TYLER TECHNOLOGIES INC
Form 10-Q
October 24, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**

For the quarterly period ended September 30, 2013

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**

Commission File Number 1-10485

TYLER TECHNOLOGIES, INC.

(Exact name of registrant as specified in its charter)

DELAWARE	**75-2303920**
(State or other jurisdiction of	**(I.R.S. employer**
incorporation or organization)	**identification no.)**

5101 TENNYSON PARKWAY

PLANO, TEXAS

75024

(Address of principal executive offices)

(Zip code)

(972) 713-3700

(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 for the past 90 days. Yes x No ¨

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

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

Large accelerated filer	x	Accelerated filer	¨
Non-accelerated filer	¨	Smaller Reporting Company	¨

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

The number of shares of common stock of registrant outstanding on October 18, 2013 was 32,245,000.

PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

TYLER TECHNOLOGIES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands, except per share amounts)

(Unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
Revenues:				
Software licenses and royalties	$ 10,495	$ 8,973	$ 29,415	$ 24,958
Subscriptions	15,214	11,335	42,550	31,856
Software services	24,860	22,099	69,406	62,366
Maintenance	49,291	44,452	141,980	126,362
Appraisal services	5,207	5,594	15,854	17,047
Hardware and other	1,954	1,392	6,703	5,347
Total revenues	107,021	93,845	305,908	267,936
Cost of revenues:				
Software licenses and royalties	583	458	1,701	1,508
Acquired software	513	478	1,585	1,370
Software services, maintenance and subscriptions	51,786	43,485	147,001	126,416
Appraisal services	3,360	3,598	10,577	11,270
Hardware and other	1,230	882	4,608	4,310
Total cost of revenues	57,472	48,901	165,472	144,874
Gross profit	49,549	44,944	140,436	123,062
Selling, general and administrative expenses	24,581	20,909	72,198	63,943
Research and development expense	5,982	4,273	17,174	14,775
Amortization of customer and trade name intangibles	1,129	1,103	3,388	3,186
Operating income	17,857	18,659	47,676	41,158
Other expense, net	285	849	919	2,325
Income before income taxes	17,572	17,810	46,757	38,833
Income tax provision	6,523	6,978	18,168	15,215
Net income	$ 11,049	$ 10,832	$ 28,589	$ 23,618
Earnings per common share:				
Basic	$ 0.34	$ 0.36	$ 0.90	$ 0.78
Diluted	$ 0.32	$ 0.33	$ 0.83	$ 0.72
Comprehensive income	$ 11,049	$ 10,914	$ 28,648	$ 23,700

See accompanying notes.

TYLER TECHNOLOGIES, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except par value and share amounts)

	September 30, 2013 (Unaudited)	December 31, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	$ 52,121	$ 6,406
Accounts receivable (less allowance for losses of $1,285 in 2013 and $1,621 in 2012)	90,503	99,212
Prepaid expenses	12,107	9,000
Other current assets	4,522	1,480
Deferred income taxes	5,512	5,544
Total current assets	164,765	121,642
Accounts receivable, long-term portion	1,098	1,187
Property and equipment, net	63,145	45,381
Non-current investments available-for-sale	2,078	2,037
Other assets:		
Goodwill	121,011	121,011
Other intangibles, net	40,628	45,800
Sundry	690	1,197
	$ 393,415	$ 338,255
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 6,974	$ 3,167
Accrued liabilities	23,162	26,018
Deferred revenue	151,510	140,550
Total current liabilities	181,646	169,735
Revolving line of credit		18,000
Deferred income taxes	4,141	5,221
Commitments and contingencies		
Shareholders equity:		
Preferred stock, $10.00 par value; 1,000,000 shares authorized, none issued		
Common stock, $0.01 par value; 100,000,000 shares authorized; 48,147,969 shares issued in 2013 and 2012	481	481
Additional paid-in capital	166,297	154,018
Accumulated other comprehensive loss, net of tax	(209)	(268)
Retained earnings	191,698	163,109
Treasury stock, at cost; 15,916,346 and 16,816,903 shares in 2013 and 2012, respectively	(150,639)	(172,041)
Total shareholders equity	207,628	145,299
	$ 393,415	$ 338,255

See accompanying notes.

TYLER TECHNOLOGIES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Nine months ended September 30, 2013	2012
Cash flows from operating activities:		
Net income	$ 28,589	$ 23,618
Adjustments to reconcile net income to net cash provided by operations:		
Depreciation and amortization	10,093	9,616
Share-based compensation expense	8,539	5,506
Excess tax benefit from exercises of share-based arrangements	(13,200)	(3,283)
Changes in operating assets and liabilities, exclusive of effects of acquired companies:		
Accounts receivable	8,798	14,431
Income tax payable	8,853	2,533
Prepaid expenses and other current assets	(2,750)	(302)
Accounts payable	841	(1,236)
Accrued liabilities	(2,022)	(2,263)
Deferred revenue	10,960	(6,366)
Net cash provided by operating activities	58,701	42,254
Cash flows from investing activities:		
Proceeds from sale of investments	50	75
Cost of acquisitions, net of cash acquired	(181)	(15,229)
Additions to property and equipment	(20,262)	(6,351)
Decrease in other	271	41
Net cash used by investing activities	(20,122)	(21,464)
Cash flows from financing activities:		
Decrease in net borrowings on revolving line of credit	(18,000)	(32,700)
Contributions from employee stock purchase plan	2,535	1,832
Proceeds from exercise of stock options	9,401	5,572
Excess tax benefit from exercises of share-based arrangements	13,200	3,283
Net cash provided (used) by financing activities	7,136	(22,013)
Net increase (decrease) in cash and cash equivalents	45,715	(1,223)
Cash and cash equivalents at beginning of period	6,406	1,326
Cash and cash equivalents at end of period	$ 52,121	$ 103

See accompanying notes.

Tyler Technologies, Inc.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

(Tables in thousands, except per share data)

(1) Basis of Presentation

We prepared the accompanying condensed consolidated financial statements following the requirements of the Securities and Exchange Commission (SEC) and accounting principles generally accepted in the United States, or GAAP, for interim reporting. As permitted under those rules, certain footnotes or other financial information that are normally required by GAAP can be condensed or omitted for interim periods. Balance sheet amounts are as of September 30, 2013 and December 31, 2012 and operating result amounts are for the three and nine months ended September 30, 2013 and 2012, and include all normal and recurring adjustments that we considered necessary for the fair summarized presentation of our financial position and operating results. As these are condensed financial statements, one should also read the financial statements and notes included in our latest Form 10-K for the year ended December 31, 2012. Revenues, expenses, assets and liabilities can vary during each quarter of the year. Therefore, the results and trends in these interim financial statements may not be the same as those for the full year.

Royalty revenue is recognized when the fees are fixed or determinable, which is known when we receive notice of the amounts earned pursuant to our third party royalty arrangements. Typically, we receive notice of royalty revenues earned on a quarterly basis 30 to 60 days after the end of the reporting period.

Certain amounts for the previous periods presented have been reclassified to conform to the current period presentation.

(2) Acquisitions

In November 2012, we acquired all of the capital stock of EnerGov Solutions, L.L.C. (EnerGov) which develops and sells enterprise permitting, land management, licensing and regulatory software solutions to governmental agencies. As of December 31, 2012 the purchase price allocation was not yet complete. In the three months ended March 31, 2013, we finalized the EnerGov purchase price allocation which resulted in additional goodwill of $1.1 million and a corresponding reduction in tangible assets. The balance sheet at December 31, 2012 has been retrospectively revised to include this adjustment.

(3) Financial Instruments

Assets recorded at fair value in the balance sheet as of September 30, 2013 are categorized based upon the level of judgment associated with the inputs used to measure their fair value. Hierarchical levels, defined by Accounting Standards Codification (ASC) 820, Fair Value Measurements and Disclosures, which are directly related to the amount of subjectivity associated with the inputs to fair valuation of these assets, are as follows:

Level 1 Inputs are unadjusted, quoted prices in active markets for identical assets or liabilities at the measurement date;

Level 2 Inputs other than Level 1 inputs that are either directly or indirectly observable; and

Level 3 Unobservable inputs, for which little or no market data exist, therefore requiring an entity to develop its own assumptions.

As of September 30, 2013 we held certain items that are required to be measured at fair value on a recurring basis. The following table summarizes the fair value of these financial assets:

	Total	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)

Investments available-for-sale	2,078	2,078

Investments available-for-sale consist of two auction rate municipal securities (ARS) which are collateralized debt obligations supported by municipal agencies and do not include mortgage-backed securities. These ARS are debt instruments with stated maturities ranging from 19 to 28 years, for which the interest rate is designed to be reset through Dutch auctions approximately every 30 days. However, due to events in the credit markets, auctions for these securities have not occurred since February 2008. Both of our ARS have had a series of small partial redemptions at par in the period from July 2009 through July 2013. As of September 30, 2013, we have continued to earn and collect interest on both of our ARS.

Because quoted prices in active markets are no longer available we determined the estimated fair values of these securities utilizing a discounted trinomial model. The model considers the probability of three potential occurrences for each auction event through the maturity date of each ARS. The three potential outcomes for each auction are (i) successful auction/early redemption, (ii) failed auction and (iii) issuer default. Inputs in determining the probabilities of the potential outcomes include but are not limited to, the securities collateral, credit rating, insurance, issuer s financial standing, contractual restrictions on disposition and the liquidity in the market. The fair value of each ARS is determined by summing the present value of the probability-weighted future principal and interest payments determined by the model. Since there can be no assurances that auctions for these securities will be successful in the near future, we have classified our ARS as non-current investments.

The par and carrying values, and related cumulative unrealized loss for our non-current ARS as of September 30, 2013 are as follows:

	Par Value	Temporary Impairment	Carrying Value
Investments available-for-sale	$ 2,400	$ 322	$ 2,078

In association with this estimate of fair value, we have recorded an after-tax temporary unrealized gain on our non-current ARS of $59,000, net of related tax effects of $32,000 in the nine months ended September 30, 2013, which is included in accumulated other comprehensive loss on our balance sheet. We consider the impairment in our ARS as temporary because we do not have the intent to sell, nor is it more-likely-than-not that we will be required to sell these securities before recovery of their cost basis. We believe that this decline in fair value is temporary, because the underlying assets of these securities are supported by municipal agencies and do not include mortgage-backed securities, have redemption features which call for redemption at 100% of par value and have a current credit rating of A or AA. The ratings on the ARS take into account credit support through insurance policies guaranteeing each of the bonds payment of principal and accrued interest, if it becomes necessary. In addition, both ARS have had a series of small partial redemptions at par in the period July 2009 through July 2013. Based on our cash and cash equivalents balance, expected operating cash flows and availability under our credit facility, we do not believe a lack of liquidity associated with our ARS will adversely affect our ability to conduct business, and believe we have the ability to hold the securities throughout the currently estimated recovery period. We will continue to evaluate any changes in the market value of our ARS and in the future, depending upon existing market conditions, we may be required to record an other-than-temporary decline in market value.

The following table reflects the activity for assets measured at fair value using level 3 inputs for the nine months ended September 30, 2013:

Balance as of December 31, 2012	$ 2,037
Transfers into level 3	
Transfers out of level 3	
Purchases, sales, issuances and settlements	(25)
Unrealized gains included in accumulated loss	
Balance as of March 31, 2013	2,012
Transfers into level 3	
Transfers out of level 3	
Unrealized gains included in accumulated loss	91
Balance as of June 30, 2013	2,103
Transfers into level 3	
Transfers out of level 3	
Purchases, sales, issuances and settlements	(25)
Unrealized gains included in accumulated loss	
Balance as of September 30, 2013	$ 2,078

(4) Shareholders Equity

The following table details activity in our common stock:

	Nine months ended September 30,			
	2013		2012	
	Shares	Amount	Shares	Amount
Stock option exercises	850	$ 9,401	506	$ 5,572
Employee stock plan purchases	50	2,535	59	1,832

As of September 30, 2013, we had authorization from our board of directors to repurchase up to 1.7 million additional shares of Tyler common stock.

(5) Revolving Line of Credit

In August 2010, we entered into a $150.0 million Credit Agreement (the Credit Facility) and a related pledge and security agreement with a group of seven financial institutions with Bank of America, N.A., as Administrative Agent. The Credit Facility provides for a revolving credit line of $150.0 million (which may be increased up to $200.0 million subject to our obtaining commitments for such increase), with a $25.0 million sublimit for letters of credit. The Credit Facility matures on August 11, 2014. Borrowings under the Credit Facility may be used for general corporate purposes, including working capital requirements, acquisitions and share repurchases.

Borrowings under the Credit Facility bear interest at a rate of either (1) the Bank of America s prime rate plus a margin of 1.50% to 2.75% or (2) the 30, 60, 90 or 180-day LIBOR rate plus a margin of 2.50% to 3.75%, with the margin determined by our consolidated leverage ratio. The Credit Facility is secured by substantially all of our assets, excluding real property. The Credit Facility requires us to maintain certain financial ratios and other financial conditions and prohibits us from making certain investments, advances, cash dividends or loans, and limits incurrence of additional indebtedness and liens. As of September 30, 2013, we were in compliance with those covenants.

As of September 30, 2013, we had no outstanding borrowings and available borrowing capacity of $145.0 million under the Credit Facility. We had outstanding letters of credit totaling $5.0 million as of September 30, 2013. Some of our customers, primarily those for our property appraisal services, require that we obtain performance bonds in connection with our contract. The maximum potential amount of an outstanding performance bond would be the remaining cost of work to be performed under our contracts. The notional amount of performance guarantees outstanding as of September 30, 2013 was estimated to be $39.6 million. We provide letters of credit as security for the issuance of performance bonds. These letters of credit are issued under our revolving line of credit and reduce our available borrowing capacity. We do not believe these letters of credit will be required to be drawn upon. These letters of credit expire in 2014.

(6) Income Tax Provision

For the three and nine months ended September 30, 2013, we had an effective income tax rate of 37.1% and 38.9%, respectively compared to an effective income tax rate of 39.2% for the three and nine months ended September 30, 2012. The effective income tax rates for the periods presented were different from the statutory United States federal income tax rate of 35% primarily due to state income taxes, non-deductible share-based compensation expense, the qualified manufacturing activities deduction, and non-deductible meals and entertainment costs.

We made federal and state income tax payments, net of refunds, of $9.3 million in the nine months ended September 30, 2013, compared to $12.7 million in net payments for the same period of the prior year.

(7) Earnings Per Share

The following table details the reconciliation of basic earnings per share to diluted earnings per share:

	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
Numerator for basic and diluted earnings per share:				
Net income	$ 11,049	$ 10,832	$ 28,589	$ 23,618
Denominator:				
Weighted-average basic common shares outstanding	32,037	30,387	31,825	30,267
Assumed conversion of dilutive securities:				
Stock options	2,727	2,599	2,649	2,571
Denominator for diluted earnings per share Adjusted weighted-average shares	34,764	32,986	34,474	32,838
Earnings per common share:				
Basic	$ 0.34	$ 0.36	$ 0.90	$ 0.78
Diluted	$ 0.32	$ 0.33	$ 0.83	$ 0.72

For the three and nine months ended September 30, 2013, stock options representing the right to purchase common stock of approximately 331,000 shares and 724,000 shares, respectively, were not included in the computation of diluted earnings per share because their inclusion would have had an anti-dilutive effect. For the three and nine months ended September 30, 2012, stock options representing the right to purchase common stock of approximately 427,000 shares and 443,000 shares, respectively, were not included in the computation of diluted earnings per share because their inclusion would have had an anti-dilutive effect.

(8) Share-Based Compensation

The following table summarizes share-based compensation expense related to share-based awards recorded in the statements of comprehensive income, pursuant to ASC 718, Stock Compensation:

	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
Cost of software services, maintenance and subscriptions	$ 408	$ 286	$ 1,087	$ 791
Selling, general and administrative expense	2,653	1,617	7,452	4,715
Total share-based compensation expense	$ 3,061	$ 1,903	$ 8,539	$ 5,506

(9) Segment and Related Information

We are a major provider of integrated information management solutions and services for the public sector, with a focus on local governments.

We provide our software systems and services and appraisal services through four business units which focus on the following products:

- financial management and education software solutions;
- financial management, municipal courts, and land and vital records software solutions;
- courts and justice software solutions; and
- appraisal and tax software solutions and property appraisal services.

In accordance with ASC 280-10, Segment Reporting, the financial management and education software solutions unit, financial management, municipal courts and land and vital records software solutions unit and the courts and justice software solutions unit meet the criteria for aggregation and are presented in one segment, Enterprise Software Solutions (ESS). The ESS segment provides municipal and county governments and schools with software systems to meet their information technology and automation needs for mission-critical back-office functions such as financial management and courts and justice processes. The Appraisal and Tax Software Solutions and Services (ATSS) segment provides systems and software that automate the appraisal and assessment of real and personal property as well as property appraisal outsourcing services for local governments and taxing authorities. Property appraisal outsourcing services include: the physical inspection of commercial and residential properties; data collection and processing; computer analysis for property valuation; preparation of tax rolls; community education; and arbitration between taxpayers and the assessing jurisdiction.

We evaluate performance based on several factors, of which the primary financial measure is business segment operating income. We define segment operating income as income before noncash amortization of intangible assets associated with their acquisition, interest expense and income taxes. Segment operating income includes intercompany transactions. The majority of intercompany transactions relate to contracts involving more than one unit and are valued based on the contractual arrangement. Segment operating income for corporate primarily consists of compensation costs for the executive management team and certain accounting and administrative staff and share-based compensation expense for the entire company. Corporate segment operating income also includes revenues and expenses related to a company-wide user conference.

For the three months ended September 30, 2013

	Enterprise Software Solutions	Appraisal and Tax Software Solutions and Services	Corporate	Totals
Revenues				
Software licenses and royalties	$ 10,126	$ 369	$	$ 10,495
Subscriptions	14,537	677		15,214
Software services	22,615	2,245		24,860
Maintenance	45,182	4,109		49,291
Appraisal services		5,207		5,207
Hardware and other	1,958		(4)	1,954
Intercompany	686		(686)	
Total revenues	$ 95,104	$ 12,607	$ (690)	$ 107,021
Segment operating income	$ 22,776	$ 2,441	$ (5,718)	$ 19,499

For the nine months ended September 30, 2013

	Enterprise Software Solutions	Appraisal and Tax Software Solutions and Services	Corporate	Totals
Revenues				
Software licenses and royalties	$ 27,849	$ 1,566	$	$ 29,415
Subscriptions	40,527	2,023		42,550
Software services	63,308	6,098		69,406
Maintenance	129,630	12,350		141,980
Appraisal services		15,854		15,854
Hardware and other	4,917		1,786	6,703
Intercompany	2,023		(2,023)	
Total revenues	$ 268,254	$ 37,891	$ (237)	$ 305,908
Segment operating income	$ 60,930	$ 7,071	$ (15,352)	$ 52,649

For the three months ended September 30, 2012

	Enterprise Software Solutions	Appraisal and Tax Software Solutions and Services	Corporate	Totals
Revenues				
Software licenses and royalties	$ 8,576	$ 397	$	$ 8,973
Subscriptions	10,960	375		11,335
Software services	20,213	1,886		22,099
Maintenance	40,282	4,170		44,452
Appraisal services		5,594		5,594
Hardware and other	1,392			1,392
Intercompany	559		(559)	
Total revenues	$ 81,982	$ 12,422	$ (559)	$ 93,845
Segment operating income	$ 21,851	$ 2,517	$ (4,128)	$ 20,240

For the nine months ended September 30, 2012

	Enterprise Software Solutions	Appraisal and Tax Software Solutions and Services	Corporate	Totals
Revenues				
Software licenses and royalties	$ 23,513	$ 1,445	$	$ 24,958
Subscriptions	30,969	887		31,856
Software services	56,659	5,707		62,366
Maintenance	114,012	12,350		126,362
Appraisal services		17,047		17,047
Hardware and other	3,688		1,659	5,347
Intercompany	1,663		(1,663)	
Total revenues	$ 230,504	$ 37,436	$ (4)	$ 267,936
Segment operating income	$ 51,101	$ 6,893	$ (12,280)	$ 45,714

Reconciliation of reportable segment operating income to the Company s consolidated totals:	Three months ended September 30, 2013	Three months ended September 30, 2012	Nine months ended September 30, 2013	Nine months ended September 30, 2012
Total segment operating income	$ 19,499	$ 20,240	$ 52,649	$ 45,714
Amortization of acquired software	(513)	(478)	(1,585)	(1,370)
Amortization of customer and trade name intangibles	(1,129)	(1,103)	(3,388)	(3,186)
Other expense, net	(285)	(849)	(919)	(2,325)
Income before income taxes	$ 17,572	$ 17,810	$ 46,757	$ 38,833

(10) Commitments and Contingencies

Other than routine litigation arising in the ordinary course of our business, there are no material legal proceedings pending to which we are party or to which any of our properties are subject.

ITEM 2. Management s Discussion and Analysis of Financial Condition and Results of Operations
CAUTIONARY NOTE CONCERNING FORWARD-LOOKING STATEMENTS

This document contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 that are not historical in nature and typically address future or anticipated events, trends, expectations or beliefs with respect to our financial condition, results of operations or business. Forward-looking statements often contain words such as believes, expects, anticipates, foresees, forecasts, estimates, plans, intends, continues, may, will, should, projects, might, cou phrases. Similarly, statements that describe our business strategy, outlook, objectives, plans, intentions or goals also are forward-looking statements. We believe there is a reasonable basis for our forward-looking statements, but they are inherently subject to risks and uncertainties and actual results could differ materially from the expectations and beliefs reflected in the forward-looking statements. We presently consider the following to be among the important factors that could cause actual results to differ materially from our expectations and beliefs: (1) changes in the budgets or regulatory environments of our customers, primarily local and state governments, that could negatively impact information technology spending; (2) our ability to protect client information from security breaches and provide uninterrupted operations of data centers; (3) material portions of our business require the Internet infrastructure to be further developed or adequately maintained; (4) our ability to achieve our financial forecasts due to various factors, including project delays by our customers, reductions in transaction size, fewer transactions, delays in delivery of new products or releases or a decline in our renewal rates for service agreements; (5) economic, political and market conditions, including the global economic and financial crisis, and the general tightening of access to debt or equity capital; (6) technological and market risks associated with the development of new products or services or of new versions of existing or acquired products or services; (7) our ability to successfully complete acquisitions and achieve growth or operational synergies through the integration of acquired businesses, while avoiding unanticipated costs and disruptions to existing operations; (8) competition in the industry in which we conduct business and the impact of competition on pricing, customer retention and pressure for new products or services; (9) the ability to attract and retain qualified personnel and dealing with the loss or retirement of key members of management or other key personnel; and (10) costs of compliance and any failure to comply with government and stock exchange regulations. A detailed discussion of these factors and other risks that affect our business are described in our filings with the Securities and Exchange Commission, including the detailed Risk Factors contained in our most recent annual report on Form 10-K. We expressly disclaim any obligation to publicly update or revise our forward-looking statements.

GENERAL

We provide integrated information management solutions and services for the public sector, with a focus on local governments. We develop and market a broad line of software products and services to address the information technology (IT) needs of cities, counties, schools and other local government entities as well as state governments. In addition, we provide professional IT services to our customers, including software and hardware installation, data conversion, and training and for certain customers, product modifications, along with continuing maintenance and support for customers using our systems. We also provide subscription-based services such as software as a service (SaaS), which utilize the Tyler private cloud, and electronic document filing solutions (e-filings). In 2010 we began providing e-filings for courts and law offices which simplify the filing and management of court related documents. Revenues for e-filings are generally derived on a per-filing basis or from fixed fee arrangements. We also provide property appraisal outsourcing services for taxing jurisdictions.

Our products generally automate three major functional areas: (1) financial management and education, (2) courts and justice and (3) property appraisal and tax and we report our results in two segments. The Enterprise Software Solutions (ESS) segment provides municipal and county governments and schools with software systems to meet their information technology and automation needs for mission-critical back-office functions such as financial management and courts and justice processes. The Appraisal and Tax Software Solutions and Services (ATSS) segment provides systems and software that automate the appraisal and assessment of real and personal property as well as property appraisal outsourcing services for local governments and taxing authorities. Property appraisal outsourcing services include: the physical inspection of commercial and residential properties; data collection and processing; computer analysis for property valuation; preparation of tax rolls; community education; and arbitration between taxpayers and the assessing jurisdiction.

Total revenues increased 14.0% and 14.2% for the three and nine months ended September 30, 2013, respectively, compared to the prior year periods. We completed four acquisitions in 2012 and organic total revenue growth for the three and nine months ended September 30, 2013 was 11.5% and 10.8%, respectively, compared to the prior year periods.

Our total employee count increased to 2,482 at September 30, 2013 from 2,276 at September 30, 2012. This increase includes 57 employees added as a result of an acquisition in November 2012.

Outlook

We expect the trend of gradual improvements in the marketplace to continue in 2013. We plan to make significant investments in our business that we believe will enhance our market leadership and improve long-term revenue and margin growth. These investments include expenses associated with new e-filing contracts as well as accelerated hiring to ensure that we are well-positioned to deliver our current backlog and anticipated new business.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The discussion and analysis of our financial condition and results of operations are based upon our condensed consolidated financial statements. These condensed consolidated financial statements have been prepared following the requirements of accounting principles generally accepted in the United States (GAAP) for interim periods and require us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates, including those related to revenue recognition and amortization and potential impairment of intangible assets and goodwill and share-based compensation expense. As these are condensed financial statements, one should also read expanded information about our critical accounting policies and estimates provided in Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations, included in our Form 10-K for the year ended December 31, 2012. There have been no material changes to our critical accounting policies and estimates from the information provided in our Form 10-K for the year ended December 31, 2012.

ANALYSIS OF RESULTS OF OPERATIONS

Revenues

	Percentage of Total Revenue			
	Third Quarter		Nine Months	
	2013	2012	2013	2012
Revenue:				
Software licenses and royalties	9.8%	9.6%	9.6%	9.3%
Subscriptions	14.2	12.1	13.9	11.9
Software services	23.2	23.5	22.7	23.3
Maintenance	46.1	47.4	46.4	47.2
Appraisal services	4.9	6.0	5.2	6.3
Hardware and other	1.8	1.4	2.2	2.0
Total revenue	100.0	100.0	100.0	100.0
Operating Expenses:				
Cost of software licenses, royalties and acquired software	1.0	1.0	1.1	1.1
Cost of software services, maintenance and subscriptions	48.4	46.3	48.0	47.2
Cost of appraisal services	3.1	3.8	3.5	4.2
Cost of hardware and other	1.1	0.9	1.5	1.6
Selling, general and administrative expenses	23.0	22.3	23.6	23.9
Research and development expense	5.6	4.6	5.6	5.5
Amortization of customer and trade name intangibles	1.1	1.2	1.1	1.2
Operating income	16.7	19.9	15.6	15.3
Other expense, net	0.3	0.9	0.3	0.8
Income before income taxes	16.4	19.0	15.3	14.5
Income tax provision	6.1	7.5	5.9	5.7
Net income	10.3%	11.5%	9.4%	8.8%

Software licenses and royalties.

The following table sets forth a comparison of our software licenses and royalties revenues for the periods presented as of September 30:

	Third Quarter		Change		Nine Months		Change	
($ in thousands)	2013	2012	$	%	2013	2012	$	%
ESS	$ 10,126	$ 8,576	$ 1,550	18%	$ 27,849	$ 23,513	$ 4,336	18%
ATSS	369	397	(28)	(7)	1,566	1,445	121	8
Total software licenses and royalties revenue	$ 10,495	$ 8,973	$ 1,522	17%	$ 29,415	$ 24,958	$ 4,457	18%

Since March 2012, we have acquired two companies which provide financial and human capital management software solutions to the K-12 education market and one company that provides enterprise permitting, land management, licensing and regulatory software solutions to governmental agencies. The results of these acquisitions are included in our ESS segment from the dates of their acquisitions. Excluding the results of acquisitions, software license and royalty revenue for the three and nine months ended September 30, 2013 increased 13% and 9%, respectively compared to the prior year periods. The majority of the growth was due to an increase of approximately $770,000 and $2.1 million for the three and nine months ended September 30, 2013 in royalties on sales of Microsoft Dynamics AX by other Microsoft partners compared to the prior year periods. We record royalty revenue when the fees are fixed or determinable, which is known when we receive notice of the amounts earned pursuant to our royalty arrangements which are generally 30 to 60 days after each quarterly reporting period. Royalty revenue is dependent upon sales volume from Microsoft partners and can vary substantially from period to period. Software license revenues grew slightly in the three months ended September 30, 2013 and were flat for the nine months ended September 30, 2013 compared to the prior year periods. However, our software license growth rate continues to be negatively impacted by a growing number of customers choosing our subscription-based options, rather than purchasing the software under a traditional perpetual software arrangement. Subscription-based arrangements result in lower software license revenues in the initial year as compared to traditional perpetual software license arrangements but generate higher overall subscription-based revenue over the term of the contract. We had 24 and 74 new customers enter into subscription-based arrangements in the three and nine months ending September 30, 2013, respectively compared to 12 and 47 new customers in the three and nine months ended September 30, 2012, respectively.

Subscriptions.

The following table sets forth a comparison of our subscriptions revenues for the periods presented as of September 30:

	Third Quarter		Change		Nine Months		Change	
($ in thousands)	2013	2012	$	%	2013	2012	$	%
ESS	$ 14,537	$ 10,960	$ 3,577	33%	$ 40,527	$ 30,969	$ 9,558	31%
ATSS	677	375	302	81	2,023	887	1,136	128
Total subscriptions revenue	$ 15,214	$ 11,335	$ 3,879	34%	$ 42,550	$ 31,856	$ 10,694	34%

Excluding the impact of acquisitions, subscriptions revenue grew approximately 33% and 32% for the three and nine months ending September 30, 2013 compared to the prior year periods. Subscription-based services revenue primarily consists of revenues derived from SaaS arrangements, which utilize the Tyler private cloud. As part of our subscription-based services, we also provide electronic document filing solutions (e-filings) that simplify the filing and management of court related documents for courts and law offices. Revenues from e-filings are generally derived from transaction fees and fixed fee arrangements. The contract term for SaaS arrangements range from one to 10 years but are typically for periods of three to six years. New SaaS customers as well as existing customers who converted to our SaaS model provided the majority of the subscriptions revenue increase. In the three months ending September 30, 2013, we added 24 new customers and 14 existing customers elected to convert to our SaaS model. Since September 30, 2012, we have added 103 new customers and 63 existing customers elected to convert to our SaaS model. E-filing services also contributed approximately $930,000 and $1.8 million of the subscriptions revenue increase for the three and nine months ended September 30, 2013, respectively. E-filing revenue for the three months ended September 30, 2013 included approximately $590,000 related to a new contract with the Texas Office of Court Administration for our Odyssey File and Serve e-filing system for Texas courts. We expect that this contract will provide a long-term recurring revenue stream of $16.0 million to $19.0 million annually when e-filing becomes fully mandatory in Texas in 2014. The remaining e-filing revenue increase is the result of existing clients expanding mandatory e-filing for court documents.

Software services.

The following table sets forth a comparison of our software services revenues for the periods presented as of September 30:

	Third Quarter		Change		Nine Months		Change	
($ in thousands)	2013	2012	$	%	2013	2012	$	%
ESS	$ 22,615	$ 20,213	$ 2,402	12%	$ 63,308	$ 56,659	$ 6,649	12%
ATSS	2,245	1,886	359	19	6,098	5,707	391	7