

COSTAR GROUP INC
Form 10-Q
July 27, 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 June 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 July 21, 2017, there were 32,820,584 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 June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Revenues	\$237,153	\$206,869	\$463,706	\$406,608
Cost of revenues	55,273	42,679	106,619	85,579
Gross margin	181,880	164,190	357,087	321,029
Operating expenses:				
Selling and marketing	91,726	80,468	168,128	155,672
Software development	23,144	19,547	45,518	37,182
General and administrative	34,557	30,227	68,552	57,703
Customer base amortization	4,570	5,829	9,344	12,052
	153,997	136,071	291,542	262,609
Income from operations	27,883	28,119	65,545	58,420
Interest and other income	605	159	1,034	243
Interest and other expense	(2,693)	(2,455)	(5,379)	(4,964)
Income before income taxes	25,795	25,823	61,200	53,699
Income tax expense	3,611	10,247	16,886	21,402
Net income	\$22,184	\$15,576	\$44,314	\$32,297
Net income per share — basic	\$0.68	\$0.48	\$1.37	\$1.01
Net income per share — diluted	\$0.68	\$0.48	\$1.36	\$1.00
Weighted average outstanding shares — basic	32,406	32,186	32,341	32,135
Weighted average outstanding shares — diluted	32,739	32,448	32,651	32,415

See accompanying notes.

COSTAR GROUP, INC.
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
 (in thousands)
 (unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Net income	\$22,184	\$15,576	\$44,314	\$32,297
Other comprehensive income (loss), net of tax				
Foreign currency translation adjustment	1,831	(1,925)	2,242	(2,458)
Net decrease in unrealized loss on investments	—	—	—	229
Total other comprehensive income (loss)	1,831	(1,925)	2,242	(2,229)
Total comprehensive income	\$24,015	\$13,651	\$46,556	\$30,068

See accompanying notes.

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

	June 30, 2017	December 31, 2016
	(unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$564,638	\$ 567,223
Accounts receivable, net of allowance for doubtful accounts of approximately \$6,441 and \$6,344 as of June 30, 2017 and December 31, 2016, respectively	51,512	48,537
Income tax receivable	—	129
Prepaid expenses and other current assets	19,837	11,602
Total current assets	635,987	627,491
Long-term investments	9,952	9,952
Deferred income taxes, net	7,834	7,273
Property and equipment, net	85,779	87,568
Goodwill	1,280,271	1,254,866
Intangible assets, net	198,097	195,965
Deposits and other assets	2,099	1,948
Total assets	\$2,220,019	\$ 2,185,063
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term debt	\$21,945	\$ 31,866
Accounts payable	16,694	11,478
Accrued wages and commissions	27,360	33,803
Accrued expenses	36,201	31,092
Deferred gain on the sale of building	2,523	2,523
Income taxes payable	—	3,814
Deferred rent	3,011	1,206
Deferred revenue	43,167	39,164
Total current liabilities	150,901	154,946
Long-term debt, less current portion	282,881	306,473
Deferred gain on the sale of building	17,454	18,715
Deferred rent	31,077	31,589
Deferred income taxes, net	20,218	18,386
Income taxes payable	753	741
Total liabilities	503,284	530,850
Total stockholders' equity	1,716,735	1,654,213
Total liabilities and stockholders' equity	\$2,220,019	\$ 2,185,063
See accompanying notes.		

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

	Six Months Ended June 30,	
	2017	2016
Operating activities:		
Net income	\$44,314	\$32,297
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	33,158	34,961
Amortization of debt issuance costs	1,487	1,610
Stock-based compensation expense	19,460	17,670
Deferred income tax expense, net	3,434	3,474
Provision for losses on accounts receivable	2,349	5,108
Changes in operating assets and liabilities, net of acquisitions:		
Accounts receivable	(5,177)	(10,868)
Prepaid expenses and other current assets	(7,887)	(2,616)
Deposits and other assets	(103)	482
Accounts payable and other liabilities	605	4,956
Deferred revenue	3,723	(380)
Net cash provided by operating activities	95,363	86,694
Investing activities:		
Proceeds from sale and settlement of investments	—	4,700
Purchases of property and equipment and other assets	(12,674)	(7,394)
Acquisitions, net of cash acquired	(45,068)	(10,795)
Net cash used in investing activities	(57,742)	(13,489)
Financing activities:		
Payments of long-term debt	(35,000)	(20,000)
Repurchase of restricted stock to satisfy tax withholding obligations	(13,456)	(13,967)
Proceeds from exercise of stock options and employee stock purchase plan	7,683	3,837
Net cash used in financing activities	(40,773)	(30,130)
Effect of foreign currency exchange rates on cash and cash equivalents	567	(742)
Net increase (decrease) in cash and cash equivalents	(2,585)	42,333
Cash and cash equivalents at the beginning of period	567,223	421,818
Cash and cash equivalents at the end of period	\$564,638	\$464,151
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 June 30, 2017 and December 31, 2016, the results of its operations for the three and six months ended June 30, 2017 and 2016, its comprehensive income for the three and six months ended June 30, 2017 and 2016, and its cash flows for the six months ended June 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 six months ended June 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, 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, including apartment listings, and (ii) providing professional property management companies and landlords with an advertising destination. 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 performs ongoing assessments of its customers' respective financial conditions and generally does not require that its customers' obligations to the Company be secured. 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 \$38 million and \$34 million for the three months ended June 30, 2017 and 2016, respectively. Advertising costs were approximately \$62 million and \$68 million for the six months ended June 30, 2017 and 2016, respectively.

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 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 six months ended June 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):

	June 30, 2017	December 31, 2016
Foreign currency translation adjustment	\$(9,949)	\$(12,191)
Accumulated net unrealized loss on investments, net of tax	(848)	(848)
Total accumulated other comprehensive loss	\$(10,797)	\$(13,039)

There were no amounts reclassified out of accumulated other comprehensive loss to the condensed consolidated statements of operations for the three and six months ended June 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 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 June 30, 2017		Six Months Ended June 30, 2016	
Numerator:				
Net income	\$22,184	\$15,576	\$44,314	\$32,297
Denominator:				
Denominator for basic net income per share — weighted-average outstanding shares	32,406	32,186	32,341	32,135
Effect of dilutive securities:				
Stock options and restricted stock	333	262	310	280
Denominator for diluted net income per share — weighted-average outstanding shares	32,739	32,448	32,651	32,415
Net income per share — basic	\$0.68	\$0.48	\$1.37	\$1.01
Net income per share — diluted	\$0.68	\$0.48	\$1.36	\$1.00

COSTAR GROUP, INC.

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES — (CONTINUED)

Net Income Per Share — (Continued)

Stock options to purchase approximately 96,000 and 227,000 shares that were outstanding for the three months ended June 30, 2017 and 2016, respectively, 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 174,000 and 231,000 shares that were outstanding for the six months ended June 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 June 30, 2017		Six Months Ended June 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.

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

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	Three Months		Six Months	
	Ended		Ended	
	June 30,		June 30,	
	2017	2016	2017	2016
Cost of revenues	\$1,339	\$1,432	\$2,510	\$2,813
Selling and marketing	1,887	1,733	3,539	3,244
Software development	1,840	1,684	3,650	3,218
General and administrative	5,037	4,490	9,761	8,395
Total stock-based compensation	\$10,103	\$9,339	\$19,460	\$17,670

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 69,993 and 16,211 shares were exercised during the three months ended June 30, 2017 and 2016, respectively. Options to purchase 78,283 and 20,711 shares were exercised during the six months ended June 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 June 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 Note 7 for additional information regarding the term loan facility and revolving credit facility. The Company amortized debt issuance costs of approximately \$715,000 and \$799,000 for the three months ended June 30, 2017 and 2016, respectively. The Company amortized debt issuance costs of approximately \$1 million and \$2 million for the six months ended June 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. The Company is currently gathering historical information to identify renewal rates by type of customer and type of service, which will help establish the amortization period. 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 \$4 million for the six months ended June 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 \$6 million, resulting in a corresponding increase in net income and an increase of \$0.20 per basic share and \$0.19 per diluted share for the three months ended June 30, 2017. In addition, the Company recognized an income tax benefit of \$7 million, resulting in a corresponding increase in net income and an increase of \$0.21 per basic and diluted share for the six months ended June 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 June 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