
**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, 2004

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 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 of the past 90 days. Yes No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Securities Exchange Act of 1934). Yes No

As of July 1, 2004, there were 18,230,617 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,	
	2004	2003	2004	2003
Revenues	\$27,456	\$23,174	\$53,734	\$45,727
Cost of revenues	8,842	7,716	16,783	15,319
Gross margin	18,614	15,458	36,951	30,408
Operating expenses				
Selling and marketing	6,898	6,397	14,097	12,966
Software development	2,236	1,702	4,165	3,402
General and administrative	7,033	6,669	13,885	13,158
Purchase amortization	1,071	1,113	2,197	2,225
	<u>17,238</u>	<u>15,881</u>	<u>34,344</u>	<u>31,751</u>
Income (loss) from operations	1,376	(423)	2,607	(1,343)
Interest income, net	286	56	524	133
Income (loss) before income taxes	1,662	(367)	3,131	(1,210)
Income tax expense (benefit)	(74)	—	(86)	—
Net income (loss)	<u>\$ 1,736</u>	<u>\$ (367)</u>	<u>\$ 3,217</u>	<u>\$ (1,210)</u>
Net income (loss) per share — basic	<u>\$ 0.10</u>	<u>\$ (0.02)</u>	<u>\$ 0.18</u>	<u>\$ (0.08)</u>
Net income (loss) per share — diluted	<u>\$ 0.09</u>	<u>\$ (0.02)</u>	<u>\$ 0.17</u>	<u>\$ (0.08)</u>
Weighted average outstanding shares — basic	<u>18,151</u>	<u>15,856</u>	<u>18,056</u>	<u>15,835</u>
Weighted average outstanding shares — diluted	<u>18,771</u>	<u>15,856</u>	<u>18,735</u>	<u>15,835</u>

See accompanying notes.

COSTAR GROUP, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands)

	June 30, 2004	December 31, 2003
	(unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 37,295	\$ 35,643
Short-term investments	70,023	61,806
Accounts receivable, less allowance for doubtful accounts of approximately \$1,513 and \$1,759 as of June 30, 2004 and December 31, 2003	2,904	4,308
Prepaid expenses and other current assets	2,778	1,981
Total current assets	113,000	103,738
Property and equipment	32,562	28,956
Accumulated depreciation	(20,047)	(18,702)
Property and equipment, net	12,515	10,254
Goodwill	41,270	37,351
Intangibles and other assets, net	30,099	31,590
Deposits	1,069	967
Total assets	\$197,953	\$183,900
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	\$ 11,755	\$ 9,645
Deferred revenue	6,086	5,886
Total current liabilities	17,841	15,531
Deferred income taxes	3,306	—
Total stockholders' equity	176,806	168,369
Total liabilities and stockholders' equity	\$197,953	\$183,900

See accompanying notes.

COSTAR GROUP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)
(unaudited)

	Six Months Ended June 30,	
	2004	2003
Operating activities:		
Net income (loss)	\$ 3,217	\$ (1,210)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation	2,672	2,430
Amortization	3,868	4,122
Income tax benefit	(86)	—
Provision for losses on accounts receivable	206	1,152
Changes in operating assets and liabilities, net of acquisitions	2,200	(1,768)
Net cash provided by operating activities	12,077	4,726
Investing activities:		
Purchases and sales of short-term investments, net	(8,291)	504
Purchases of property and equipment	(4,869)	(1,290)
Other assets	(74)	(349)
Cash held for acquisition	—	16,386
Acquisitions, net of cash acquired	(1,969)	(17,419)
Net cash used in investing activities	(15,203)	(2,168)
Financing activities:		
Proceeds from exercise of stock options	4,576	2,347
Net cash provided by financing activities	4,576	2,347
Effect of foreign currency exchange rates on cash and cash equivalents	202	56
Net increase in cash and cash equivalents	1,652	4,961
Cash and cash equivalents at the beginning of period	35,643	25,546
Cash and cash equivalents at the end of period	\$ 37,295	\$ 30,507

See accompanying notes.

COSTAR GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. ORGANIZATION

CoStar Group, Inc. (the "Company") has created a comprehensive, proprietary database of commercial real estate information for metropolitan areas throughout the United States and the United Kingdom. Based on its unique database, the Company provides information services to the commercial real estate and related business community and operates within one business segment. The information services are typically distributed to its clients under subscription-based license agreements which have a minimum term of one year and renew automatically.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The consolidated financial statements of the Company include the accounts of the Company and its wholly owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

Interim Financial Statements

The accompanying unaudited condensed consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States 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, 2004, the results of its operations for the three and six months ended June 30, 2004 and 2003, and its cash flows for the six months ended June 30, 2004 and 2003. 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, 2003, the Company's Quarterly Report on Form 10-Q/A for the quarter ended June 30, 2003 and the Company's Quarterly Reports on Form 10-Q for the quarters ended September 30, 2003 and March 31, 2004.

The results of operations for the three and six months ended June 30, 2004 are not necessarily indicative of future financial results.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States 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.

Foreign Currency Translation

The Company's functional currency in its foreign location 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 (loss) in stockholders' equity. Net gains or losses resulting from foreign currency exchange transactions are included in the consolidated statements of operations. The Company had an increase (decrease) in comprehensive income (loss) of approximately \$(58,000) and \$827,000 for the three months ended June 30, 2004 and 2003, respectively, and \$489,000 and \$759,000 for the six months ended June 30, 2004 and 2003, respectively, from translation of its foreign subsidiary's assets and liabilities into U.S. dollars. There were no material gains or losses from foreign currency exchange transactions for the three and six months ended June 30, 2004.

COSTAR GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (CONTINUED)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES — (CONTINUED)

Comprehensive Income (Loss)

During the three months ended June 30, 2004 and 2003, total comprehensive income was approximately \$1.6 million and \$460,000, respectively, and during the six months ended June 30, 2004 and 2003, total comprehensive income (loss) was \$3.7 million and \$(451,000), respectively. As of June 30, 2004, accumulated other comprehensive income (loss) included a gain from foreign currency translation adjustments of approximately \$2.9 million and an unrealized loss on short-term investments of approximately \$74,000.

Net Income (Loss) Per Share

Net income (loss) per share is computed by dividing net income (loss) 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 shares of common stock that may be issued under outstanding stock options. Diluted net income (loss) 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 (loss) per share (in thousands except per share amounts):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2004	2003	2004	2003
Numerator:				
Net income (loss)	\$ 1,736	\$ (367)	\$ 3,217	\$ (1,210)
Denominator:				
Denominator for basic net income (loss) per share - weighted-average outstanding shares	18,151	15,856	18,056	15,835
Effect of dilutive securities:				
Stock options	620	—	679	—
Denominator for diluted net income (loss) per share - weighted-average outstanding shares	18,771	15,856	18,735	15,835
Net income (loss) per share — basic	\$ 0.10	\$ (0.02)	\$ 0.18	\$ (0.08)
Net income (loss) per share — diluted	\$ 0.09	\$ (0.02)	\$ 0.17	\$ (0.08)

Stock-Based Compensation

The Company accounts for its stock-based compensation in accordance with Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25"). Under APB 25, compensation expense is based on the difference, if any, on the date of grant between the fair value of the Company's common stock and the exercise price of the option and is recognized ratably over the vesting period of the option. Stock-based compensation related to options granted to non-employees is accounted for using the fair value method in accordance with the Statement of Financial Accounting Standards No. 123 "Accounting for Stock-Based Compensation" ("SFAS 123").

COSTAR GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (CONTINUED)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES — (CONTINUED)

Stock-Based Compensation (continued)

Statement of Financial Accounting Standards No. 148, “Accounting for Stock-Based Compensation—Transition and Disclosure, an amendment of FASB Statement No. 123 (“SFAS 148”) amends the disclosure requirements of SFAS 123 to require prominent disclosures in both annual and interim financial statements. The Company has adopted the disclosure requirements of SFAS 123 and SFAS 148. The following table illustrates the effect on net income (loss) and net income (loss) per share as if the Company had applied the fair value recognition provisions of SFAS 123 to stock-based employee compensation (in thousands, except per share amounts):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2004	2003	2004	2003
Net income (loss)	\$ 1,736	\$ (367)	\$ 3,217	\$(1,210)
Add: total stock-based employee compensation expense included in reported net income (loss)	—	—	—	—
Add (deduct): total stock-based employee compensation (benefit) expense determined under fair value based method for all awards	(1,633)	(1,377)	(3,180)	(2,980)
Pro forma net income (loss).	<u>\$ 103</u>	<u>\$(1,744)</u>	<u>\$ 37</u>	<u>\$(4,190)</u>
Net income (loss) per share:				
Basic — as reported	<u>\$ 0.10</u>	<u>\$ (0.02)</u>	<u>\$ 0.18</u>	<u>\$ (0.08)</u>
Basic — pro forma	<u>\$ 0.01</u>	<u>\$ (0.11)</u>	<u>\$ 0.00</u>	<u>\$ (0.26)</u>
Diluted — as reported	<u>\$ 0.09</u>	<u>\$ (0.02)</u>	<u>\$ 0.17</u>	<u>\$ (0.08)</u>
Diluted — pro forma	<u>\$ 0.01</u>	<u>\$ (0.11)</u>	<u>\$ 0.00</u>	<u>\$ (0.26)</u>

3. ACQUISITIONS

On May 4, 2004, the Company acquired all of the outstanding capital stock of Peer Market Research, Inc. (“PeerMark”), an online provider of commercial real estate information in Nashville and Memphis, Tennessee, for \$623,000 in cash and 5,318 shares of the Company’s common stock valued at approximately \$208,000. In addition, the PeerMark acquisition agreement provides for additional consideration to be paid by the Company to the former shareholders of PeerMark based on the future operating performance of the acquired company.

In addition, on June 16, 2004, the Company’s U.K. subsidiary acquired Scottish Property Network (“SPN”), a provider of online commercial property information in Scotland. The Company acquired substantially all of the assets of the SPN business, together with all of the outstanding capital stock of SPN, for approximately \$1.3 million in cash.

Both acquisitions have been accounted for using purchase accounting. The purchase price for each acquisition was allocated primarily to acquired database technology and customer base. The acquired database technology for each acquisition is being amortized on a straight-line basis over 5 years. The customer base for each acquisition, which consists of one distinct intangible asset composed of acquired customer contracts and the related customer

COSTAR GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (CONTINUED)

relationships, is being amortized on a 125% declining balance method over 10 years. Goodwill will not be amortized, but is subject to annual impairment tests. The results of operations of PeerMark and SPN have been consolidated with those of the Company since the respective dates of acquisition and are not considered material to the consolidated financial statements of the Company. Accordingly, pro forma financial information has not been presented for either acquisition.

4. GOODWILL

Goodwill consists of the following (in thousands):

	<u>June 30, 2004</u>	<u>December 31, 2003</u>
	(unaudited)	
Goodwill	\$ 52,493	\$ 48,574
Accumulated amortization	<u>(11,223)</u>	<u>(11,223)</u>
Goodwill, net	<u>\$ 41,270</u>	<u>\$ 37,351</u>

During January 2004, the Company completed its review of current information regarding the income tax attributes and deferred taxes related to the Property Intelligence acquisition and recorded deferred income taxes and related goodwill of approximately \$3.1 million as a result of the value previously assigned to identified intangible assets. In June 2004, the company also recorded deferred income taxes and related goodwill of approximately \$400,000 for the SPN Acquisition. The amortization of these assets is non-deductible for income tax purposes, and as a result, the Company will realize an income tax benefit as the deferred income taxes are reduced in connection with the related amortization of these assets over their useful lives.

COSTAR GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (CONTINUED)

5. INTANGIBLES AND OTHER ASSETS

Intangibles and other assets consists of the following (in thousands):

	June 30, 2004	December 31, 2003	Weighted- Average Amortization Period (in years)
	(unaudited)		
Capitalized product development costs	\$ 1,795	\$ 1,795	5
Accumulated amortization	(1,707)	(1,626)	
Capitalized product development costs, net	88	169	
Building photography	4,851	4,777	5
Accumulated amortization	(4,332)	(4,048)	
Building photography, net	519	729	
Acquired database technology	20,038	19,438	4
Accumulated amortization	(17,397)	(16,245)	
Acquired database technology, net	2,641	3,193	
Acquired customer base	42,710	41,107	10
Accumulated amortization	(18,216)	(16,175)	
Acquired customer base, net	24,494	24,932	
Acquired tradename	4,198	4,198	10
Accumulated amortization	(1,841)	(1,631)	
Acquired tradename, net	2,357	2,567	
Intangibles and other assets, net	<u>\$ 30,099</u>	<u>\$ 31,590</u>	

COSTAR GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (CONTINUED)

6. 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.

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

The following Management's Discussion and Analysis of Financial Condition and Results of Operations contains "forward-looking statements", including statements about our beliefs and expectations. There are many risks and uncertainties that could cause actual results to differ materially from those discussed in the forward-looking statements. Potential factors that could cause actual results to differ materially from those discussed in any forward-looking statements include, but are not limited to, those stated below under the headings "Cautionary Statement Concerning Forward-Looking Statements" and "Risk Factors" as well as those described from time to time in our other filings with the Securities and Exchange Commission.

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

Overview

CoStar is the leading provider of information services to the commercial real estate industry in the United States and the United Kingdom based on the fact that we offer the most comprehensive commercial real estate database available, have the largest research department and the most clients in the industry, provide more information services than any of our competitors and believe we generate more revenues than any of our competitors. We have created a standardized information platform where the 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, information for clients' web sites, information about industry professionals and their business relationships, analytic information, data integration, property marketing, organizational tools for contact and property information and industry news.

We completed our initial public offering in July 1998 and received net proceeds of approximately \$22.7 million. We used those net proceeds to fund the geographic and service expansion of our business, including three strategic acquisitions, and to expand our sales and marketing organization. In May 1999, we completed a follow-on public offering and received net proceeds of approximately \$97.4 million. We used a portion of those net proceeds to fund the acquisitions of COMPS.COM, Inc. ("Comps") and Property Intelligence plc ("Property Intelligence"). In November 2003, we completed an additional follow-on public offering and issued approximately 1.7 million shares of common stock and received net proceeds of approximately \$53.5 million. We expect to use the remainder of the proceeds from these public offerings for development and distribution of new services, expansion of existing services across our current markets, geographic expansion in the U.S. and international markets, strategic acquisitions, working capital and general corporate purposes.

From 1994 through 2004, we have expanded the geographical coverage of our existing information services and developed new information 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 September 1999, we acquired ARES Development Group, LLC, a Los Angeles-based developer and distributor of ARES for ACT!. In February 2000, we acquired Comps, a San Diego-based provider of commercial real estate information. In November 2000, we acquired First Image Technologies, Inc. ("First Image"). In September 2002, we expanded further into Portland, Oregon through the acquisition of certain of the assets of Napier Realty Advisors d/b/a REAL-NET ("REAL-NET"). In January 2003, we established a base in the United Kingdom with our acquisition of London-based Property Intelligence. In May 2004, we expanded into Tennessee through the acquisition of Peer

Market Research, Inc. (“PeerMark”), and in June 2004, we extended our coverage of the United Kingdom through the acquisition of Scottish Property Network (“SPN”). The recent acquisitions are discussed later in this section.

Since our inception, the growth of our business has required substantial investments for the expansion of our services and the establishment of operating markets throughout the United States, which resulted in substantial net losses on an overall basis until 2003. Throughout 1999 and 2000, we experienced a rapid expansion in the number of services that we offered and the number of markets in which we operated. By the beginning of 2001, we had substantially established a national platform of service offerings in 50 U.S. metropolitan markets from which we believe we can appropriately meet the commercial real estate community’s needs for comprehensive U.S. building-specific information. From 2001 through 2003, we focused on continuing to grow revenue while controlling and reducing costs, in order to reduce operating losses and become profitable in accordance with accounting principles generally accepted in the United States (“GAAP”). During the second quarter of 2004, our GAAP net income increased from a net loss of \$(367,000) for the quarter ended June 30, 2003 to net income of \$1.7 million for the quarter ended June 30, 2004. In addition, we increased EBITDA (net income before interest, taxes, depreciation and amortization) by \$1.7 million from \$2.9 million in the second quarter of 2003 to \$4.6 million in the second quarter of 2004. Our use of non-GAAP financial measures is discussed later in this section.

During the second quarter of 2004, we began the field research phase of our current geographic expansion plan. The plan includes entering an expected 21 new metropolitan markets throughout the United States as well as expanding the geographical boundaries of many of our existing U.S. markets during 2004 and 2005. We generally have not experienced this type of internal geographic expansion since 2000. Our planned 2004 expansion will cause our cost structure to escalate in advance of revenues that we expect to generate in these 21 new metropolitan markets, as we invest in future revenue growth opportunities for 2005 and beyond. In addition, the incremental costs of introducing new services or increasing geographic coverage in an existing market may further increase our operating cost structure and reduce the profitability of that market prior to release of the additional service offerings or increase in market coverage.

We expect 2004 revenue to grow significantly over 2003 revenue as a result of expected further penetration of our services in our potential customer base across our existing platform, as well as the expected successful cross-selling of our services into our existing customer base. In addition, we expect 2004 EBITDA to significantly increase over 2003 EBITDA and 2004 GAAP net income to significantly increase over 2003 GAAP net income, each as a result of our expectation that we will be able to balance earnings growth from our existing platform with continued expansion and focus on long-term opportunities. If we achieve our expected revenue growth and balance our earnings growth with our current expansion plan, we believe we will maintain positive cash flow from operating activities throughout 2004.

Historically, our calculations of weighted-average outstanding shares for basic and diluted net loss per share have been identical because shares issuable under stock options that would have had an anti-dilutive effect on the calculation have been properly excluded from the calculation. In the third quarter of 2003, we achieved GAAP net income, and as a result our calculation of weighted-average outstanding shares for diluted net income per share since then has included the effect of any dilutive stock options, which are any outstanding stock options that have an exercise price lower than the average market price of our common stock for the period presented. We have maintained GAAP net income through the quarter ended June 30, 2004. As a result, we expect that our diluted net income per share may be lower than our basic net income per share for any future periods in which we report GAAP net income due to the dilutive effect of outstanding stock options.

In the third quarter of 2003, we achieved positive pre-tax income for the first time since our inception in 1987. We have maintained positive pre-tax income through the quarter ended June 30, 2004, which has enabled us to utilize some of our net operating loss carryforwards for tax purposes. Although our net operating loss carryforwards are substantial, we are subject to limitations on their use. Furthermore, we are subject to federal alternative minimum taxes and state and local tax jurisdictions may not recognize portions of these loss carryforwards. As a result, we incurred current income tax expense of approximately \$56,000 for the second quarter of 2004. In addition, during January 2004 upon the completion of our review of current information regarding the income tax attributes and deferred taxes related to the Property Intelligence acquisition, we recorded deferred income taxes of \$3.1 million on the separately identified intangible assets. We will realize an income tax benefit from these deferred income taxes as the identified intangible assets are amortized over their useful lives. Accordingly, we recognized an

income tax benefit of approximately \$130,000 during the second quarter of 2004 to offset the non-deductible amortization expense of the related identified intangible assets acquired in connection with the Property Intelligence acquisition. We also recorded deferred income taxes of approximately \$400,000 for the SPN acquisition in June 2004. We will recognize an income tax benefit from those deferred income taxes as the identified intangible assets are amortized over their useful lives. We recognized a net income tax benefit of approximately \$74,000 for the quarter ended June 30, 2004.

We continue to develop and distribute new services and expand existing services and geographic boundaries across our current U.S. and U.K. markets. The incremental cost of introducing new services, expanding existing services, or expanding geographic boundaries in the future may reduce the profitability of a market or cause it to incur losses. In addition to our planned geographic expansion into 21 new metropolitan markets throughout the United States, we may continue further geographic expansion in the United States or we may seek additional international geographic expansion. Any future significant geographic expansion could also significantly increase our capital expenditures. Therefore, while we expect current service offerings in existing markets to remain generally profitable and provide substantial funding for our overall business, it is possible that further overall expansion could cause us to generate losses and negative cash flow from operations in the future.

While our services continue to expand, our subscription-based information services, consisting primarily of CoStar Property Professional, CoStar Tenant, CoStar COMPS Professional and FOCUS services, currently generate over 90% of our total revenues. Our contracts for our subscription-based information services typically have a minimum term of one year and renew automatically. Upon renewal, many of the subscription contract rates may increase 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 based on the number of sites, number of users, organization size, the client's business focus 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 month periods ended June 30, 2004 and 2003, our contract renewal rate was 91% and 87%, respectively.

Application of Critical Accounting Policies and Estimates

The preparation of financial statements and related disclosures in conformity with accounting principles generally accepted in the United States 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. Factors we consider important that could trigger an impairment review include the following:

- 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 measure any impairment based on a projected discounted cash flow method using a discount rate determined by our management to be commensurate with the risk inherent in our then-current business model.

Goodwill and identifiable intangible assets not subject to amortization are tested annually 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 measure any impairment loss to the extent that the carrying amount of the asset exceeds its fair value.

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 current tax exposure under currently enacted tax laws and assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included in our consolidated balance sheets. We must 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 statement of operations. Based on our history of operating losses and our planned geographic expansion, which if not managed effectively may adversely impact our results of operations, we have not yet concluded that it is more likely than not that we will utilize all or a portion of our net deferred tax assets. Therefore a full valuation allowance is currently held against our net deferred tax assets. As a result of maintaining a full valuation allowance, our effective tax rate differs from the statutory tax rate primarily due to the release of valuation allowance attributable to the expected utilization of net operating loss and tax credit carryforwards for the year ending December 31, 2004, offset by current estimated state and local income tax expense.

Our decision to maintain a full valuation allowance against our deferred tax assets is based primarily on our history of net operating losses as compared to only a recent trend of profitable operations, the potential for future stock option deductions to significantly reduce taxable income, our annual net operating loss limitations pursuant to Section 382 of the Internal Revenue Code and the need to generate significant amounts of taxable income in future periods, on a consistent and prolonged basis, in order to utilize the remaining deferred tax assets. If we continue to meet our financial projections and improve our results of operations, or if circumstances otherwise change, it is reasonably possible that we may release all, or a portion, of the remaining valuation allowance in the near term. Any such release would cause us to record a tax benefit that would increase net income in the period the allowance is released, which will cause our effective tax rate for future periods to approximate the statutory tax rate. In addition, our deferred tax assets include net operating losses related to acquired businesses and the exercise of employee stock options for which any change in associated valuation allowance will be recorded as an adjustment to goodwill and a credit to additional paid-in-capital, respectively.

Accounting for employee stock options

As permitted under Statement of Financial Accounting Standard No. 123, "Accounting for Stock-Based Compensation," we account for employee stock options in accordance with Accounting Principles Board Opinion No. 25 ("APB No. 25"), "Accounting for Stock Issued to Employees." Under APB No. 25, we recognize compensation cost based on the intrinsic value of the equity instrument awarded as determined at the measurement date. We disclose the required pro forma information in our notes to consolidated financial statements as if the fair value method prescribed by SFAS No. 123 had been applied.

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. These non-GAAP financial measures include EBITDA, which is our net income (loss) before interest, income taxes, depreciation and

amortization; and pro forma earnings, which is net income (loss) before purchase amortization in cost of revenues, purchase amortization in operating expenses and the related income tax benefit. We disclose EBITDA in our earnings releases, investor conference calls and filings with the Securities and Exchange Commission. We disclose pro forma earnings in our earnings releases and investor conference calls. 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 other 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 and pro forma earnings as operating performance measures and as such we believe that the GAAP financial measure most directly comparable to them is net income (loss). In calculating EBITDA and pro forma earnings, 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 and pro forma earnings are not measurements of financial performance under GAAP and should not be considered as measures of liquidity, as alternatives to net income (loss) or as indicators of any other measure of performance derived in accordance with GAAP. Investors and potential investors in our securities should not rely on EBITDA and pro forma earnings 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 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 and pro forma earnings.

EBITDA and pro forma earnings are used by management to internally measure our operating and management performance and by investors as supplemental financial measures to evaluate the performance of our business that, when viewed with our GAAP results and the accompanying reconciliation, we believe provide additional information that is useful to gain an understanding of the factors and trends affecting our business. We have spent more than 16 years building our database of commercial real estate information and expanding our markets and services partially through acquisitions of complimentary businesses. Due to the expansion of our information services, which included acquisitions, our net income (loss) includes significant charges for purchase amortization, depreciation and other amortization. EBITDA and pro forma earnings, which exclude these charges, provide 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 and pro forma earnings helps investors meaningfully evaluate and compare our performance from quarter to quarter and from year to year. We also believe EBITDA and pro forma earnings are measures 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 regularly rely on EBITDA and pro forma earnings to provide a financial measure by which to compare our operating performance against that of other companies in our industry. Finally, management and the Board of Directors use pro forma earnings as one of several criteria to determine the achievement of performance-based cash bonuses.

Set forth below are descriptions of the financial items that have been excluded from our net income (loss) to calculate EBITDA and pro forma earnings and the material limitations associated with using these non-GAAP financial measures 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 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 tradenames. We do not believe these charges 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 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, management does not consider the amount of net interest income representative 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 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, management does not consider the amount of income tax expense (benefit) representative of the day-to-day operating performance of our business.

Management compensates for the above-described limitations of using non-GAAP measures by only using non-GAAP measures 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.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2004	2003	2004	2003
Net income (loss)	\$ 1,736	\$ (367)	\$ 3,217	\$ (1,210)
Purchase amortization in cost of revenues	677	704	1,298	1,407
Purchase amortization in operating expenses	1,071	1,113	2,197	2,225
Depreciation and other amortization	1,475	1,464	3,045	2,920
Interest income, net	(286)	(56)	(524)	(134)
Income tax expense	56	—	159	—
Income tax benefit from purchase amortization	(130)	—	(245)	—
EBITDA	\$ 4,599	\$ 2,858	\$ 9,147	\$ 5,208
Cash flows provided by (used in)				
Operating activities	5,992	3,629	\$ 12,077	\$ 4,726
Investing activities	(2,812)	(299)	(15,203)	(2,168)
Financing activities	2,720	2,222	4,576	2,347

Comparison of Three Months Ended June 30, 2004 and Three Months Ended June 30, 2003

Revenues. Revenues grew 18.5% from \$23.2 million in the second quarter of 2003 to \$27.5 million in the second quarter of 2004. This growth was the result of further penetration of our subscription-based information services in our existing and potential customer base, as well as the successful cross-selling of our information services into our existing customer base across our service platform. Approximately \$90,000 of our revenue growth for the second quarter of 2004 resulted from the acquisitions of PeerMark and SPN during the second quarter of 2004. Our subscription-based information services, consisting primarily of CoStar Property Professional, CoStar Tenant, CoStar COMPS Professional and FOCUS services, currently generate over 90% of our total revenues.

Gross Margin. Gross margin increased from \$15.5 million in the second quarter of 2003 to \$18.6 million in the second quarter of 2004. Gross margin percentage also increased from 66.7% to 67.8%. The increase in the gross margin amount and percentage resulted principally from internal revenue growth from our subscription-based information services. Cost of revenues increased from \$7.7 million for the second quarter of 2003 to \$8.8 million for the second quarter of 2004 principally due to service enhancements for our existing platform and approximately \$700,000 for increased research department hiring, training, compensation and other operating costs associated with our current expansion plan.

Selling and Marketing Expenses. Selling and marketing expenses increased from \$6.4 million in the second quarter of 2003 to \$6.9 million in the second quarter of 2004 and decreased as a percentage of revenues from 27.6% in the second quarter of 2003 to 25.1% in the second quarter of 2004. The increase in the amount of selling and marketing expenses was primarily due to increased sales headcount in our U.K. markets and increased marketing campaigns.

Software Development Expenses. Software development expenses increased from \$1.7 million in the second quarter of 2003 to \$2.2 million in the second quarter of 2004 and increased as a percentage of revenues from 7.3% in the first quarter of 2003 to 8.1% in the second quarter of 2004. This increase in the amount and percentage of software and development expenses was due to the hiring of new employees to support our continued focus on enhancements to our existing services, development of new services and development costs for our internal information systems.

General and Administrative Expenses. General and administrative expenses increased from \$6.7 million in the second quarter of 2003 to \$7.0 million in the second quarter of 2004 and decreased as a percentage of revenues from 28.8% in the second quarter of 2003 to 25.6% in the second quarter of 2004. The increase in the amount of general and administrative expenses was primarily due to an increase in professional fees and occupancy costs.

Purchase Amortization. Purchase amortization remained stable at \$1.1 million in the second quarters of 2003 and 2004.

Interest Income, Net. Interest income increased from \$56,000 in the second quarter of 2003 to \$286,000 in the second quarter of 2004. This increase was primarily a result of higher total cash, cash equivalents and short-term investments for the second quarter of 2004 as compared to the second quarter of 2003.

Income Tax Expense (Benefit). Income tax benefit increased from \$0 in the second quarter of 2003 to \$74,000 in the second quarter of 2004. This increase is a result of the realized income tax benefit of approximately \$130,000 recognized to offset the non-deductible amortization expense of the related identified intangible assets acquired in connection with the Property Intelligence acquisition. This increase was offset by approximately \$56,000 of income tax expense, which we incurred because we are subject to Federal alternative minimum taxes and because certain state and local tax jurisdictions do not currently recognize portions of our net loss carryforwards.

Comparison of Six Months Ended June 30, 2004 and Six Months Ended June 30, 2003

Revenues. Revenues grew 17.5% from \$45.7 million in the six months ended June 30, 2003 to \$53.7 million in the six months ended June 30, 2004. This growth was the result of further penetration of our subscription-based information services in our existing and potential customer base across our service platform, as well as the successful cross-selling of our information services into our existing customer base. Approximately \$90,000 of our revenue growth for the second quarter of 2004 resulted from the acquisitions of PeerMark and SPN during the second quarter of 2004. Our subscription-based information services, consisting primarily of CoStar Property Professional, CoStar Tenant, CoStar COMPS Professional and FOCUS services, currently generate over 90% of our total revenues.

Gross Margin. Gross margin increased from \$30.4 million in the six months ended June 30, 2003 to \$37.0 million in the six months ended June 30, 2004. Gross margin percentage also increased from 66.5% to 68.8%. The increase in the gross margin amount and percentage resulted principally from internal revenue growth from our subscription-based information services. Cost of revenues increased from \$15.3 million for the six months ended June 30, 2003 to \$16.8 million for the six months ended June 30, 2004, principally due to service enhancements for

our existing platform and approximately \$700,000 for increased research department hiring, training, compensation and other operating costs associated with our current expansion plan.

Selling and Marketing Expenses. Selling and marketing expenses increased from \$13.0 million in the six months ended June 30, 2003 to \$14.1 million in the six months ended June 30, 2004 and decreased as a percentage of revenues from 28.4% for the six months ended June 30, 2003 to 26.2% for the six months ended June 30, 2004. The increase in the amount of selling and marketing expenses was primarily due to increased sales headcount in our U.K. markets and increased marketing campaigns.

Software Development Expenses. Software development expenses increased from \$3.4 million in the six months ended June 30, 2003 to \$4.2 million in the six months ended June 30, 2004 and increased as a percentage of revenues from 7.4% in the six months ended June 30, 2003 to 7.8% in the six months ended June 30, 2004. This increase in the amount and percentage of software and development expenses was due to hiring of new employees to support our continued focus on service enhancements to existing services, development of new services and development costs for our internal information systems.

General and Administrative Expenses. General and administrative expenses increased from \$13.2 million in the six months ended June 30, 2003 to \$13.9 million in the six months ended June 30, 2004 and decreased as a percentage of revenues from 28.8% in the six months ended June 30, 2003 to 25.8% in the six months ended June 30, 2004. The increase in the amount of general and administrative expenses was primarily due to increased professional fees and occupancy costs.

Purchase Amortization. Purchase amortization remained relatively stable at \$2.2 million in the six months ended June 30, 2003 and 2004.

Interest Income, Net. Interest income increased from \$133,000 in the six months ended June 30, 2003 to \$524,000 in the six months ended June 30, 2004. This increase was primarily a result of higher total cash, cash equivalents and short-term investment balances for the six months ended June 30, 2004 as compared to the six months ended June 30, 2003.

Income Tax Expense (Benefit). Income tax benefit increased from \$0 in the six months ended June 30, 2003 to \$86,000 in the six months ended June 30, 2004. This increase is a result of the realized income tax benefit of approximately \$245,000 recognized to offset the non-deductible amortization expense of the related identified intangible assets acquired in connection with the Property Intelligence acquisition. This increase was offset by approximately \$159,000 of income tax expense, which we incurred because we are subject to federal alternative minimum taxes and because certain state and local tax jurisdictions do not currently recognize portions of our net loss carryforwards.

Recent Acquisitions

Peer Market Research, Inc. On May 4, 2004, we acquired all of the outstanding capital stock of PeerMark, an online provider of commercial real estate information in Nashville and Memphis, Tennessee, for \$623,000 in cash and 5,318 shares of our common stock. In addition, the PeerMark acquisition agreement provides for us to pay additional consideration to the former shareholders of PeerMark based on the future operating performance of the acquired company.

Scottish Property Network. On June 16, 2004, our U.K. subsidiary acquired SPN, a provider of online commercial property information in Scotland. We acquired substantially all of the assets of the SPN business, together with all of the outstanding capital stock of SPN, for approximately \$1.3 million in cash.

Accounting Treatment. Both acquisitions have been accounted for using purchase accounting. The purchase price for each acquisition was allocated primarily to acquired database technology and customer base. The acquired database technology for each acquisition is being amortized on a straight-line basis over 5 years. The customer base for each acquisition, which consists of one distinct intangible asset composed of acquired customer contracts and the related customer relationships, is being amortized on a 125% declining balance method over 10 years. Goodwill

will not be amortized, but is subject to annual impairment tests. The results of operations of PeerMark and SPN have been consolidated with our results since the respective dates of acquisition. The operating results of each of PeerMark and SPN are not considered material to our consolidated financial statements, and accordingly, pro forma financial information has not been presented for either 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 \$9.9 million from \$97.4 million at December 31, 2003 to \$107.3 million at June 30, 2004. This increase was primarily due to increasing EBITDA, improved cash collections and cash proceeds of \$4.6 million from employee stock option exercises to purchase approximately 347,000 shares of common stock, offset by purchases of property and equipment of approximately \$4.9 million and cash used for the SPN and PeerMark acquisitions.

Net cash provided by operating activities for the six months ended June 30, 2004 was \$12.1 million compared to \$4.7 million for the six months ended June 30, 2003. This \$7.4 million increase in net cash provided by operating activities was principally the result of revenue growth and the resulting growth in gross margin, which contributed to our \$3.2 million of GAAP net income in for the six months ended June 30, 2004 compared to a GAAP net loss of \$(1.2) million for the six months ended June 30, 2003.

Net cash used in investing activities was \$15.2 million for the six months ended June 30, 2004 compared to \$2.2 million for the six months ended June 30, 2003. This \$13.0 million increase in net cash used in investing activities was principally due to purchases of \$8.3 million of short-term investments and \$4.9 million of property and equipment.

Net cash provided by financing activities was \$4.6 million for the six months ended June 30, 2004 compared to \$2.3 million for the six months ended June 30, 2003. This \$2.3 million increase in net cash provided by financing activities was the result of cash proceeds from employee stock option exercises to purchase approximately 347,000 shares of common stock in the first two quarters of 2004.

In May 2004, the Company amended its Bethesda, Maryland office lease agreement to include additional space effective September 2004. The amendment requires additional commitments of approximately \$2.9 million with approximately \$165,000 for the partial year 2004, approximately \$523,000 in annual commitments for 2005 through 2009 and approximately \$140,000 for the partial year 2010.

During the three months ended June 30, 2004, we incurred capital expenditures of approximately \$4.1 million, with approximately \$3.1 million related to the purchase of field research vehicles and equipment in connection with our planned 21-market expansion, and the remaining \$1.0 million to support our existing operations. Capital expenditures during the third quarter are expected to include investments in assets required to support our planned market expansion, including additional field research vehicles, building photography and initial databases, as well as communications, measuring, photographic and computer equipment, totaling approximately \$1.0 to \$1.5 million. Additionally, we expect to incur approximately \$500,000 to \$1.0 million of capital expenditures during the third quarter to support our existing operations.

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 expect to use cash, stock, debt or other means of funding to make these acquisitions.

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

In the third quarter of 2003, we achieved positive pre-tax income for the first time since our inception in 1987. We have maintained positive pre-tax income through the quarter ended June 30, 2004, which has enabled us to utilize some of our net operating loss carryforwards for tax purposes. Although our net operating loss carryforwards are substantial, we are subject to limitations on their use. Furthermore, we are subject to federal alternative minimum taxes and state and local tax jurisdictions may not recognize portions of these loss carryforwards. As a

result, we incurred current income tax expense of approximately \$56,000 for the second quarter of 2004. In addition, during January 2004 upon the completion of our review of current information regarding the income tax attributes and deferred taxes related to the Property Intelligence acquisition, we recorded deferred income taxes of \$3.1 million on the separately identified intangible assets. We will realize an income tax benefit from these deferred income taxes as the identified intangible assets are amortized over their useful lives. Accordingly, we recognized an income tax benefit of approximately \$130,000 during the second quarter of 2004 to offset the non-deductible amortization expense of the related identified intangible assets acquired in connection with the Property Intelligence acquisition. We also recorded deferred income taxes of approximately \$400,000 for the SPN acquisition in June 2004. We will recognize an income tax benefit from those deferred income taxes as the identified intangible assets are amortized over their useful lives. We recognized a net income tax benefit of approximately \$74,000 for the quarter ended June 30, 2004.

We do not believe the impact of inflation has significantly affected our operations.

Recent Accounting Pronouncements

In March 2004, the Financial Accounting Standards Board issued an Exposure Draft on "Share-Based Payment, an amendment of FASB Statements No. 123 and 95." In this proposed Statement, the FASB states its belief that employee services received in exchange for equity instruments give rise to recognizable compensation cost as the services are used in the issuing entity's operations. As a result, the proposed Statement would require that public companies measure the compensation cost related to employee services received in exchange for equity instruments issued based on the grant-date fair value of those instruments. The FASB will also consider other items such as streamlining volatility assumptions and addressing the fair value measurement models. The proposed requirements in the Exposure Draft would be effective as of the beginning of the first fiscal year beginning after December 15, 2004 for public companies.

If we elected, or were required, to record an expense for our stock-based compensation plans using the fair value method, we could have significant accounting charges. For example for the six months ended June 30, 2004, had we accounted for stock-based compensation plans using the fair-value method prescribed in SFAS 123 as amended by SFAS 148, we believe diluted net income per share would have been reduced by \$0.17 per share and we would have reported no net income per share. We are evaluating our compensation practices and may develop alternative stock-based employee compensation plans, including without limitation the issuance of restricted stock, which may result in recording additional expense to our consolidated statements of operations and reduce our GAAP net income.

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 2004 and beyond, our possible or assumed future results of operations generally, and other statements and information regarding assumptions about our revenues, pro forma earnings, EBITDA, GAAP net income, taxable income, cash flow from operating activities, available cash, operating costs, amortization expense, intangible asset recovery, net income per share, diluted net income per share, weighted-average outstanding shares, capital and other expenditures, purchase amortization, financing plans, geographic expansion, capital structure, contractual obligations, legal proceedings and claims, our database, services and facilities, employee relations, future economic performance, 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 "Legal Proceedings", "Management's Discussion and Analysis of Financial Condition and Results of Operations", "Risk Factors", "Quantitative and Qualitative Disclosures About Market Risk" and the Financial Statements and related Notes.

Our forward-looking statements are also identified by words such as "believes," "expects," "thinks," "anticipates," "intends," "estimates" or similar expressions. You should understand that these forward-looking statements are necessarily estimates reflecting our judgment, 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 in "Risk Factors," and other unforeseen events or circumstances, could affect our future results and could

cause those results or other outcomes to differ materially from those expressed or implied in our forward-looking statements: customer retention; competition; general economic conditions; our ability to identify and integrate acquisitions; our ability to control costs; our ability to complete successfully our planned expansion; changes or consolidations within the commercial real estate industry; release of new and upgraded services by us or our competitors; data quality; development of our sales force; employee retention; technical problems with our services; managerial execution; changes in relationships with real estate brokers and other strategic partners; foreign currency fluctuations; legal and regulatory issues; changes in accounting policies or practices; 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 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 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.

Risk Factors

We may not be able to complete successfully our planned geographic expansion, which may negatively impact our business, results of operations and financial condition. Expanding into new markets imposes additional burdens on our research, systems development, sales, marketing and general managerial resources. During the remainder of 2004 and continuing into 2005, we expect to expand into 21 new U.S. markets and expand geographic coverage in certain of our existing markets. If we are unable to manage this expansion plan effectively, our financial condition could be adversely affected. In addition, if we incur significant costs to expand into these new markets, or are not successful in marketing and selling our services in these markets, our expansion may have a material adverse effect on our financial condition by increasing our expenses without increasing our revenues, adversely affecting our profitability.

We have experienced operating losses and our future profitability is uncertain. Until the third quarter of 2003, we had not recorded an overall operating profit because the investment required for geographic expansion and new information services had caused our expenses to exceed our revenues. Our ability to continue to earn a profit will largely depend on our ability to manage our growth, including our expansion plans, and to generate revenues that exceed our expenses. In addition, our ability to continue to earn a profit, to increase revenues or to control costs could be affected by the factors set forth in this section. We may not be able to generate revenues or control expenses to a degree sufficient to earn a profit, to increase profits on a quarterly or annual basis, or to sustain or increase our future revenue growth and, as a result, the market price of our common stock may decline.

If our operating costs are higher than we expect, our profitability may be reduced. Many of our expenses, particularly personnel costs and occupancy costs, are relatively fixed. As a result, we may not be able to adjust spending quickly enough to offset any unexpected revenue shortfall or increase in expenses. Additionally, we may experience higher than expected operating costs, including increased personnel costs, occupancy costs, selling and marketing costs, investments in geographic expansion, acquisition costs, communications costs, travel costs, software development costs, outside services costs and other costs. If operating costs exceed our expectations or cannot be adjusted accordingly, our profitability may be reduced and our results of operations and financial condition will be adversely affected.

A downturn or consolidation in the commercial real estate industry may decrease customer demand for our services. The commercial real estate industry has begun to stabilize in recent months, as evidenced by improving leasing activity, rental rates and absorption rates. However, a reversal of this trend or renewed downturn in the commercial real estate market may continue to affect our ability to generate revenues and may lead to more cancellations by our current or future customers, both of which could cause our revenues or our revenue growth rate to decline and reduce our profitability. A depressed commercial real estate market has a negative impact on our core customer base, which could decrease demand for our information services. Also, companies in this industry are consolidating, often in order to reduce expenses. Consolidation may lead to more cancellations of our information services by our customers, reduce the number of our existing clients, reduce the size of our target market or increase

our clients' bargaining power, all of which could cause our revenues or our revenue growth rate to decline and reduce our profitability.

General economic conditions could increase our expenses and reduce our revenues. Our business and the commercial real estate industry are particularly affected by negative trends in the general economy. The success of our business depends on a number of factors relating to general global, national, regional and local economic conditions, including inflation, interest rates, perceived and actual economic conditions, taxation policies, availability of credit, employment levels, and wage and salary levels. Negative general economic conditions could adversely affect our business by reducing our revenues and profitability. Additionally, any war in which the United States is involved or any significant terrorist attack is likely to have a dampening effect on the economy in general, which could negatively affect our financial performance and our stock price. In addition, a significant increase in inflation could increase our expenses, which may not be offset by increased revenues. If clients choose to cancel our information services as a result of economic conditions, and we do not acquire new clients, our revenues may decline and our financial position would be adversely affected.

If we are not able to successfully identify and integrate acquisitions, our business operations and financial condition could be adversely affected. We have expanded our markets and services in part through acquisitions of complementary businesses, services, databases and technologies, and expect to continue to do so in the future. Our strategy to acquire complementary companies or assets depends on our ability to identify, and the availability of, suitable acquisition candidates. In addition, acquisitions involve numerous risks, including managing the integration of personnel and products; managing geographically remote operations, such as SPN in Scotland; the diversion of management's attention from other business concerns; the inherent risks in entering markets and sectors in which we have either limited or no direct experience; and the potential loss of key employees or clients of the acquired companies. We may not successfully integrate any acquired businesses or assets and may not achieve anticipated benefits of any acquisition. Future acquisitions that we may pursue could result in dilutive issuances of equity securities, the incurrence of debt, one-time write-offs of goodwill and substantial amortization expenses of other intangible assets.

If we account for employee stock-based compensation using the fair value method, it could significantly reduce our net income and earnings per share. There has been ongoing public debate over whether grants under employee stock option incentive plans should be treated as a compensation expense and, if so, how to properly value such charges. If we elected or were required to record an expense for our stock-based compensation using the fair value method, we could have significant accounting charges that would significantly lower our GAAP net income. For example, for the six months ended June 30, 2004, had we accounted for stock-based compensation using the fair-value method prescribed in SFAS 123 as amended by SFAS 148, we believe our diluted net income per share would have been reduced by \$0.17 per share and we would have reported no net income per share. We are not currently required to record any compensation expense using the fair value method in connection with option grants to employees that have an exercise price at or above fair market value at the grant date. See Note 2 to our Notes To Condensed Consolidated Financial Statements for a more detailed presentation of accounting for stock-based compensation.

We may not be able to successfully introduce new or upgraded information services, which could decrease our revenues and our profitability. Our future business and financial success will depend on our ability to continue to introduce new and upgraded services into the marketplace. To be successful, we must adapt to rapid technological changes by continually enhancing our information services. Developing new services and upgrades to services imposes heavy burdens on our systems department, management and researchers. This process is costly, and we cannot assure you that we will be able to successfully develop and enhance our services. In addition, successfully launching and selling a new service puts pressure on our sales and marketing resources. If we are unable to develop new or upgraded services, then our customers may choose a competitive service over ours and our revenues may decline and our profitability may be reduced. In addition, if we incur significant costs in developing new or upgraded services, are not successful in marketing and selling these new services or upgrades, or our customers fail to accept these new services, it could have a material adverse effect on our results of operations by decreasing our revenues or our revenue growth rate and by reducing our profitability.

Our stock price may be negatively affected by fluctuations in our operating results. Our operating results, revenues and expenses may fluctuate with general economic conditions and also for many other reasons, many of

which are outside of our control, such as: cancellations or non-renewals of our services; competition; our ability to control expenses; loss of clients or revenues; changes or consolidation in the real estate industry; our investments in geographic expansion; interest rate fluctuations; the timing and success of new service introductions and enhancements; successful execution of our expansion plan; the development of our sales force; managerial execution; data quality; employee retention; foreign currency fluctuations; successful adoption of and training our services; the timing of investing the net proceeds from our offerings; acquisitions of other companies or assets; sales, brand enhancement and marketing promotional activities; client training and support activities; changes in client budgets; or our investments in other corporate resources. In addition, changes in accounting policies or practices may affect our level of GAAP net income, including without limitation, changes requiring us to expense stock options. Fluctuations in our operating results, revenues and expenses may cause the market price of our common stock to decline.

Our revenues and financial condition will be adversely affected if we are not able to attract and retain clients. Our success and revenues depend on attracting and retaining subscribers to our information services. Our subscription-based information services generate the largest portion of our revenues. However, we may be unable to attract new clients in planned expansion markets and our clients in existing markets may decide not to add, not to renew or to cancel subscription services as a result of several factors, including without limitation: a decision that they have no need for our services; a decision to use alternative services; pricing and budgetary constraints; consolidation in the real estate industry; data quality; technical problems; or economic or competitive pressures. If clients decide not to renew or cancel their agreements, and we do not attract new clients, then our revenues or our revenue growth rate may decline.

Competition could render our services uncompetitive. The market for information systems and services in general is highly competitive and rapidly changing. Our existing competitors, or future competitors, may have greater name recognition, larger customer bases, better technology or data, lower prices, easier access to data, greater user traffic or greater financial, technical or marketing resources than we have. Our competitors may be able to undertake more effective marketing campaigns, obtain more data, adopt more aggressive pricing policies, make more attractive offers to potential employees, subscribers, distribution partners and content providers or may be able to respond more quickly to new or emerging technologies or changes in user requirements. Increased competition could result in lower revenues and higher expenses, which would reduce our profitability.

International expansion may result in new business risks which may reduce our profitability. Our international expansion could subject us to new business risks, including: adapting to the differing business practices and laws in foreign countries; difficulties in managing foreign operations; limited protection for intellectual property rights in some countries; difficulty in collecting accounts receivable and longer collection periods; costs of enforcing contractual obligations; impact of recessions in economies outside the United States; currency exchange rate fluctuations; and potentially adverse tax consequences. In addition, international expansion imposes additional burdens on our executive and administrative personnel, systems development, research and sales departments and general managerial resources. If we are not able to manage our growth successfully, we may incur higher expenses and our profitability may be reduced. Finally, the investment required for international expansion could exceed the profit generated from such expansion, which would reduce our profitability and adversely affect our financial condition.

Fluctuating foreign currencies may negatively impact our business, results of operations and financial condition. As a result of the Property Intelligence and SPN acquisitions, a portion of our business is denominated in the British Pound and as a result, fluctuations in foreign currencies may have an impact on our business, results of operations, and financial condition. Currencies may be affected by internal factors, and external developments in other countries, all of which can have an adverse impact on a country's currency. Currently, we do not have any hedging transactions to reduce our exposure to exchange rate fluctuations. We may seek to enter into hedging transactions in the future but we may be unable to enter into these transactions successfully, on acceptable terms or at all. We cannot predict whether we will incur foreign exchange losses in the future, and significant foreign exchange fluctuations resulting in a decline in the British Pound may decrease the value of our foreign assets, as well as decrease our revenues and earnings from our foreign subsidiaries.

If we are unable to hire, retain and continue to develop our sales force, our revenues could be adversely affected. In order to support revenue growth, we need to continue to develop, train and retain our sales force. Our ability to

build and develop a strong sales force may be affected by a number of factors, including: our ability to attract, integrate and motivate sales personnel; our ability to effectively train our sales force; the ability of our sales force to sell an increased number of services; our ability to attract and retain an effective Vice President of Sales; the length of time it takes new sales personnel to become productive; the competition we face from other companies in hiring and retaining sales personnel; and our ability to effectively manage a multi-location sales organization. If we are unable to hire, develop or retain the members of our sales force, or if our sales force is unproductive, or if we are unable to attract and retain an effective Vice President of Sales, our revenues could decline or cease to grow and our expenses could increase.

If we are not able to obtain and maintain accurate, comprehensive or reliable data, we could experience reduced demand for our information services. Our success depends on our clients' confidence in the comprehensiveness, accuracy and reliability of the data we provide. The task of establishing and maintaining accurate and reliable data is challenging. If our data, including the data we obtain from third parties, is not current, accurate, comprehensive or reliable, we could experience reduced demand for our services or legal claims by our customers or others, which could result in lower revenues and higher expenses.

Temporary or permanent outages of our computers, software or telecommunications equipment could lead to reduced demand for our information services. Our operations depend on our ability to protect our database, computers and software, telecommunications equipment and facilities against damage from potential dangers such as fire, power loss, security breaches, computer viruses, hackers, and telecommunications failures. Any temporary or permanent loss of one or more of these systems or facilities from an accident, equipment malfunction, virus or some other cause could harm our business. If we experience a failure that prevents us from delivering our information services to clients, we could experience reduced demand for our information services.

Technical problems that affect our customers' use of or access to our services could lead to reduced demand for our information services. Our business increasingly depends upon the satisfactory performance, reliability and availability of our web site, the Internet and our service providers. Problems with our web site, the Internet or the services provided by our local exchange carriers or Internet service providers could result in slower connections for our customers or interfere with our customers' access to our information services. If we experience technical problems in distributing our services, we could experience reduced demand for our information services. In addition, the software underlying our services is complex and may contain undetected errors. Despite testing, we cannot be certain that errors will not be found in our software. Any errors could result in adverse publicity, impaired use of our services, loss of revenues, cost increases and legal claims by customers. All these factors could seriously damage our business, operating results and financial condition.

Our business depends on retaining and attracting highly capable management and operating personnel. Our success depends in large part on our ability to retain and attract management and operating personnel, including our President and Chief Executive Officer, Andrew Florance, our officers and other key employees. Our business requires highly skilled technical, sales, management, web-development, marketing and research personnel, all of whom are in high demand and are often subject to competing offers. To retain and attract key personnel, we use various measures, including employment agreements, a stock incentive plan and incentive bonuses for key executive officers. These measures may not be enough to retain and attract the personnel we need or to offset the impact on our business of the loss of the services of Mr. Florance or other key officers or employees.

Litigation in which we become involved or newly-adopted laws and regulations may significantly increase our expenses. Currently and from time to time, we are involved in litigation incidental to the conduct of our business. We cannot assure you that we will have sufficient insurance to cover our pending claims or our future claims. Any lawsuits in which we are involved could cost us a significant amount of time and money. If any claims are determined against us, our profitability could be reduced and our financial position could be adversely affected. In addition, governments in the United States or abroad could adopt laws that could harm our business by for example, regulating the information we provide or regulating our transmissions over the Internet, or exposing our business to additional taxes in various jurisdictions. Compliance with any such laws could increase our costs or make our services less attractive.

If we are unable to enforce or defend our ownership and use of our intellectual property, our business, competitive position and operating results could be harmed. The success of our business depends in large part on

the intellectual property involved in our methodologies, database, services and software. We rely on a combination of trade secret, patent, copyright and other laws, nondisclosure and noncompetition provisions, license agreements and other contractual provisions and technical measures to protect our intellectual property rights. However, current law may not provide for adequate protection of our databases and the actual data. In addition, legal standards relating to the validity, enforceability and scope of protection of proprietary rights in Internet-related businesses are uncertain and evolving, and we cannot assure you of the future viability or value of any of our proprietary rights. Our business could be significantly harmed if we are not able to protect our content and our other intellectual property. The same would be true if a court found that our services infringe other persons' intellectual property rights. Any intellectual property or other lawsuits in which we are involved, either as a plaintiff or as a defendant, could cost us a significant amount of time and money and distract management's attention from operating our business. In addition, if we do not prevail on any intellectual property or other claims, this could result in a change to our methodology or information services and could reduce our profitability.

We may be subject to legal liability for displaying or distributing information. Because the content in our database is distributed to others, we may be subject to claims for defamation, negligence or copyright or trademark infringement or claims based on other theories. We could also be subject to claims based upon the content that is accessible from our web site through links to other web sites or information on our web site supplied by third parties. Even if these claims do not result in liability to us, we could incur significant costs in investigating and defending against any claims. Our potential liability for information distributed by us to others could require us to implement measures to reduce our exposure to such liability, which may require us to expend substantial resources and limit the attractiveness of our information services to users.

Market volatility may have an adverse effect on our stock price. The trading price of our common stock has fluctuated widely in the past, and we expect that it will continue to fluctuate in the future. The price could fluctuate widely based on numerous factors, including: quarter-to-quarter variations in our operating results; changes in analysts' estimates of our earnings; announcements by us or our competitors of technological innovations or new services; general conditions in the commercial real estate industry; developments or disputes concerning copyrights or proprietary rights; the success of our planned expansion; and economic or other factors. In addition, in recent years, the stock market in general, and the shares of Internet-related and other technology companies in particular, have experienced extreme price fluctuations. This volatility has had a substantial effect on the market prices of securities issued by many companies for reasons unrelated to the operating performance of the specific companies.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We provide information services to the commercial real estate and related business community in the United States and the United Kingdom. Our functional currency for our operations in the United Kingdom is the local currency. As such, fluctuations in the British Pound may have an impact on our business, results of operations and financial condition. We currently do not use financial instruments to hedge our exposure to exchange rate fluctuations with respect to our foreign subsidiary. We may seek to enter into hedging transactions in the future to reduce our exposure to exchange rate fluctuations, but we may be unable to enter into hedging transactions successfully, on acceptable terms or at all. As of June 30, 2004, accumulated other comprehensive income included a gain from foreign currency translation adjustments of approximately \$2.9 million.

We do not have significant exposure to market risks associated with changes in interest rates related to cash equivalent securities held as of June 30, 2004.

We have a substantial amount of intangible assets. Although as of June 30, 2004 we believe our intangible assets will be recoverable, 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 for 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 SEC'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 June 30, 2004, 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 lawsuit or proceeding that, in the opinion of our management, is likely to have a material adverse effect on our financial position or results of operations.

Item 2. Changes in Securities, Use of Proceeds and Issuer Purchases of Equity Securities

As partial consideration for the acquisition of PeerMark, on May 4, 2004, we issued to the shareholders of PeerMark 5,318 shares of the Company's common stock, par value \$.01 per share. The shares were issued in reliance on the exemption from registration under Section 4(2) of the Securities Act of 1933, as amended.

Item 3. Defaults upon Senior Securities

None

Item 4. Submission of Matters to a Vote of Security Holders

The Annual Meeting of our stockholders was held on June 9, 2004. The following people were elected to our Board of Directors for a one-year term: Michael R. Klein, Andrew C. Florance, David Bonderman, Warren H. Haber, Josiah O. Low, III, Christopher J. Nassetta and Catherine B. Reynolds. The vote was as follows:

Name	Votes For	Votes Withheld
Michael R. Klein	12,856,495	3,597,842
Andrew C. Florance	16,452,521	1,816
David Bonderman	12,093,225	4,361,112
Warren H. Haber	16,393,713	60,624
Josiah O. Low, III	16,393,713	60,624
Christopher J. Nassetta	16,452,521	1,816
Catherine B. Reynolds	16,452,521	1,816

The appointment of Ernst & Young, LLP as our independent public accountants for the fiscal year ending December 31, 2004 was approved upon the following vote: For, 15,888,900 shares; against, 565,037 shares; and abstain, 400 shares.

Item 5. Other Information

None

Item 6. Exhibits and Reports on Form 8-K

(a) 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 30, 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 ending June 30, 1999)
- 3.3 Amended and Restated By-Laws (Incorporated by reference to Exhibit 3.2 to the 1998 Form S-1)
- 10.1 Addendum No. 3 to Office Lease, dated as of May 12, 2004, between Newlands Building Venture, LLC, and CoStar Realty Information, Inc. (filed herewith)
- 10.2 Addendum to Employment Agreement, dated as of April 1, 2004, between CoStar Realty Information, Inc. and Frank Carchedi (filed herewith)*
- 10.3 Addendum to Employment Agreement, dated as of April 1, 2004, between CoStar Realty Information, Inc. and David Schaffel (filed herewith)*
- 10.4 Addendum to Employment Terms, dated as of April 1, 2004, between CoStar Realty Information, Inc. and Craig Farrington (filed herewith)*
- 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)

* Management Contract or Compensatory Plan of Arrangement

(b) Reports on Form 8-K

Current Report on Form 8-K furnished to the SEC on April 20, 2004, furnishing CoStar Group, Inc.'s earnings release for the quarter ended March 31, 2004.

Current Report on Form 8-K furnished to the SEC on July 20, 2004, furnishing CoStar Group, Inc.'s earnings release for the quarter ended June 30, 2004.

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: August 6, 2004

By: /s/ Frank A. Carchedi
Frank A. Carchedi
Chief Financial Officer (Principal Financial and
Accounting Officer and Duly Authorized Officer)

THE FRANCIS G. NEWLANDS BUILDING

ADDENDUM NO. 3 TO OFFICE LEASE

THIS ADDENDUM NO. 3 TO OFFICE LEASE (this "Addendum") is made and entered into this 12th day of May, 2004, by and between NEWLANDS BUILDING VENTURE, LLC, a Maryland limited liability company, hereinafter called "Lessor," and COSTAR REALTY INFORMATION, INC., a Delaware corporation, hereinafter called "Lessee."

WITNESSETH:

WHEREAS, by Office Lease dated the 12th day of August, 1999, as amended by Addendum No. 1 to Office Lease dated the 15th day of May, 2000, and Addendum No. 2 to Office Lease dated as of the 1st day of July, 2000 (as so amended, the "Lease"), Lessor leased to Lessee approximately 60,041 square feet of rentable area (the "Existing Demised Premises") on the ninth (9th), tenth (10th) and eleventh (11th) floors of the office building situated at Two Bethesda Metro Center, Bethesda, Maryland (the "Building"), together with certain storage space therein; and

WHEREAS, Lessor and Lessee desire to expand the Existing Demised Premises by adding thereto and incorporating therein, upon the terms and conditions hereinafter set forth, additional space on the fourth (4th) floor of the Building comprising an agreed rentable area of approximately 13,522 square feet (the "Additional Space"), measured in accordance with the Building Owners and Managers Association (BOMA) Standard Method of Measurement (ANSI Z65.1 1996).

NOW, THEREFORE, in consideration of the mutual covenants and agreements hereinafter set forth, the parties hereto do mutually agree that the Lease shall be and is hereby amended to provide as follows, all capitalized terms being as defined in the Lease unless otherwise noted herein:

1. ADDITIONAL SPACE

Lessor does hereby lease to Lessee, and Lessee does hereby lease from Lessor, the Additional Space, subject to and upon all of the terms and conditions of the Lease, as amended. Except as otherwise provided in this Addendum, hereafter, references in the Lease to the Demised Premises shall include both the Existing Demised Premises and the Additional Space. The Additional Space is outlined on the floor plan attached hereto and made a part hereof as Exhibit A.

2. TERM

The Additional Space shall be added to the Existing Demised Premises on the Addition Date, which shall be the earlier of (i) Lessee's occupancy of the Additional Space for the conduct of its business, or (ii) the 15th day of September, 2004; it being understood and agreed that on the

first (1st) business day following the full execution and delivery of this Addendum (the ‘Possession Date”), Lessor shall deliver possession of the Additional Space to Lessee to permit Lessee to commence the construction of its Additional Space Work (as defined below), subject to the terms and conditions of Section 6 below. The term of the Lease as to the Additional Space shall expire on the 31st day of March, 2010, so as to be coterminous for all purposes with the initial term of the Lease as to the Existing Demised Premises, subject to Lessee’s right to extend the term of the Lease pursuant Section 35 of the Lease.

3. RENT

The additional monthly rent for the Additional Space (“Additional Monthly Rent”), which Lessee hereby agrees to pay in advance to Lessor and Lessor hereby agrees to accept, shall be as follows, computed at the respective per square foot rate set forth below:

Lease Period	Additional Monthly Rent	Rate per Rentable Square Foot
- From the Addition Date through August 31, 2005	\$41,129.42	(\$36.50/sf)
- From September 1, 2005 through August 31, 2006	\$42,154.84	(\$37.41/sf)
- From September 1, 2006 through August 31, 2007	\$43,214.06	(\$38.35/sf)
- From September 1, 2007 through August 31, 2008	\$44,295.82	(\$39.31/sf)
- From September 1, 2008 through August 31, 2009	\$45,400.12	(\$40.29/sf)
- From September 1, 2009 through March 31, 2010	\$46,538.22	(\$41.30/sf)

The Additional Monthly Rent is in addition to, and not in lieu of, the Monthly Rent set forth in Section 4 of the Lease. Such Additional Monthly Rent shall be payable in advance on the first day of each calendar month beginning from and after the Addition Date, and continuing during the initial term of the Lease, as extended as provided above, without any rent credit, abatement or waiver by Lessor. If the Addition Date is a date other than the first day of a calendar month, Additional Monthly Rent from such date until the first day of the following calendar month shall be prorated at the rate of one-thirtieth (1/30th) of the Additional Monthly Rent for each day, payable in advance.

4. RENTAL ESCALATION FOR INCREASES IN EXPENSES

(A) Effective as of the Addition Date, Section 5 of the Lease shall be and is hereby amended to provide that (i) Additional Space Base Operating Expenses are defined to be the amount of Operating Expenses actually incurred by Lessor in calendar year 2004, and (ii) Additional Space Base Operating Costs are defined to be the amount of Operating Costs actually incurred by Lessor in calendar year 2004. Operating Expenses and Operating Costs for each calendar year (including Additional Space Base Operating Expenses and Additional Space Base

Operating Costs) shall be those actually incurred, provided, however, that if the Building was not at least ninety-five percent (95%) occupied during the entire calendar year, the Operating Expenses (including without limitation Real Estate Taxes) and Operating Costs shall be adjusted, using reasonable projections taking into account any leases which are net of electric and/or char service, and only to the extent any items of Operating Expenses or Operating Costs vary with the occupancy level of the Building, to project the Operating Expenses and Operating Costs as if the Building were ninety-five percent (95%) occupied during the entire calendar year by tenants using substantially all Building services.

(B) Effective as of the Addition Date, "Lessee's Additional Space Proportionate Share" of (i) increases in Operating Expenses shall be 4.88% (13,522 rentable square feet divided by 277,133 rentable square feet of office and retail space in the Building), and (ii) increases in Operating Costs shall be 5.31% (13,522 rentable square feet divided by 254,633 rentable square feet of office space in the Building).

(C) Section 5 of the Lease shall be and remain applicable and effective with respect to the Existing Demised Premises through the term of the Lease. However, effective as of the first anniversary of the Addition Date, and continuing through the initial term of the Lease, in addition to the Operating Expenses and Operating Costs payable with respect to the Existing Demised Premises, Lessee shall be obligated to pay its Lessee's Additional Space Proportionate Share of increases in Operating Expenses and Operating Costs over Additional Space Base Operating Expenses and Additional Space Base Operating Costs in accordance with the methods and procedures set forth in Section 5 of the Lease.

5. RIGHT OF FIRST NEGOTIATION

In addition to the expansion rights granted to Lessee in Section 36 of the Lease, Lessee shall have the right of first negotiation hereinafter set forth in this Section 5.

If the Lease, as amended hereby, shall then be unassigned (except to a subsidiary or affiliate of Lessee), in full force and effect and Lessee is not in default under any of the provisions of the Lease (as amended hereby) beyond the expiration of any applicable notice or grace period (it being understood and agreed that the right granted to Lessee in this Section 5 is not assignable and that the same shall be deemed null and void upon any assignment or transfer of the Lease by Lessee to a party other than a subsidiary or affiliate of Lessee), Lessor agrees that at each time during the initial term of the Lease, but subject to the continued occupancy thereof by initial tenants and any rights of first negotiation or expansion options granted to tenants of the Building prior to the date of this Addendum, additional space on the seventh (7th) or eighth (8th) floors of the Building becomes available to Lessor for leasing to third parties, then Lessor shall give to Lessee written notice of such availability as soon as practicable but not more than twelve (12) months prior to the date of availability, accompanied by Lessor's opinion (acting reasonably and in good faith) as to the fair market rent for such available space, which shall be the fair market rent prevailing (taking into account then prevailing tenant concession packages including, without limitation, rental abatement (if any) and construction allowance (if any) on leases having a term most nearly equal to the remaining initial term of the Lease) for comparable space in comparable office buildings in the Bethesda-Chevy Chase market area, but in no event less than

the Additional Monthly Rent (expressed as an annual rental rate per square foot) then payable for the Additional Space under this Addendum. Lessee shall then have a period of fifteen (15) days in which to notify Lessor in writing of Lessee's election to lease such available space at said rental, time being of the essence; provided, however, that from and after the commencement of the seventh (7th) Lease Year, any such election by Lessee must be accompanied by written notice of Lessee's irrevocable election to extend the term of the Lease for the First Renewal Term pursuant to Section 35 of the Lease. Should Lessee fail to notify Lessor in writing within the said fifteen (15)-day period of Lessee's election to lease such available space (and, if so applicable, to so extend the term of the Lease), time being of the essence, then Lessee's right to lease such available space shall thereupon terminate and be of no force or effect, and Lessor shall be free to lease such available space to any party upon any terms and conditions, subject to Lessee's rights herein with respect to such space the next time it becomes available to Lessor for leasing to third parties.

Should Lessee notify Lessor in writing within the said fifteen (15)-day period of Lessee's election to lease such available space (and, if so applicable, to so extend the term of the Lease), and if Lessor and Lessee shall fail to agree on the said fair market rent for such available space within thirty (30) days after Lessor's receipt of Lessee's written notification of its election to lease such available space, then such fair market rent (taking into account the said tenant concessions) shall be determined, within sixty (60) days after Lessor's receipt of Lessee's written notification of its election to lease such available space, as nearly as practicable in accordance with the "3-broker method" set forth in Section 35 of the Lease. Within ten (10) days after such determination of the fair market rent for the available space, Lessee shall have the right to rescind its exercise of its election to lease such available space by written notice to Lessor within the said ten (10)-day period, time being of the essence. If Lessee fails to so rescind its exercise of its election to lease such available space, then Lessee's election shall be deemed irrevocable, and Lessor shall prepare, and Lessor and Lessee shall promptly execute and deliver, an addendum to the Lease amending the appropriate provisions hereof. If Lessee so rescinds its election to lease such available space, then Lessor shall be free to lease such available space to any party upon any terms and conditions.

6. TENANT WORK IN THE ADDITIONAL SPACE

(A) The Additional Space has been previously occupied and improved for occupancy, and, subject to Lessor's (i) construction of demising walls for the Additional Space in accordance with applicable code provisions and in a good and workmanlike manner, and (ii) performing such work as is necessary to cause the common corridor on the fourth (4th) floor of the Building to be similar in character and quality of finish and appearance to the other multi-tenanted floors in the Building (collectively, "Lessor's Work"), Lessee shall accept the Additional Space in its current "as is" condition; provided, however, that Lessor represents and warrants to Lessee that (i) to the best of Lessor's knowledge, without investigation, the Additional Space does not contain any Materials (as defined in the Lease), except in accordance with all Environmental Regulations (as defined in the Lease), and (ii) all mechanical, electrical, and plumbing systems in the Additional Space are in good working order. Lessor and Lessee will coordinate the Lessor's Work and the Additional Space Work (as defined below) so as to undertake and complete the same in the normal sequencing and coordination of landlord/tenant construction activity, and such that Lessor's Work will not subject Lessee to any material delay in the performance of the Additional Space Work.

(B) Any and all additional tenant work and installations desired by Lessee for its initial occupancy of the Additional Space ("Additional Space Work") shall be undertaken by Lessee at its cost and expense (subject to the cash allowance provided for below), shall be subject to the written approval of Lessor, and shall not be commenced until such approval is obtained. Lessor's approval of the Additional Space Work and any plans and specifications therefor shall not be unreasonably withheld, conditioned or delayed by Lessor; it being understood that Lessor's decision will be based upon aesthetics (only as to items of Additional Space Work visible from outside the Additional Space), as well as whether the Additional Space Work would have a material adverse on the structure of the Building and its mechanical, plumbing and electrical systems. All Additional Space Work shall be done in accordance with the plans and specifications prepared by Lessee's contractor or architect and as approved by Lessor.

(C) Lessee shall submit to Lessor plans and specifications for the Additional Space Work, including, without limitation, complete mechanical, fire protection, electrical and plumbing ("MEP") plans (but only to the extent necessary to obtain any required building permits). Lessee shall provide to Lessor such other information as Lessor may reasonably request in order to complete its review of Lessee's plans and specifications. No construction of any tenant work and installations will be commenced until Lessor's written approval is obtained

(D) Within seven (7) business days after Lessor receives such plans and specifications from Lessee, Lessor shall notify Lessee in writing as to whether Lessor approves or disapproves such plans and specifications. If Lessor disapproves the same, Lessor shall state, to the extent possible, its specific objections, and Lessee shall promptly thereafter resubmit plans and specifications revised to satisfy those objections. Within four (4) business days after Lessor receives such resubmittals of plans and specifications (and within four (4) business days after any subsequent resubmittals), Lessor shall notify Lessee in writing as to whether Lessor approves or disapproves such resubmittals of plans and specifications. If Lessor fails to respond within the required period as to either the initial submission of Lessee's plans and specifications or such

resubmittals thereof, Lessor's approval shall be deemed granted. When Lessor approves Lessee's plans and specifications, a copy thereof shall be initialed by Lessor and Lessee for identification purposes. Upon such approval of Lessee's plans and specifications for the Additional Space Work and the occurrence of the Possession Date, Lessee, its employees, agents and contractors, may enter upon the Additional Space at reasonable times for the purpose of installing the Additional Space Work, trade fixtures and other equipment for the conduct of Lessee's business in the Additional Space; provided, however, that any such pre-Addition Date entry by Lessee shall be upon the terms and conditions of the Lease, as amended hereby, including Lessee's indemnification of Lessor pursuant to Section 18 of the Lease, and excluding only Lessee's obligation to pay Additional Monthly Rent.

(E) Lessee shall elect to either undertake its own construction management or retain a third party construction manager with respect to the Additional Space Work, and Lessee shall pay to Lessor a plan review and coordination fee (the "Plan Review Fee") in an amount equal to one percent (1%) of the hard cost of the Additional Space Work, payable within thirty (30) days after Lessee's receipt of an invoice from Lessor. Further, Lessee may elect to use Girard Engineering as its MEP engineer. Lessee's selection of any other MEP engineer shall be subject to the prior written approval of Lessor, which approval shall not be unreasonably withheld or delayed, and shall also be subject to Lessee's payment of Girard Engineering's fee (the "MEP Plan Review Fee"), which shall not exceed One Thousand Three Hundred Fifty and 00/100 Dollars (\$1,350.00) to review the MEP plans prepared by any other MEP engineer. The payment of the Plan Review Fee or the MEP Plan Review Fee, as the case may be, shall constitute additional rent, and in the event of nonpayment thereof by Lessee, Lessor shall have all the rights and remedies set forth in the Lease with respect to nonpayment of rent.

(F) Lessor shall pay to Lessee, on the following terms and conditions, a cash allowance of up to Two Hundred Two Thousand Eight Hundred Thirty and 00/100 Dollars (\$202,830.00) (the "Additional Construction Allowance), to be applied to the payment of the cost and expense incurred by Lessee in the design and construction of the Additional Space Work, including (i) hard costs, (ii) the costs of permits, space planning, architectural, engineering and design fees, (iii) the Plan Review Fee or the MEP Plan Review Fee, as the case may be, and (iv) telecommunications systems and equipment and computer cabling installed in the Additional Space. Any balance of the Additional Construction Allowance (which balance shall not exceed the amount of One Hundred One Thousand Four Hundred Fifteen and 00/100 Dollars (\$101,415.00) shall be applied to the Additional Monthly Rent first due under this Addendum until such balance is exhausted.

The Additional Construction Allowance shall be disbursed as the Additional Space Work progresses upon Lessee's submission of a requisition statement, not more frequently than monthly, with supporting invoices representing the cost of such work since Lessee's last requisition, together with evidence of payment of the cost of all such work covered by the last requisition. Lessee shall also submit lien waivers by all contractors and suppliers employed by Lessee for such work. Lessor shall have the right to verify all such invoices, and after inspection and approval by Lessor and its architect, which approval shall not be unreasonably withheld, conditioned or delayed, Lessor shall pay to Lessee or its contractor an amount equal to the approved requisition sum; provided, however, that in no event shall Lessor's total liability for

such payments exceed the Additional Construction Allowance. All Additional Space Work, whether at Lessor's or Lessee's expense, or the joint expense of Lessor and Lessee, shall become and remain the property of Lessor and be surrendered with the Additional Space upon the expiration or earlier termination of the Lease, as amended hereby.

(G) The selection of Lessee's contractor(s) to perform the Additional Space Work shall be subject to the prior written approval of Lessor, which approval shall not be unreasonably withheld, conditioned or delayed, and shall be based upon the contractor being properly licensed and insured in accordance with Section 18(D) of the Lease and past job performance. Lessor may further require that Lessee obtain and deliver to Lessor written and unconditional waivers of mechanic's and materialmen's liens upon the Land and Building for all work, labor and services to be performed, and materials to be furnished in connection with such work, signed by all contractors, subcontractors, and materialmen to become involved in such work. Lessor shall have the right to inspect work performed by Lessee's contractors. Further, all provisions of Section 10 of the Lease shall apply to all work performed by Lessee's contractors.

Lessee shall not be required to remove or alter any Additional Space Work at the expiration or earlier termination of the term of the Lease, as amended hereby.

7. BROKER AND AGENT

Lessor and Lessee each represent and warrant one to another that, except as hereinafter set forth, neither of them has employed any broker in carrying on the negotiations, or had any dealings with any broker, relating to this Addendum. Lessor represents that it has employed its Management Agent as its broker, and Lessee represents that Lincoln Property Company has co-brokered this expansion and renewal transaction on behalf of Lessee. Lessor acknowledges that Lessor shall be responsible for any commissions due to said brokers pursuant to separate agreements. Lessor shall indemnify and hold Lessee harmless, and Lessee shall indemnify and hold Lessor harmless, from and against any claims or claims for brokerage or other commission arising from or out of any breach of the foregoing representation and warranty by the respective indemnitors.

8. PARKING

Upon the Addition Date, Lessee shall have the option to lease up to twenty (20) additional spaces in the Building's parking garage and six (6) additional spaces in the parking garage in the adjacent building known as and situated at Three Bethesda Metro Center, such parking spaces to be for use only by Lessee, its employees and permitted sublessees. If Lessee shall elect to exercise said option, it shall do so by giving written notice thereof to Lessor not later than thirty (30) days following the Addition Date. Any such lease of additional parking spaces shall be with the manager of said parking garage, and shall be on a monthly basis, upon the same terms as leased to other monthly users, and at the same prevailing rate charged by the garage operator from time to time to other monthly users, including any premium charged by the garage operator to other monthly users from time to time for reserved parking spaces. Lessee's parking rights allocable to the Existing Demised Premises shall be and remain as provided for in Section 34 of the Lease.

9. LEASE PROVISIONS APPLICABLE

Except to the extent expressly modified by this Addendum, all of the terms and conditions of the Lease, as amended or supplemented hereby, shall remain in full force and effect. Except as may otherwise be provided in this Addendum, the Additional Space shall be deemed to be a part of the premises demised under the Lease for all purposes.

(Signatures on Following Page)

IN WITNESS WHEREOF, Lessor and Lessee have caused this Addendum to be signed in their names by their duly authorized representatives and delivered as their act and deed, intending to be legally bound by its terms and provisions.

LESSOR:

NEWLANDS BUILDING VENTURE, LLC
a Maryland limited liability company

Attest:

By: The Chevy Chase Land Company
of Montgomery County, Maryland,
Managing Member

/s/

By: /s/ Michele Horwitz Cornwell, S.V.P.

Secretary
(SEAL)

Name: Michele Horwitz Cornwell
Title: Senior Vice President

LESSEE:

COSTAR REALTY INFORMATION, INC.
a Delaware corporation

Attest:

By: /s/ Frank Carchedi

/s/ Carla J. Garrett

Secretary
(SEAL)

Name: Frank Carchedi
Title: Chief Financial Officer

STATE OF MARYLAND
COUNTY OF MONTGOMERY, ss:

I, Donna Geraci, a Notary Public in and for the jurisdiction aforesaid, do hereby certify that Michele H. Cornwell, who is personally well known to me as the person who executed the foregoing and annexed Addendum, dated the 12 day of May, 2004, on behalf of the Lessor, to acknowledge the same, personally appeared before me in said jurisdiction and acknowledged said Addendum to be the act and deed of The Chevy Chase Land Company of Montgomery County, Maryland, as Managing Member of and for and on behalf of the Lessor, and delivered the same as such.

GIVEN under my hand and seal this 12 day of May, 2004.

/s/ Donna Geraci

Notary Public

My commission expires: 5.1.07

STATE OF MARYLAND
COUNTY OF MONTGOMERY, ss:

I, Georgeann B. Murrell, a Notary Public in and for the jurisdiction aforesaid, do hereby certify that Frank Carchedi, who is personally well known to me to be the person who executed the foregoing and annexed Addendum, dated the 12 day of May, 2004 on behalf of Lessee, to acknowledge the same, personally appeared before me in said jurisdiction and acknowledged said Addendum to be the act and deed of CoStar Realty Information, Inc., and delivered the same as such.

GIVEN under my hand and seal this 12 day of May, 2004.

/s/ Georgeann B. Murrell

Notary Public

My commission expires: 4.1.07

ADDENDUM TO EMPLOYMENT AGREEMENT

This Addendum is made as April 1, 2004 (the "Addendum") by and between CoStar Realty Information, Inc. (the "Company"), and Frank Carchedi (the "Employee") and is executed pursuant to and made a part of the Employment Agreement, dated as of April 24, 1998 (the "Employment Agreement"), between the OLD RIG, a predecessor in interest to the Company, and the Employee.

Any capitalized term used in this Addendum and not otherwise defined shall have the meaning set forth in the Employment Agreement.

NOW THEREFORE, in consideration for the increased compensation and the other consideration given to Employee in connection with his annual review, the Company and the Employee agree that the Employment Agreement shall be amended as follows:

1. The last sentence of Section 4(b) of the Employment Agreement shall be amended and replaced in its entirety with the following:

Beginning in 2004, it is expected that the Annual Bonus will be at a target level of not less than 50% nor more than 80% of the Base Compensation paid during such calendar year.

2. Employee and the Company agree that except as expressly provided above, all of the terms of the Employment Agreement will remain in full force and effect.

IN WITNESS WHEREOF, the parties hereto have executed this Addendum on the day and year set forth below.

Employee:

/s/

Frank Carchedi

Company:

By: /s/

**Andrew C. Florance
Chief Executive Officer and President**

ADDENDUM TO EMPLOYMENT AGREEMENT

This Addendum is made as April 1, 2004 (the "Addendum") by and between CoStar Realty Information, Inc. (the "Company"), and David Schaffel (the "Employee") and is executed pursuant to and made a part of the Employment Agreement, dated as of April 24, 1998 (the "Employment Agreement"), between OLD RIG, a predecessor in interest to the Company, and the Employee.

Any capitalized term used in this Addendum and not otherwise defined shall have the meaning set forth in the Employment Agreement.

NOW THEREFORE, in consideration for the increased compensation and the other consideration given to Employee in connection with his annual review, the Company and the Employee agree that the Employment Agreement shall be amended as follows:

1. The last sentence of Section 4(b) of the Employment Agreement shall be amended and replaced in its entirety with the following:

Beginning in 2004, the Annual Bonus will be up to 75% of the Base Compensation paid during such calendar year.

2. Employee and the Company agree that except as expressly provided above, all of the terms of the Employment Agreement will remain in full force and effect.

IN WITNESS WHEREOF, the parties hereto have executed this Addendum on the day and year set forth below.

Employee:

/s/ _____
David Schaffel

Company:

By: /s/ _____
Andrew C. Florance
Chief Executive Officer and President

ADDENDUM TO EMPLOYMENT TERMS

This Addendum is made as April 1, 2004 (the "Addendum") by and between CoStar Realty Information, Inc. (the "Company"), and Craig Farrington (the "Employee") and is executed pursuant to and made a part of the Offer Letter, dated as of March 3, 2000 (the "Offer Letter"), between Comps, Inc., a predecessor in interest to the Company, and the Employee.

Any capitalized term used in this Addendum and not otherwise defined shall have the meaning set forth in the Offer Letter.

NOW THEREFORE, in consideration for the increased compensation and the other consideration given to Employee in connection with his annual review, the Company and the Employee agree that the Offer Letter terms shall be amended as follows:

1. **Notwithstanding anything set forth to the contrary in the Offer Letter, beginning in 2004, the Employee shall have the opportunity to earn an annual bonus of up to 75% of the annual base salary (pro rated for partial calendar years during the employment term).**
2. Employee and the Company agree that except as expressly provided above, all of the terms of the Offer Letter will remain in full force and effect.

IN WITNESS WHEREOF, the parties hereto have executed this Addendum on the day and year set forth below.

Employee:

/s/

Craig Farrington

Company:

By: /s/

Andrew C. Florance
Chief Executive Officer and President

CERTIFICATION

I, Andrew C. Florance, certify that:

1. I have reviewed this quarterly report on Form 10-Q of CoStar Group, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 6, 2004

By: Andrew C. Florance

/s/ Andrew C. Florance

Andrew C. Florance

Chief Executive Officer

(Principal Executive Officer and Duly Authorized Officer)

CERTIFICATION

I, Frank A. Carchedi, certify that:

1. I have reviewed this quarterly report on Form 10-Q of CoStar Group, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 6, 2004

By: Frank A. Carchedi

/s/ Frank A. Carchedi

Frank A. Carchedi

Chief Financial Officer

(Principal Financial and Accounting Officer and Duly Authorized Officer)

CoStar Group, Inc.
2 Bethesda Metro Center, 10th floor
Bethesda, MD 20814

August 6, 2004

Securities and Exchange Commission
450 5th Street, NW
Washington, DC 20549

Re: **Certification Of Principal Executive Officer Pursuant To 18 U.S.C. Sec. 1350**

Dear Ladies and Gentlemen:

In connection with the accompanying Quarterly Report on Form 10-Q of CoStar Group, Inc., for the quarter ended June 30, 2004, I, Andrew C. Florance, Chief Executive Officer of CoStar Group, Inc., hereby certify pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1) such Quarterly Report on Form 10-Q of CoStar Group, Inc., for the quarter ended June 30, 2004, fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2) the information contained in such Quarterly Report on Form 10-Q of CoStar Group, Inc., for the quarter ended June 30, 2004, fairly presents, in all material respects, the financial condition and results of operations of CoStar Group, Inc.

By:

/s/ Andrew C. Florance

Andrew C. Florance
Chief Executive Officer
(Principal Executive Officer and Duly Authorized Officer)

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to CoStar Group, Inc. and will be retained by CoStar Group, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

In accordance with Item 601 of Regulation S-K, this certification is being "furnished" as Exhibit 32.1 to CoStar Group, Inc.'s quarterly report and shall not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934 (the "Exchange Act") or otherwise subject to the liabilities of that section, nor shall it be deemed incorporated by reference in any filing under the Securities Act of 1933 or the Exchange Act, except as expressly set forth by specific reference in such a filing.

CoStar Group, Inc.
2 Bethesda Metro Center, 10th floor
Bethesda, MD 20814

August 6, 2004

Securities and Exchange Commission
450 5th Street, NW
Washington, DC 20549

Re: **Certification Of Principal Financial Officer Pursuant To 18 U.S.C. Sec. 1350**

Dear Ladies and Gentlemen:

In connection with the accompanying Quarterly Report on Form 10-Q of CoStar Group, Inc., for the quarter ended June 30, 2004, I, Frank A. Carchedi, Chief Financial Officer of CoStar Group, Inc., hereby certify pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1) such Quarterly Report on Form 10-Q of CoStar Group, Inc., for the quarter ended June 30, 2004, fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2) the information contained in such Quarterly Report on Form 10-Q of CoStar Group, Inc., for the quarter ended June 30, 2004, fairly presents, in all material respects, the financial condition and results of operations of CoStar Group, Inc.

By:

/s/ Frank A. Carchedi

Frank A. Carchedi
Chief Financial Officer
(Principal Financial and Accounting Officer and Duly Authorized
Officer)

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to CoStar Group, Inc. and will be retained by CoStar Group, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

In accordance with Item 601 of Regulation S-K, this certification is being "furnished" as Exhibit 32.1 to CoStar Group, Inc.'s quarterly report and shall not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934 (the "Exchange Act") or otherwise subject to the liabilities of that section, nor shall it be deemed incorporated by reference in any filing under the Securities Act of 1933 or the Exchange Act, except as expressly set forth by specific reference in such a filing.