

TYLER TECHNOLOGIES INC

Form 10-Q

October 25, 2007

Table of Contents

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q**

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

For the quarterly period ended September 30, 2007

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
(State or other jurisdiction of
incorporation or organization)

75-2303920
(I.R.S. employer
identification no.)

5949 SHERRY LANE, SUITE 1400
DALLAS, TEXAS
75225

(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 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 Accelerated filer Non-accelerated filer

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

Number of shares of common stock of registrant outstanding at October 22, 2007: 38,870,335

TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

TYLER TECHNOLOGIES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share amounts)

(Unaudited)

TYLER TECHNOLOGIES, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except par value and share amounts)

TYLER TECHNOLOGIES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

Tyler Technologies, Inc.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

(Tables in thousands, except per share data)

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

ITEM 3. Quantitative and Qualitative Disclosures About Market Risk

ITEM 4. Evaluation of Disclosure Controls and Procedures

Part II. OTHER INFORMATION

ITEM 1. Legal Proceedings

ITEM 1A. Risk Factors

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

ITEM 3. Defaults Upon Senior Securities

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

ITEM 5. Other Information

ITEM 6. Exhibits

SIGNATURES

Certification Pursuant to Section 302

Certification Pursuant to Section 302

Certifications Pursuant to Section 906

Table of Contents**PART I. FINANCIAL INFORMATION**

ITEM 1. Financial Statements

TYLER TECHNOLOGIES, INC.
 CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
 (In thousands, except per share amounts)
 (Unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2007	2006	2007	2006
Revenues:				
Software licenses	\$ 8,196	\$ 10,422	\$ 24,560	\$ 27,817
Software services	18,276	14,497	51,068	42,678
Maintenance	22,132	18,847	62,526	54,220
Appraisal services	4,927	4,920	16,514	14,727
Hardware and other	1,401	1,453	4,708	4,706
Total revenues	54,932	50,139	159,376	144,148
Cost of revenues:				
Software licenses	1,888	2,500	5,823	7,592
Acquired software	427	353	1,248	1,007
Software services and maintenance	26,737	22,647	77,505	67,341
Appraisal services	3,248	3,386	11,340	10,246
Hardware and other	1,002	1,096	3,471	3,397
Total cost of revenues	33,302	29,982	99,387	89,583
Gross profit	21,630	20,157	59,989	54,565
Selling, general and administrative expenses	12,691	12,421	38,448	35,578
Research and development expense	639	780	3,266	2,494
Amortization of customer and trade name intangibles	372	326	1,075	973
Operating income	7,928	6,630	17,200	15,520
Other income, net	441	306	1,252	603
Income before income taxes	8,369	6,936	18,452	16,123
Income tax provision	3,209	2,523	7,141	5,938
Net income	\$ 5,160	\$ 4,413	\$ 11,311	\$ 10,185
Earnings per common share:				
Basic	\$ 0.13	\$ 0.11	\$ 0.29	\$ 0.26

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Diluted	\$ 0.12	\$ 0.11	\$ 0.27	\$ 0.24
Basic weighted average common shares outstanding	38,688	38,705	38,717	38,947
Diluted weighted average common shares outstanding	41,395	41,898	41,673	41,911

See accompanying notes.

Table of Contents

TYLER TECHNOLOGIES, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except par value and share amounts)

	September 30, 2007 (Unaudited)	December 31, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 15,823	\$ 17,212
Restricted cash equivalents	4,462	4,962
Short-term investments available-for-sale	28,390	19,543
Accounts receivable (less allowance for losses of \$1,756 in 2007 and \$2,971 in 2006)	56,919	58,188
Prepaid expenses	6,401	6,864
Other current assets	2,487	2,326
Deferred income taxes	2,579	2,579
Total current assets	117,061	111,674
Accounts receivable, long-term portion	62	1,675
Property and equipment, net	9,556	7,390
Other assets:		
Goodwill	71,431	66,127
Customer related intangibles, net	18,080	17,502
Software, net	11,749	14,554
Trade name, net	1,103	1,188
Sundry	188	166
	\$ 229,230	\$ 220,276
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	\$ 3,759	\$ 5,063
Accrued liabilities	17,109	17,735
Deferred revenue	66,655	62,387
Total current liabilities	87,523	85,185
Deferred income taxes	8,130	9,216
Commitments and contingencies		
Shareholders equity:		
Preferred stock, \$10.00 par value; 1,000,000 shares authorized, none issued		

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Common stock, \$0.01 par value; 100,000,000 shares authorized; 48,147,969 shares issued in 2007 and 2006	481	481
Additional paid-in capital	148,641	151,627
Accumulated other comprehensive loss, net of tax	(4)	(10)
Retained earnings	29,442	18,131
Treasury stock, at cost; 9,300,843 and 9,255,783 shares in 2007 and 2006, respectively	(44,983)	(44,354)
Total shareholders' equity	133,577	125,875
	\$ 229,230	\$ 220,276

See accompanying notes.

Table of Contents

TYLER TECHNOLOGIES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Nine months ended September	
	2007	2006
Cash flows from operating activities:		
Net income	\$ 11,311	\$ 10,185
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	7,795	7,592
Share-based compensation expense	1,705	1,529
Purchased in-process research and development charge		140
Non-cash interest and other charges		307
Deferred income taxes		(141)
Changes in operating assets and liabilities, exclusive of effects of acquired companies:		
Accounts receivable	6,532	5,496
Income tax payable	(800)	(2,201)
Prepaid expenses and other current assets	504	(591)
Accounts payable	(1,465)	177
Accrued liabilities	(1,289)	(103)
Deferred revenue	245	297
Net cash provided by operating activities	24,538	22,687
Cash flows from investing activities:		
Proceeds from sale of short-term investments	21,103	14,691
Purchases of short-term investments	(29,940)	(14,966)
Cost of acquisitions, net of cash acquired	(9,005)	(12,237)
Investment in software development costs	(158)	(203)
Additions to property and equipment	(2,575)	(3,288)
Reduction in restricted investments	500	
Other	40	(6)
Net cash used by investing activities	(20,035)	(16,009)
Cash flows from financing activities:		
Purchase of treasury shares	(11,134)	(9,923)
Contributions from employee stock purchase plan	833	719
Proceeds from exercise of stock options	3,291	2,420
Excess tax benefits from share-based compensation expense	1,118	425
Net cash used by financing activities	(5,892)	(6,359)

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Net (decrease) increase in cash and cash equivalents	(1,389)	319
Cash and cash equivalents at beginning of period	17,212	20,733
Cash and cash equivalents at end of period	\$ 15,823	\$ 21,052

See accompanying notes.

3

Table of Contents

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, 2007 and December 31, 2006 and operating result amounts are for the three and nine months ended September 30, 2007 and 2006, 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, 2006. 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.

Although we have a number of divisions, separate segment data has not been presented as they meet the criteria set forth in Statement of Financial Accounting Standards (SFAS) No. 131, Disclosures About Segments of an Enterprise and Related Information to be presented as one segment.

In addition, certain other amounts for the previous year have been reclassified to conform to the current year presentation.

(2) Revenue Recognition

We recognize revenue related to our software arrangements pursuant to the provisions of Statement of Position (SOP) 97-2, Software Revenue Recognition, as amended by SOP 98-4 and SOP 98-9, and related interpretations, as well as the Securities and Exchange Commission (SEC) Staff Accounting Bulletin No. 104, Revenue Recognition. We recognize revenue on our appraisal services contracts using the proportionate performance method of accounting, with considerations for the provisions of Emerging Issues Task Force (EITF) No. 00-21, Revenue Arrangements with Multiple Deliverables.

Software Arrangements:

We earn revenue from software licenses, post-contract customer support (PCS or maintenance), software related services and hardware. PCS includes telephone support, bug fixes, and rights to upgrades on a when-and-if available basis. We provide services that range from installation, training, and basic consulting to software modification and customization to meet specific customer needs. In software arrangements that include rights to multiple software products, specified upgrades, PCS, and/or other services, we allocate the total arrangement fee among each deliverable based on the relative fair value of each.

We typically enter into multiple element arrangements, which include software licenses, software services, PCS and occasionally hardware. The majority of our software arrangements are multiple element arrangements, but for those arrangements that involve significant production, modification or customization of the software, or where software services are otherwise considered essential to the functionality of the software in the customer s environment, we use contract accounting and apply the provisions of SOP 81-1 Accounting for Performance of Construction Type and Certain Production Type Contracts.

If the arrangement does not require significant production, modification or customization or where the software services are not considered essential to the functionality of the software, revenue is recognized when all of the following conditions are met:

- i. persuasive evidence of an arrangement exists;
- ii. delivery has occurred;
- iii. our fee is fixed or determinable; and
- iv. collectibility is probable.

For multiple element arrangements, each element of the arrangement is analyzed and we allocate a portion of the total arrangement fee to the elements based on the fair value of the element using vendor-specific objective evidence of fair value (VSOE), regardless of any separate prices stated within the contract for each element. Fair value is considered the price a customer would

Table of Contents

be required to pay if the element was sold separately based on our historical experience of stand-alone sales of these elements to third parties. For PCS, we use renewal rates for continued support arrangements to determine fair value. For software services, we use the fair value we charge our customers when those services are sold separately. We monitor our transactions to insure we maintain and periodically revise VSOE to reflect fair value. In software arrangements in which we have the fair value of all undelivered elements but not of a delivered element, we apply the residual method as allowed under SOP 98-9 in accounting for any element of a multiple element arrangement involving software that remains undelivered such that any discount inherent in a contract is allocated to the delivered element. Under the residual method, if the fair value of all undelivered elements is determinable, the fair value of the undelivered elements is deferred and the remaining portion of the arrangement fee is allocated to the delivered element(s) and is recognized as revenue assuming the other revenue recognition criteria are met. In software arrangements in which we do not have VSOE for all undelivered elements, revenue is deferred until fair value is determined or all elements for which we do not have VSOE have been delivered. Alternatively, if sufficient VSOE does not exist and the only undelivered element is services that do not involve significant modification or customization of the software, the entire fee is recognized over the period during which the services are expected to be performed.

Software Licenses

We recognize the revenue allocable to software licenses and specified upgrades upon delivery of the software product or upgrade to the customer, unless the fee is not fixed or determinable or collectibility is not probable. If the fee is not fixed or determinable, including new customers whose payment terms are three months or more from shipment, revenue is generally recognized as payments become due from the customer. If collectibility is not considered probable, revenue is recognized when the fee is collected. Arrangements that include software services, such as training or installation, are evaluated to determine whether those services are essential to the product's functionality.

A majority of our software arrangements involve off-the-shelf software. We consider software to be off-the-shelf software if it can be added to an arrangement with minor changes in the underlying code and it can be used by the customer for the customer's purpose upon installation. For off-the-shelf software arrangements, we recognize the software license fee as revenue after delivery has occurred, customer acceptance is reasonably assured, that portion of the fee represents a non-refundable enforceable claim and is probable of collection, and the remaining services such as training are not considered essential to the product's functionality.

For arrangements that involve significant production, modification or customization of the software, or where software services are otherwise considered essential, we recognize revenue using contract accounting. We generally use the percentage-of-completion method to recognize revenue from these arrangements. We measure progress-to-completion primarily using labor hours incurred, or value added. The percentage-of-completion method generally results in the recognition of reasonably consistent profit margins over the life of a contract since we have the ability to produce reasonably dependable estimates of contract billings and contract costs. We use the level of profit margin that is most likely to occur on a contract. If the most likely profit margin cannot be precisely determined, the lowest probable level of profit in the range of estimates is used until the results can be estimated more precisely. These arrangements are often implemented over an extended time period and occasionally require us to revise total cost estimates. Amounts recognized in revenue are calculated using the progress-to-completion measurement after giving effect to any changes in our cost estimates. Changes to total estimated contract costs, if any, are recorded in the period they are determined. Estimated losses on uncompleted contracts are recorded in the period in which we first determine that a loss is apparent.

For arrangements that include new product releases for which it is difficult to estimate final profitability except to assume that no loss will ultimately be incurred, we recognize revenue under the completed contract method. Under the completed contract method, revenue is recognized only when a contract is completed or substantially complete.

Historically these amounts have been immaterial.

Software Services

Some of our software arrangements include services considered essential for the customer to use the software for the customer's purposes. For these software arrangements, both the software license revenue and the services revenue are recognized as the services are performed using the percentage-of-completion contract accounting method. When software services are not considered essential, the fee allocable to the service element is recognized as revenue as we perform the services.

Computer Hardware Equipment

Revenue allocable to computer hardware equipment, which is based on VSOE, is recognized when we deliver the equipment and collection is probable.

Table of Contents

Postcontract Customer Support

Our customers generally enter into PCS agreements when they purchase our software licenses. Our PCS agreements are typically renewable annually. Revenue allocated to PCS is recognized on a straight-line basis over the period the PCS is provided. All significant costs and expenses associated with PCS are expensed as incurred. Fair value for the maintenance and support obligations for software licenses is based upon the specific sale renewals to customers.

Appraisal Services:

For our property appraisal projects, we recognize revenue using the proportionate performance method of revenue recognition since many of these projects are implemented over one to three year periods and consist of various unique activities. Under this method of revenue recognition, we identify each activity for the appraisal project, with a typical project generally calling for bonding, office set up, training, routing of map information, data entry, data collection, data verification, informal hearings, appeals and project management. Each activity or act is specifically identified and assigned an estimated cost. Costs which are considered to be associated with indirect activities, such as bonding costs and office set up, are expensed as incurred. These costs are typically billed as incurred and are recognized as revenue equal to cost. Direct contract fulfillment activities and related supervisory costs such as data collection, data entry and verification are expensed as incurred. The direct costs for these activities are determined and the total contract value is then allocated to each activity based on a consistent profit margin. Each activity is assigned a consistent unit of measure to determine progress towards completion and revenue is recognized for each activity based upon the percentage complete as applied to the estimated revenue for that activity. Progress for the fulfillment activities is typically based on labor hours or an output measure such as the number of parcel counts completed for that activity. Estimated losses on uncompleted contracts are recorded in the period in which we first determine that a loss is apparent.

Other:

The majority of deferred revenue consists of unearned support and maintenance revenue that has been billed based on contractual terms in the underlying arrangement with the remaining balance consisting of payments received in advance of revenue being earned under software licensing, software and appraisal services and hardware installation. Unbilled revenue is not billable at the balance sheet date but is recoverable over the remaining life of the contract through billings made in accordance with contractual agreements. The termination clauses in most of our contracts provide for the payment for the fair value of products delivered and services performed in the event of an early termination.

Prepaid expenses and other current assets include direct and incremental costs, consisting primarily of commissions associated with arrangements for which revenue recognition has been deferred and third party subcontractor payments. Such costs are expensed at the time the related revenue is recognized.

(3) Acquisitions

In September 2007, we completed the acquisition of all the capital stock of EDP Enterprises, Inc. (EDP), which develops and sells financial and student information and management systems for public school districts in Texas. The total purchase price, including transaction costs and excluding cash balances acquired, was \$3.9 million in cash.

In February 2007, we completed the acquisition of all of the capital stock of Advanced Data Systems, Inc. (ADS), which develops and sells fund accounting solutions, primarily in New England. The total purchase price, including transaction costs along with an office building used in the business, was approximately \$4.2 million in

cash. In January 2007 we also purchased certain software assets to enhance our courts and justice product line for approximately \$756,000 in cash, including transaction costs.

We believe these acquisitions will complement our business model by broadening our customer base and will give us additional opportunities to provide our customers with solutions tailored specifically for the public sector.

In connection with these three transactions we acquired total assets of approximately \$5.3 million and assumed total liabilities of approximately \$4.9 million. We recorded goodwill of \$5.3 million, of which \$2.4 million is expected to be deductible for tax purposes, and other intangible assets of \$3.3 million. The \$3.3 million of intangible assets is attributable to acquired software and customer relationships that will be amortized over a weighted average period of approximately 6 years. Our consolidated balance sheet as of September 30, 2007 reflects the allocation of the purchase price to the assets acquired and liabilities assumed based on

Table of Contents

their estimated fair values at the dates of acquisition. The EDP purchase price allocation is preliminary. The operating results of these acquisitions are included in our results of operations since their respective dates of acquisition.

(4) Shareholders' Equity

The following table details activity in our common stock:

	Nine months ended September 30,			
	2007		2006	
	Shares	Amount	Shares	Amount
Purchases of common stock	(889)	\$(11,134)	(987)	\$(9,923)
Stock option exercises	767	3,291	526	2,420
Employee stock plan purchases	77	853	80	700
Shares issued for acquisitions			325	2,891

As of September 30, 2007, we have authorization from our board of directors to repurchase up to 2.1 million shares of Tyler common stock.

(5) Income Tax Provision

The following table sets forth a comparison of our income tax provision for the following periods:

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2007	2006	2007	2006
Income tax provision	\$3,209	\$2,523	\$7,141	\$5,938
Effective income tax rate	38.3%	36.4%	38.7%	36.8%

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.

The effective tax rate for the three months ended September 30, 2006 included the benefit from previously unclaimed tax credits resulting from the completion of state income tax audits. The effective tax rate for the nine months ended September 30, 2006 also included the benefit of changes in the Texas franchise tax law and related rates enacted in the second quarter of 2006.

We made federal and state income tax payments, net of refunds, of \$6.9 million in the nine months ended September 30, 2007, compared to \$7.9 million in net payments for the same period of the prior year.

We adopted the provisions of Financial Standards Accounting Board Interpretation (FIN) No. 48, Accounting for Uncertainty in Income Taxes, on January 1, 2007. As a result of the implementation of FIN 48, we recognized no material adjustments in the liability for unrecognized income tax benefits. At the adoption date we did not have any unrecognized tax benefits and did not have any interest or penalties accrued.

We are subject to United States federal tax as well as income tax of multiple state and local jurisdictions. We are no longer subject to United States federal income tax examinations for years before 2004 and are no longer subject to state and local income tax examinations by tax authorities for the years before 2002. The Internal Revenue Service concluded an examination of our United States federal tax return for 2005 in the second quarter of 2007, which did not result in any material adjustments.

Table of Contents**(6) 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,	
	2007	2006	2007	2006
Numerator for basic and diluted earnings per share:				
Net income	\$ 5,160	\$ 4,413	\$ 11,311	\$ 10,185
Denominator:				
Weighted-average basic common shares outstanding	38,688	38,705	38,717	38,947
Assumed conversion of dilutive securities:				
Stock options	1,685	1,921	1,753	1,734
Warrants	1,022	1,272	1,203	1,230
Potentially dilutive common shares	2,707	3,193	2,956	2,964
Denominator for diluted earnings per share Adjusted weighted-average shares	41,395	41,898	41,673	41,911
Earnings per common share:				
Basic	\$ 0.13	\$ 0.11	\$ 0.29	\$ 0.26
Diluted	\$ 0.12	\$ 0.11	\$ 0.27	\$ 0.24

Effective September 10, 2007, warrants to purchase 1.6 million shares of common stock at \$2.50 per share expired and the effect of these warrants is not included in the potentially dilutive common shares after that date. See Note 8 Commitments and Contingencies for further information.

(7) Share-Based Compensation**Share-based compensation plan**

We have a stock option plan that provides for the grant of stock options to key employees, directors and non-employee consultants. Stock options vest after three to five years of continuous service from the date of grant and have a contractual term of ten years. Once options become exercisable, the employee can purchase shares of our common stock at the market price on the date we granted the option. Effective January 1, 2006, we adopted the provisions of SFAS No. 123R, Share-Based Payment, which establishes accounting for share-based awards exchanged for employee services, using the modified prospective application transition method. Under this transition method, compensation cost recognized in 2007 and 2006 includes the applicable amounts of:

- (a) compensation cost of all share-based payments granted prior to, but not yet vested as of, January 1, 2006 (based on the grant-date fair value estimated in accordance with the original provisions of SFAS No. 123, Accounting for Stock-Based Compensation, and previously presented in the pro forma footnote disclosures), and
- (b) compensation cost for all share-based payments granted subsequent to January 1, 2006 (based on the grant-date fair value estimated in accordance with the new provisions of SFAS No. 123R).

Determining Fair Value Under SFAS No. 123R

Valuation and Amortization Method. We estimate the fair value of share-based awards granted using the Black-Scholes option valuation model. We amortize the fair value of all awards on a straight-line basis over the requisite service periods, which are generally the vesting periods.

8

Table of Contents

Expected Life. The expected life of awards granted represents the period of time that they are expected to be outstanding. We determine the expected life using the simplified method in accordance with Staff Accounting Bulletin No. 107.

Expected Volatility. Using the Black-Scholes option valuation model, we estimate the volatility of our common stock at the date of grant based on the historical volatility of our common stock.

Risk-Free Interest Rate. We base the risk-free interest rate used in the Black-Scholes option valuation model on the implied yield currently available on U.S. Treasury zero-coupon issues with an equivalent remaining term equal to the expected life of the award.

Expected Dividend Yield. We have not paid any cash dividends on our common stock in the last ten years and we do not anticipate paying any cash dividends in the foreseeable future. Consequently, we use an expected dividend yield of zero in the Black-Scholes option valuation model.

Expected Forfeitures. We use historical data to estimate pre-vesting option forfeitures. We record stock-based compensation only for those awards that are expected to vest.

We did not grant any options during the three months ended September 30, 2007. We granted options for 120,000 shares during the three months ended September 30, 2006.

The following weighted average assumptions were used for options granted during the three months ended September 30:

	2007	2006
Expected life (in years)		6.5
Expected volatility	%	44.7%
Risk-free interest rate	%	5.0%
Expected forfeiture rate	%	3%

Share-Based Compensation Under SFAS No. 123R

The following table summarizes share-based compensation expense related to share-based awards under SFAS No. 123R recorded in the statements of operations:

	Three months ended September 30,		Nine months ended September 30,	
	2007	2006	2007	2006
Cost of software services and maintenance	\$ 59	\$ 37	\$ 158	\$ 110
Selling, general and administrative expenses	573	517	1,547	1,419
Total share-based compensation expense	\$ 632	\$ 554	\$ 1,705	\$ 1,529

(8) Commitments and Contingencies

As of June 30, 2007, we had warrants outstanding to purchase 1.6 million shares of common stock at \$2.50 per share, which were held by Bank of America, N. A. (BOA) pursuant to the terms of two Amended and Restated Stock Purchase Warrants (collectively, the Warrants). The exercise price could be paid either in cash or by a cashless exercise in which the holder was required to surrender the Warrants in exchange for warrant shares based on the following formula: $[(\text{Market Price} - \$2.50) / (\text{Market Price})] \times 1.6$ million shares, with the Market Price calculated as the immediately preceding 60-day trading average of our common stock. The Warrants identified specific exercise procedures for each method of exercise and further provided that any exercise would not be

effective until we received all applicable documents, instruments, and the purchase price. The Warrants were originally issued on September 10, 1997 and were exercisable from that date until 5:00 p.m., Central Time, on September 10, 2007, when they expired.

On September 10, 2007, at 4:44 p.m., BOA attempted to effectuate a cashless exercise of the Warrants via email; however, we believe BOA did not comply with all of the requirements set forth in the Warrants for an effective exercise. At 5:37 p.m., Central Time, BOA recalled this email exercise notice, which we subsequently accepted. At 6:10 p.m., Central Time, BOA attempted to

Table of Contents

effectuate a cash exercise of the Warrants by emailing a different notice of exercise, which we believe also failed to comply with all of the requirements set forth in the Warrants for an effective exercise, and in any event, was after the expiration date of the Warrants. As a result, we believe these Warrants expired as of September 10, 2007 and have excluded the effect of the Warrants from potentially dilutive common shares as of such date in our earnings per share computation.

On October 12, 2007, we filed a declaratory judgment action against BOA in the District Court of Dallas County, Texas, 101st Judicial District requesting the court to declare, among other things, that the Warrants have expired pursuant to their terms. As of the date of this Form 10-Q, BOA has not filed a response to the litigation. While we believe the Warrants expired as of September 10, 2007, there can be no assurance as to the ultimate resolution of this matter.

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

(9) Recent Accounting Pronouncements

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements . SFAS No. 157 defines fair value, establishes a framework for measuring fair value in accordance with accounting principles generally accepted in the United States, and expands disclosures about fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007, with earlier application encouraged. Any amounts recognized upon adoption as a cumulative effect adjustment will be recorded to the opening balance of retained earnings in the year of adoption. We have not yet determined the impact of SFAS No. 157 on our financial condition and results of operations.

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

The statements in this discussion that are not historical statements are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements include statements about our business, financial condition, business strategy, plans and the objectives of our management, and future prospects. In addition, we have made in the past and may make in the future other written or oral forward-looking statements, including statements regarding future operating performance, short- and long-term revenue and earnings growth, the timing of the revenue and earnings impact for new contracts, backlog, the value of new contract signings, business pipeline, and industry growth rates and our performance relative thereto. Any forward-looking statements may rely on a number of assumptions concerning future events and be subject to a number of uncertainties and other factors, many of which are outside our control, which could cause actual results to differ materially from such statements. These include, but are not limited to: our ability to improve productivity and achieve synergies from acquired businesses; technological risks associated with the development of new products and the enhancement of existing products; changes in the budgets and regulating environments of our government customers; competition in the industry in which we conduct business and the impact of competition on pricing, revenues and margins; with respect to customer contracts accounted for under the percentage-of-completion method of accounting, the performance of such contracts in accordance with our cost and revenue estimates; our ability to maintain health and other insurance coverage and capacity due to changes in the insurance market and the impact of increasing insurance costs on the results of operations; the costs to attract and retain qualified personnel, changes in product demand, the availability of products, economic conditions, costs of compliance with corporate governance and public disclosure requirements as issued by the Sarbanes-Oxley Act of 2002 and New York Stock Exchange rules, changes in tax risks and other risks indicated in our filings with the Securities and Exchange Commission. The factors described in this paragraph and other factors that may affect Tyler, our management or future financial results, as and when applicable, are discussed in our filings with the Securities and Exchange Commission, on its Form 10-K for the year ended December 31, 2006. Except to the extent required by law, we are

not obligated to update or revise any forward-looking statements whether as a result of new information, future events or otherwise. When used in this Quarterly Report, the words believes, plans, estimates, expects, anticipa intends, continue, may, will, should, projects, forecast, might, could or the negative of such terms expressions as they relate to Tyler or our management are intended to identify forward-looking statements.

Table of Contents

GENERAL

We provide integrated information management solutions and services for local governments. We develop and market a broad line of software solutions and services to address the information technology (IT) needs of cities, counties, schools and other local government entities. In addition, we provide professional IT services to our customers, including software and hardware installation, data conversion, training and for certain customers, product modifications, along with continuing maintenance and support for customers using our systems. We also provide property appraisal outsourcing services for taxing jurisdictions.

In September 2007, we completed the acquisition of all the capital stock of EDP Enterprises, Inc. (EDP), which develops and sells financial and student information management systems for public school districts in Texas. The total purchase price, including transaction costs and excluding acquired cash balances, was \$3.9 million in cash. In the first quarter of 2007, we acquired one company, Advanced Data Systems, Inc. (ADS), as well as certain software assets to enhance our courts and justice product line. The combined purchase price for ADS and the software assets was approximately \$5.1 million in cash. In connection with these three transactions we acquired total assets of approximately \$5.3 million and assumed total liabilities of approximately \$4.9 million. We recorded goodwill of \$5.3 million and other intangible assets of \$3.3 million. See Note 3 in the Notes to the Unaudited Condensed Consolidated Financial Statements.

As of September 30, 2007, our total full-time equivalent employee count increased to 1,640 from 1,474 at September 30, 2006. Approximately one-half of these additions were to our implementation and support staff, including additions to our capacity to deliver our backlog, particularly for our Odyssey courts and justice solutions. Our implementation and support staff at September 30, 2007 includes 73 full-time equivalent employees added as a result of several acquisitions completed in the first nine months of 2007.

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. 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, 2006. There have been no material changes to our critical accounting policies and estimates from the information provided in our 10-K for the year ended December 31, 2006, except as follows:

We account for uncertain tax positions in accordance with Financial Accounting Standards Board (FASB) Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109. The application of income tax law is inherently complex. Laws and regulations in this area are voluminous and are often ambiguous. As such, we are required to make many subjective assumptions and judgments regarding our income tax exposures. Interpretations of and guidance surrounding income tax laws and regulations change over time. Changes in our subjective assumptions and judgments can materially affect amounts recognized in the consolidated balance sheets and statements of income. See Note 5 in the Notes to the Unaudited Condensed Consolidated Financial Statements for additional detail.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements . SFAS No. 157 defines fair value, establishes a framework for measuring fair value in accordance with accounting principles generally accepted in the

United States, and expands disclosures about fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007, with earlier application encouraged. Any amounts recognized upon adoption as a cumulative effect adjustment will be recorded to the opening balance of retained earnings in the year of adoption. We have not yet determined the impact of SFAS No. 157 on our financial condition and results of operations.

Table of Contents

ANALYSIS OF RESULTS OF OPERATIONS

Revenues

The following table sets forth the key components of our revenues for the periods presented as of September 30:

(\$in thousands)	2007	Third Quarter		% Increase/		Nine Months		% Increase/		
		% of Total	2006	% of Total	(Decrease)	% of Total	2006	% of Total	(Decrease)	
Software licenses	\$ 8,196	15%	\$ 10,422	21%	(21)%	\$ 24,560	16%	\$ 27,817	19%	(12)%
Software services	18,276	33	14,497	29	26	51,068	32	42,678	30	20
Maintenance	22,132	40	18,847	37	17	62,526	39	54,220	38	15
Appraisal services	4,927	9	4,920	10		16,514	10	14,727	10	12
Hardware and other	1,401	3	1,453	3	(4)	4,708	3	4,706	3	
Total revenues	\$ 54,932	100%	\$ 50,139	100%	10%	\$ 159,376	100%	\$ 144,148	100%	11%

Software licenses. Software license revenues consist of the following components for the periods presented as of September 30:

(\$in thousands)	2007	Third Quarter		% Increase/		Nine Months		% Increase/		
		% of Total	2006	% of Total	(Decrease)	% of Total	2006	% of Total	(Decrease)	
Financial management	\$ 6,383	78%	\$ 7,677	74%	(17)%	\$ 17,753	72%	\$ 20,874	75%	(15)%
Courts and justice	915	11	1,501	14	(39)	3,989	16	3,679	13	8
Appraisal and tax and other	898	11	1,244	12	(28)	2,818	12	3,264	12	(14)
Total software license revenues	\$ 8,196	100%	\$ 10,422	100%	(21)%	\$ 24,560	100%	\$ 27,817	100%	(12)%

In the three months ended September 30, 2007 we signed 26 material new contracts with average software license fees of approximately \$319,000 compared to 23 material new contracts signed in the three months ended September 30, 2006 with average software license fees of approximately \$230,000. In the nine months ended September 30, 2007 we signed 59 material new contracts with average software license fees of approximately \$447,000 compared to 64 material new contracts signed in the nine months ended September 30, 2006 with average software license fees of approximately \$309,000. We consider contracts with a license fee component of \$100,000 or more to be material. Although a contract is signed in a particular quarter, the period in which the revenue is recognized may be different because we recognize revenue according to our revenue recognition policy as described in Note 2 in the Unaudited Condensed Consolidated Financial Statements.

Changes in software license revenues consist of the following components:

Software license revenue related to our financial management solutions for the three and nine months ended September 30, 2007 decreased 17% and 15%, respectively compared to the prior year periods. In the three months ended September 30, 2007, the number of customers choosing our subscription-based options, rather than purchasing the software under a traditional perpetual software license arrangement, represented a relatively small percentage of new customers; however, the size of those contracts was larger than in the prior year period. Subscription-based arrangements result in lower software license revenues in the initial year as compared to traditional perpetual software license arrangement but generate higher overall revenues over the term of the contract. The decline in software license for the nine months ended September 30, 2007 compared to the prior year period was also impacted by a large installation of our MUNIS financial management application in the United States Virgin Islands in the second quarter of 2006 and a product mix in 2007 that required less third party software.

Table of Contents

Software license revenue related to our courts and justice software solutions declined 39% for the three months ended September 30, 2007, and increased 8% for the nine months ended September 30, 2007 compared to the prior year periods. Although the number of active Odyssey contracts has increased by almost 50%, the software license revenue recognition for several of the larger arrangements will be deferred until 2008 in accordance with our revenue recognition policy and terms of the contracts.

Software services. Changes in software services revenues consist of the following components:

Software services revenue related to financial management solutions, which comprises more than half of our software services revenue in the periods presented, experienced strong increases compared to the three and nine months ended September 30, 2006. Approximately one-half of these increases were due to new customers for our subscription-based application service provider hosted arrangements and disaster recovery services. While this does not represent a fundamental change in our business model, we provide our solutions to clients under a variety of innovative options that address their specific needs. Government is relatively deliberate in its pace of change, but over time, we expect to generate significant subscription-based revenue. Our current annualized revenue run rate for these subscription services is approximately \$8.5 million, and we expect the new subscription contracts signed in the three months ended September 30, 2007, will increase the annualized run rate in future quarters to more than \$10.8 million. We have also added to our implementation staff over the last twelve months, which has enabled us to deliver our backlog at a faster rate.

Software services revenue related to our Odyssey courts and justice solutions experienced substantial increases compared to the three and nine months ended September 30, 2006, reflecting increased contract volume. We had approximately 35 Odyssey contracts in the first nine months of 2007 compared to approximately 20 Odyssey contracts in the first nine months of 2006.

Software services revenue related to appraisal and tax and other solutions, which comprise approximately 20% of our software services revenue in the periods presented, had strong increases for the three and nine months ended September 30, 2007 compared to the prior year periods. The majority of the increase is related to one large appraisal and tax software implementation, which is expected to be substantially complete by December 31, 2007.

Maintenance. We provide maintenance and support services for our software products and third party software. Maintenance revenues increased over the prior year periods due to growth in our installed customer base and slightly higher maintenance rates on most of our solutions.

Appraisal services. Appraisal services are project-oriented and are driven in part by revaluation cycles in various states. Appraisal services revenue for the three months ended September 30, 2007 was flat compared to the prior year period and 12% higher for the nine months ended September 30, 2007 compared to the prior year period. The year-to-date increase was due to activity related to Ohio's revaluation cycle, which occurs every six years, and a \$4.0 million contract with Fulton County, Georgia, which began late in 2006. The Ohio revaluation projects began with smaller counties late in the first quarter of 2006 and expanded to larger counties by the third quarter of 2006. A substantial portion of the Ohio revaluation projects was complete by September 30, 2007. The level of appraisal services revenues for 2008 will depend on our ability to replace the appraisal services revenues associated with the Ohio revaluation.

Table of ContentsCost of Revenues and Gross Margins

The following table sets forth a comparison of the key components of our cost of revenues, and those components stated as a percentage of related revenues for the periods presented as of September 30:

(\$ in thousands)	2007	Third Quarter		% of Related Revenues	2007	Nine Months		% of Related Revenues
		% of Related Revenues	2006			% of Related Revenues	2006	
Software licenses	\$ 1,888	23%	\$ 2,500	24%	\$ 5,823	24%	\$ 7,592	27%
Acquired software	427	5	353	3	1,248	5	1,007	4
Software services and maintenance	26,737	66	22,647	68	77,505	68	67,341	69
Appraisal services	3,248	66	3,386	69	11,340	69	10,246	70
Hardware and other	1,002	72	1,096	75	3,471	74	3,397	72
Total cost of revenue	\$ 33,302	61%	\$ 29,982	60%	\$ 99,387	62%	\$ 89,583	62%

The following table sets forth a comparison of gross margin percentage by revenue type for the periods presented as of September 30:

Gross Margin percentages	2007	Third Quarter			2007	Nine Months	
		2006	Change	2006		Change	
Software licenses & acquired software	71.8%	72.6%	(0.8)%	71.2%	69.1%	2.1%	
Software services and maintenance	33.8	32.1	1.7	31.8	30.5	1.3	
Appraisal services	34.1	31.2	2.9	31.3	30.4	0.9	
Hardware and other	28.5	24.6	3.9	26.3	27.8	(1.5)	
Overall gross margin	39.4%	40.2%	(0.8)%	37.6%	37.9%	(0.3)%	

Software license revenues. The main component of our cost of software license revenues is amortization expense for capitalized development costs on certain software products, with third party software costs making up the balance. Once a product is released, we begin to amortize, over the estimated useful life of the product, the costs associated with its development. Amortization expense is determined on a product-by-product basis at an annual rate not less than straight-line basis over the product's estimated life, which is generally five years. Development costs consist mainly of personnel costs, such as salary and benefits paid to our developers, and rent for related office space. For the nine months ended September 30, 2007, our software license gross margin percentage increased slightly compared to the prior year period due to lower amortization expense of software development costs because some products became fully amortized during the first quarter of 2006. Additionally our product mix in the first nine months of 2007 included less third party software, which has higher associated costs than proprietary software.

Software services and maintenance revenues. Cost of software services and maintenance primarily consists of personnel costs related to installation of our software, conversion of customer data, training customer personnel and support activities. For the three months and nine months ended September 30, 2007, the software services and maintenance gross margin percentage was slightly higher than the comparable prior year periods because maintenance costs typically grow at a slower rate than related revenues due to leverage in the utilization of our support and

maintenance staff and economies of scale. We have increased our implementation and support staff by 163 full-time equivalent employees since September 30, 2006. This increase includes 73 additional employees related to acquisitions completed in the first nine months of 2007. The remaining additions were to increase our capacity to train and deliver our contract backlog, particularly for our Odyssey courts and justice solutions.

Table of Contents

Appraisal services. Higher revenues associated with increased activity on the Ohio revaluation projects contributed to the slight appraisal services gross margin percentage increase.

Our blended gross margin for the three months ended September 30, 2007 declined .8% compared to the prior year period due to a revenue mix that included less software license. Software license revenue inherently has higher gross margins than other revenues such as professional services and hardware. Although the revenue mix for the nine months ended September 30, 2007 also included less software license than the prior year period, the negative impact on the gross margin was offset by lower amortization expense of software development costs as well as lower third party software costs described above.

Selling, General and Administrative Expenses

The following table sets forth a comparison of our selling, general and administrative expenses (SG&A) for the periods presented as of September 30:

(\$ in thousands)	Third Quarter		Change		Nine Months		Change	
	2007	2006	\$	%	2007	2006	\$	%
Selling, general and administrative expenses	\$12,691	\$12,421	\$270	2%	\$38,448	\$35,578	\$2,870	8%
Percent of revenues	23.1%	24.8%			24.1%	24.7%		

For the three months ended September 30, 2007, SG&A costs grew at a slower rate than revenues due to leverage in the utilization of our administrative and sales staff.

Research and Development Expense

The following table sets forth a comparison of our research and development expense for the periods presented as of September 30:

(\$ in thousands)	Third Quarter		Change		Nine Months		Change	
	2007	2006	\$	%	2007	2006	\$	%
Research and development expense	\$639	\$780	(\$141)	(18)%	\$3,266	\$2,494	\$772	31%
Percent of revenues	1.2%	1.6%			2.0%	1.7%		

For the three and nine months ended September 30, 2007, research and development expense included costs associated with the Microsoft Dynamics AX project, in addition to costs associated with other new product development efforts. In January 2007 we entered into a strategic alliance with Microsoft Corporation (Microsoft) to jointly develop core public sector functionality for Microsoft Dynamics AX to address the accounting needs of public sector organizations worldwide. In September 2007, we amended the agreement with Microsoft. Under the amended agreement, Microsoft will assist in funding our Microsoft Dynamics AX development costs in exchange for intellectual property rights for use outside the public sector. We are accounting for this funding from Microsoft as a funded development activity. In the three months ended September 30, 2007, we reduced our research and development expense by \$880,000, which was the amount earned under the terms of the contract with Microsoft. We anticipate these costs and associated reimbursements from Microsoft will continue into 2009; however, the actual amount and timing of those costs and related reimbursements from Microsoft and whether they are capitalized or expensed, may vary.

Amortization of Customer and Trade Name Intangibles

Acquisition intangibles are comprised of the excess of the purchase price over the fair value of net tangible assets acquired that is allocated to acquired software and customer and trade name intangibles. The remaining excess purchase price is allocated to goodwill that is not subject to amortization. Amortization expense related to acquired software is included with cost of revenues

Table of Contents

while amortization expense of customer and trade name intangibles is recorded as a non-operating expense. The following table sets forth a comparison of amortization of customer and trade name intangibles for the periods presented as of September 30:

(\$ in thousands)	Third Quarter		Change		Nine Months		Change	
	2007	2006	\$	%	2007	2006	\$	%
Amortization of customer and trade name intangibles	\$372	\$326	\$46	14%	\$1,075	\$973	\$102	10%

In the first nine months of 2007, we completed three acquisitions, which increased amortizable customer intangibles by \$3.3 million. This amount will be amortized over a weighted average period of approximately 6 years.

Income Tax Provision

The following table sets forth comparison of our income tax provision for the periods presented as of September 30:

(\$ in thousands)	Third Quarter		Change		Nine Months		Change	
	2007	2006	\$	%	2007	2006	\$	%
Income tax provision	\$3,209	\$2,523	\$686	27%	\$7,141	\$5,938	\$1,203	20%

Effective income tax rate

	38.3%	36.4%		38.7%	36.8%
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The effective income tax rates for the three and nine months ended September 30, 2007 and 2006 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.

The effective tax rate for the three months ended September 30, 2006 included the benefit from previously unclaimed tax credits resulting from the completion of state income tax audits. The effective tax rate for the nine months ended September 30, 2006 also included the benefit of changes in the Texas franchise tax law and related rates enacted in the second quarter of 2006.

FINANCIAL CONDITION AND LIQUIDITY

As of September 30, 2007, we had cash and cash equivalents (including restricted cash equivalents) of \$20.3 million and short-term investments of \$28.4 million, compared to cash and cash equivalents (including restricted cash equivalents) of \$22.2 million and short-term investments of \$19.5 million at December 31, 2006. As of September 30, 2007 we had outstanding letters of credit totaling \$4.5 million to secure surety bonds required by some of our customer contracts. These letters of credit expire through mid-2008.

The following table sets forth a summary of cash flows for the periods presented as of September 30:

Nine Months Ended September 30,	2007	2006
Cash flows provided by (used by):		
Operating activities	\$ 24,538	\$ 22,687
Investing activities	(20,035)	(16,009)
Financing activities	(5,892)	(6,359)
Net (decrease) increase in cash and cash equivalents	\$ (1,389)	\$ 319

Table of Contents*Operating Activities*

Net cash provided by operating activities continues to be our primary source of funds to finance operating needs and capital expenditures. Other capital resources include cash on hand and access to the capital markets. For the nine months ended September 30, 2007, operating activities provided net cash of \$24.5 million, primarily generated from net income of \$11.3 million, non-cash depreciation and amortization charges of \$7.8 million, and non-cash share-based compensation expense of \$1.7 million, and a net decrease in operating assets and liabilities of \$3.7 million. The operating asset decline mainly relates to the timing of collection of annual maintenance renewals that are billed near the end of June.

Our days sales outstanding (DSO) was 93 days at September 30, 2007 and 102 days at December 31, 2006. DSO decreased compared to the fourth quarter of 2006 because of annual maintenance billing collections. Our maintenance billings typically peak in December and June of each year and are followed by collections in the subsequent quarter. DSO is calculated based on total accounts receivable divided by the quotient of annualized quarterly revenues divided by 360 days.

For the nine months ended September 30, 2006 operating activities provided net cash of \$22.7 million, primarily generated from net income of \$10.2 million, non-cash depreciation and amortization charges of \$7.6 million, and non-cash share-based compensation expense of \$1.5 million, and by a net decline in operating assets and liabilities of \$3.1 million. The net decrease in operating assets and liabilities is attributable to timing of cash receipts related to annual maintenance billings.

For the nine months ended September 30, 2007, net cash used by investing activities of \$20.0 million includes cash payments of \$9.0 million for the acquisitions of EDP Enterprises, Inc., Advanced Data Systems, Inc. and certain software assets to enhance our courts and justice product line. In addition, investing activities includes \$8.8 million, net of sales, to purchase short-term investments and \$2.6 million in property and equipment. The property and equipment increase was due to expenditures related to computer hardware and software and other asset additions to support internal growth.

For the nine months ended September 30, 2006 net cash used by investing activities of \$16.0 million includes cash payments of \$12.2 million for two acquisitions, MazikUSA Inc. and TACS, Inc. In addition, we spent \$3.3 million for property and equipment related to computer hardware and software, including a new enterprise-wide customer relationship management system, and other asset additions to support internal growth.

For the nine months ended September 30, 2007 and 2006, net cash used in financing activities was \$5.9 million and \$6.4 million, respectively, and was attributable to purchases of treasury shares, net of proceeds from stock option exercises and employee stock purchase plan activity.

During the nine months ended September 30, 2007, we purchased 889,000 shares of our common stock for an aggregate purchase price of \$11.1 million. A summary of the repurchase activity during the nine months ended September 30, 2007 is as follows:

Period	Total number of shares repurchased	Additional number of shares authorized that may be repurchased	Average price paid per share	Maximum number of shares that may be repurchased under current authorization
January 1 through January 31	131		\$ 13.92	900
February 1 through February 28	92		13.63	808
March 1 through March 31	67		13.05	741
April 1 through April 30	60		12.01	681

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Additional authorization by the board of directors		2,000		2,681
May 1 through May 31	539		11.99	2,142
June 1 through June 30				2,142
July 1 through July 31				2,142
August 1 through August 31				2,142
September 1 through September 30				2,142
Total nine months ended September 30, 2007	889	2,000	\$ 12.52	

The repurchase program, which was approved by our board of directors, was announced in October 2002, and was amended in

Table of Contents

April and July 2003, October 2004, October 2005 and May 2007. On May 17, 2007, our board of directors authorized the repurchase of an additional 2.0 million shares of our common stock. As of September 30, 2007 we had remaining authorization to repurchase up to 2.1 million additional shares of our common stock. There is no expiration date specified for the authorization and we intend to repurchase stock under the plan from time to time in the future.

We made federal and state income tax payments, net of refunds of \$6.9 million in the nine months ended September 30, 2007 compared to \$7.9 million in the comparable prior year.

From time to time we engage in discussions with potential acquisition candidates. In order to consummate any such opportunities, which could require significant commitments of capital, we may be required to incur debt or issue additional potentially dilutive securities in the future. No assurance can be given as to our future acquisitions and how such acquisitions may be financed. In the absence of future acquisitions, we believe our current cash balances and expected future cash flows from operations will be sufficient to meet our anticipated cash needs for working capital, capital expenditures and other activities through the next twelve months. If operating cash flows are not sufficient to meet our needs, we believe that credit would be available to us.

ITEM 3. Quantitative and Qualitative Disclosures About Market Risk

Market risk represents the risk of loss that may affect us due to adverse changes in financial market prices and interest rates. As of September 30, 2007, we had funds invested in auction rate municipal securities and state and municipal bonds, which were accounted for in accordance with SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities. These investments were treated as available-for-sale under SFAS No. 115. The carrying value of these investments approximates fair market value. Due to the nature of these investments, we are not subject to significant market rate risk.

We have no outstanding debt at September 30, 2007, and are therefore not subject to any interest rate risk.

ITEM 4. Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures designed to ensure that we are able to collect the information we are required to disclose in the reports we file with the Securities and Exchange Commission (SEC), and to process, summarize and disclose this information within the time periods specified in the rules of the SEC. Based on an evaluation of our disclosure controls and procedures as of the end of the period covered by this report conducted by our management, with the participation of the Chief Executive Officer and the Chief Financial Officer, the Chief Executive Officer and Chief Financial Officer believe that these controls and procedures are effective to ensure that we are able to collect, process and disclose the information we are required to disclose in the reports we file with the SEC within the required time periods.

Part II. OTHER INFORMATION**ITEM 1. Legal Proceedings**

As of June 30, 2007, we had warrants outstanding to purchase 1.6 million shares of common stock at \$2.50 per share, which were held by Bank of America, N. A. (BOA) pursuant to the terms of two Amended and Restated Stock Purchase Warrants (collectively, the Warrants). The exercise price could be paid either in cash or by a cashless exercise in which the holder was required to surrender the Warrants in exchange for warrant shares based on the following formula: $[(\text{Market Price} - \$2.50) / (\text{Market Price})] \times 1.6$ million shares, with the Market Price calculated as the immediately preceding 60-day trading average of our common stock. The Warrants identified specific exercise procedures for each method of exercise and further provided that any exercise would not be effective until we received all applicable documents, instruments, and the purchase price. The Warrants were originally issued on September 10, 1997 and were exercisable from that date until 5:00 p.m., Central Time, on September 10, 2007, when they expired. On September 10, 2007, at 4:44 p.m., BOA attempted to effectuate a cashless exercise of the Warrants via email; however, we believe BOA did not comply with all of the requirements set forth in the Warrants for an effective exercise. At 5:37 p.m., Central Time, BOA recalled this email exercise notice, which we subsequently accepted. At 6:10 p.m., Central Time, BOA attempted to effectuate a cash exercise of the Warrants by emailing a different notice of exercise, which we believe also failed to comply with all of the requirements set forth in the Warrants for an effective exercise, and in any event, was after the expiration date of the Warrants. As a result, we believe these Warrants expired as of September 10, 2007 and have excluded the effect of the Warrants from potentially dilutive common shares as of such date in our earnings per share computation.

Table of Contents

On October 12, 2007, we filed a declaratory judgment action against BOA in the District Court of Dallas County, Texas, 101st Judicial District requesting the court to declare, among other things, that the Warrants have expired pursuant to their terms. As of the date of this Form 10-Q, BOA has not filed a response to the litigation. While we believe the Warrants expired as of September 10, 2007, there can be no assurance as to the ultimate resolution of this matter.

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

ITEM 1A. Risk Factors

No material changes.

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

None

ITEM 3. Defaults Upon Senior Securities

None

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

None

ITEM 5. Other Information

None

ITEM 6. Exhibits

Exhibit 31.1 Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

Exhibit 31.2 Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

Exhibit 32.1 Certifications Pursuant to 18 U.S.C. Section 1350, as adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Table of Contents

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.

TYLER TECHNOLOGIES, INC.

By: /s/ Brian K. Miller
Brian K. Miller
Senior Vice President and Chief
Financial Officer (principal financial
officer and an authorized signatory)

Date: October 22, 2007

20