating segment. International revenues decreased \$1.7 million to \$4.2 million in the first quarter of 2009 from \$5.9 million in the first quarter of 2008 due primarily to foreign currency fluctuations.

Segment EBITDA. U.S. EBITDA increased to \$14.6 million in the first quarter of 2009 from \$12.6 million in the first quarter of 2008. The increase in U.S. EBITDA was due to increased revenue and lower personnel costs, partially offset by an increase in bad debt expense and legal fees. International EBITDA increased to a loss of \$169,000 in the first quarter of 2009 from a loss of \$1.1 million in the first quarter of 2008. This decreased loss was primarily due to lower personnel costs for the first quarter of 2009 compared to the first quarter of 2008. Additionally, the first quarter of 2009 had a lower corporate allocation than the first quarter of 2008. International EBITDA includes a corporate allocation of approximately \$100,000 and \$325,000 for the three months ended March 31, 2009 and 2008, respectively. The corporate allocation represents costs incurred for U.S. employees involved in international management and expansion activities.

Recent Acquisition

On April 1, 2008, we acquired certain assets of First CLS, Inc. (doing business as the Dorey Companies and DoreyPRO), an Atlanta-based provider of local commercial real estate information for \$3.0 million in initial cash consideration and deferred consideration payable within approximately six months after the one-year anniversary of closing. The First CLS, Inc. acquisition was accounted for using the purchase method of accounting. The purchase

price for the acquisition was primarily allocated to customer base. The acquired customer base, which consists of one distinct intangible asset and is composed of acquired customer contracts and the related customer relationships, is being amortized on a 125% declining balance method over ten years. The results of operations of First CLS, Inc. have been consolidated with those of the Company since the date of the acquisition and are not considered material to our consolidated financial statements. Accordingly, pro forma financial information has not been presented for the acquisition.

Liquidity and Capital Resources

Our principal sources of liquidity are cash, cash equivalents and short-term investments. Total cash, cash equivalents and short-term investments increased to \$204.1 million at March 31, 2009 from \$195.3 million at December 31, 2008. The increase in cash, cash equivalents and short-term investments for the three months ended March 31, 2009 was primarily due to net cash provided by operating activities of approximately \$9.3 million partially offset by purchases of property and equipment and other assets of approximately \$1.0 million.

Net cash provided by operating activities for the three months ended March 31, 2009 was \$9.3 million compared to \$8.1 million for the three months ended March 31, 2008. This \$1.2 million increase was primarily due to decreased payments for accounts payable and accrued expenses of approximately \$4.9 million, partially offset by approximately \$1.7 million in decreased cash receipts on accounts receivable due to increased balances and declining economic conditions and a decrease of approximately \$1.4 million due to changes in prepaid expenses. The decreased payments for accounts payable and accrued expenses were \$4.9 million lower for the three months ended March 31, 2009 primarily due to the one-time payment of \$2.9 million of deferred consideration for the Propex acquisition that was paid in the three months ended March 31, 2008 and that did not occur in the three months ended March 31, 2009.

Net cash provided by investing activities was \$1.6 million for the three months ended March 31, 2009, compared to \$28.5 million for the three months ended March 31, 2008. This \$26.9 million decrease in net cash provided by investing activities was primarily due to the decision in 2008 to invest in money market funds and U.S. treasuries instead of short-term investment instruments, which resulted in a net sale of investments of approximately \$29.7 million in the three months ended March 31, 2008 compared to a net sale of investments of approximately \$2.6 million in the three months ended March 31, 2009.

Net cash used in financing activities was \$134,000 for the three months ended March 31, 2009, compared to \$412,000 of net cash provided by financing activities for the three months ended March 31, 2008. The change is due to decreased proceeds from exercise of stock options and increased share repurchases from employees to satisfy employee tax liabilities arising from vesting of restricted stock.

During the three months ended March 31, 2009, we incurred capital expenditures of approximately \$1.0 million. We expect to make capital expenditures in 2009 of approximately \$4.0 to \$7.0 million.

To date, we have grown in part by acquiring other companies and we may continue to make acquisitions. Our 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 April 2008, we paid \$3.0 million in initial cash consideration and made a commitment for deferred consideration payable within approximately six months after the one-year anniversary of closing for the online commercial real estate information assets of First CLS, Inc., an Atlanta-based provider of local commercial real estate information.

As of December 31, 2008, we had utilized all of our U.S. net operating loss carryforwards for federal income tax purposes. As a result, we expect our cash payments for taxes to be approximately \$20.0 million in 2009.

As of March 31, 2009, we had \$33.1 million par value of long-term investments in student loan ARS, which failed to settle at auctions. The majority of these investments are of high credit quality with AAA credit ratings and are primarily securities supported by guarantees from the Federal Family Education Loan Program ("FFELP") of the U.S. Department of Education. While we continue to earn interest on these investments, the investments are not liquid in the short term. In the event we need to immediately access these funds, we may have to sell these securities at an amount below par value. Based on our ability to access our cash, cash equivalents and other short-term investments and our expected operating cash flows, we do not anticipate having to sell these investments below par value in order to operate our business in the foreseeable future.

Recent Accounting Pronouncements

There have been no developments to the Recent Accounting Pronouncements discussion included in our Annual Report on Form 10-K for the year ended December 31, 2008, including the expected dates of adoption and estimated effects on our consolidated financial statements, except for the following:

In April 2009, the FASB issued FASB Staff Position (“FSP”) No. FAS 141(R)-1, Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies (“FSP 141(R)-1”), to amend SFAS 141 (revised 2007) Business Combinations. FSP 141(R)-1 addresses the initial recognition, measurement and subsequent accounting for assets and liabilities arising from contingencies in a business combination. It requires that such assets acquired or liabilities assumed be initially recognized at fair value at the acquisition date if fair value can be determined during the measurement period. When fair value cannot be determined, companies should typically account for the acquired contingencies using existing guidance. FSP 141(R)-1 also requires that a systematic and rational basis for subsequently measuring and accounting for the assets or liabilities be developed depending on their nature. FSP 141(R)-1 is effective for contingent assets or liabilities arising from business combinations with an acquisition date on or after January 1, 2009. The adoption of FSP 141(R)-1 will change the accounting treatment and disclosure for certain specific items in a business combination, but the effect on our results of operations or financial position will depend upon the specifics of any business combination with an acquisition date subsequent to December 31, 2008.

In April 2009, the FASB issued FASB Staff Position No. 157-4, Determining Fair Value When the Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly (“FSP 157-4”). FSP 157-4 provides additional guidance for determining whether a market is active or inactive, and whether a transaction is distressed. FSP 157-4 is applicable to all assets and liabilities (financial and non-financial) and will require enhanced disclosures. The provisions of FSP 157-4 are effective for our interim period ending June 30, 2009. The adoption of FSP 157-4 is not expected to have a material impact on our results of operations or financial position, but may require additional disclosures in our interim financial statements.

In April 2009, the FASB issued FASB Staff Position No. 107-1 and APB 28-1, Interim Disclosures about Fair Value of Financial Instruments. (“FSP 107-1”) FSP 107-1 requires disclosures in interim reporting periods concerning the fair value of financial instruments that were previously only required in the annual financial statements. The provisions of FSP 107-1 are effective for our interim period ending June 30, 2009. The adoption of FSP 107-1 is not expected to have a material impact on our results of operations or financial position, but may require additional disclosures in the interim financial statements.

In April 2009, the FASB issued FASB Staff Position No. 115-2 and 124-2, Recognition and Presentation of Other-Than-Temporary Impairments (“FSP 115-2”). FSP 115-2 applies to debt securities. FSP 115-2 redefines what constitutes an other-than-temporary impairment, defines credit and non-credit components of an other-than-temporary impairment, prescribes their financial statement treatment, and requires enhanced disclosures relating to such impairments. The provisions of FSP 115-2 are effective for our interim period ending June 30, 2009. We are currently evaluating the effect that the provisions of FSP 115-2 may have on our financial statements.

Cautionary Statement Concerning Forward-Looking Statements

We have made forward-looking statements in this Report and make forward-looking statements in our press releases and conference calls 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 2009 and beyond, our possible or assumed future results of operations generally, and other statements and information regarding assumptions about our revenues, EBITDA, fully diluted net income, net income per share, diluted net income per share, weighted-average outstanding shares, taxable income, future taxable income, cash flow from operating

activities, available cash, operating costs, amortization expense, intangible asset recovery, capital and other expenditures, effective tax rate, equity compensation charges, purchase amortization, financing plans, geographic expansion,

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capital structure, contractual obligations, legal proceedings and claims, our database, database growth, services and facilities, employee relations, future economic performance, our ability to liquidate or realize our short-term and long-term investments, interest income, management's plans, goals and objectives for future operations and growth and markets for our stock. The 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", "Legal Proceedings" and "Risk Factors".

Our forward-looking statements are also identified by words such as "believes," "expects," "thinks," "anticipates," "intend," "estimates" or similar expressions. 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" in Item 1A. of Part II of this report, 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: general economic conditions; commercial real estate market conditions; changes or consolidations within the commercial real estate industry; customer retention; competition; foreign currency fluctuations; our ability to identify, acquire and integrate acquisition candidates; our ability to recruit and hire qualified and effective sales management and employees; development of our sales force; employee retention; our ability to obtain any required financing on favorable terms; global credit market conditions affecting investments; our ability to integrate our U.S. and international product offerings; our ability to continue to expand successfully; our ability to effectively penetrate the market for retail real estate information and gain acceptance in that market; our ability to control costs; litigation; changes in accounting policies or practices; release of new and upgraded services by us or our competitors; data quality; technical problems with our services; managerial execution; changes in relationships with real estate brokers 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 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/marketing services to the commercial real estate and related business community in the U.S., U.K. and France. Our functional currency for our operations in the United Kingdom and France is the local currency. As such, fluctuations in the British Pound 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 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 March 31, 2009, accumulated other comprehensive income (loss) included a loss from foreign currency translation adjustments of approximately \$9.2 million.

We do not have material exposure to market risks associated with changes in interest rates related to cash equivalent securities held as of March 31, 2009. As of March 31, 2009, we had \$204.1 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, cash equivalents and short-term investments. Based on our ability to access our cash, cash equivalents and short-term investments, 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.

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Included within our long-term investments are investments in student loan ARS, most of which are AAA rated. These securities are primarily securities supported by guarantees from the FFELP of the U.S. Department of Education. As of March 31, 2009, auctions for \$33.1 million of our investments in auction rate securities failed. 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 March 31, 2009, we determined that there was a decline in the fair value of our ARS investments of approximately \$3.7 million, which was deemed to be a temporary impairment and recorded as an unrealized loss in accumulated other comprehensive income (loss) in stockholders' equity. If the issuers are unable to successfully close future auctions and 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 other comprehensive income or as an other-than-temporary impairment charge to earnings. Based on our ability to access our cash, cash equivalents and short-term investments, 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 Note 4 to our consolidated financial statements included in this Quarterly Report on Form 10-Q for further discussion.

We have approximately \$68.6 million in intangible assets as of March 31, 2009. As of March 31, 2009, 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 March 31, 2009, 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 the 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 lawsuits or proceedings that, in the opinion of our management based on consultations with legal counsel,

are likely to have a material adverse effect on our results of operations or financial position.

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, 2008, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on 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 Annual Report on Form 10-K for the year ended December 31, 2008.

Item 2. Unregistered Sales of Equity in 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 March 31, 2009:

ISSUER PURCHASES OF EQUITY SECURITIES

| Month | 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 |
|--------------------------------------|----------------------------------|------------------------------|--|--|
| January 1 through January 31, 2009 | 510(1) | \$ 30.98 | ¾ | ¾ |
| February 1 through February 28, 2009 | 5,820(1) | \$ 26.74 | ¾ | ¾ |
| March 1 through March 31, 2009 | 1,687(1) | \$ 25.66 | ¾ | ¾ |
| Total | 8,017(1) | \$ 26.78 | ¾ | ¾ |

(1) The number of shares purchased consists of shares of common stock tendered by employees to the Company to satisfy the employees' tax withholding obligations arising as a result of vesting of restricted stock grants under the Company's 1998 Stock Incentive Plan, as amended, and the Company's 2007 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. Submission of Matters to a Vote of Security Holders

None

Item 5. Other Information

None

Item 6. Exhibits

3.1 Restated Certificate of Incorporation (Incorporated by reference to Exhibit 3.1 to the Registration Statement on Form S-1 of the Registrant (Reg. No. 333-47953) filed with the Commission on March 13, 1998 (the "1998 Form S-1"))

3.2 Certificate of Amendment of Restated Certificate of Incorporation (Incorporated by reference to Exhibit 3.1 to the Registrant's Report on Form 10-Q for the period ended June 30, 1999)

3.3 Amended and Restated By-Laws (Incorporated by reference to Registrant's Annual Report on Form 10-K for the period ended December 31, 2008)

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31.1 Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith)

31.2 Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith)

32.1 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)

32.2 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)

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: May 7, 2009

By:

/S/ Brian J. Radecki
Brian J. Radecki
Chief Financial Officer
(Principal Financial and Accounting
Officer and Duly Authorized Officer)