

TYLER TECHNOLOGIES INC

Form 10-Q

April 29, 2010

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**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 March 31, 2010

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 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 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 Smaller Reporting Company
(Do not check if a 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

The number of shares of common stock of registrant outstanding on April 27, 2010 was 35,008,809.

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ITEM 1. Financial Statements

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

| | Three months ended March 31, | |
|---|---------------------------------|-----------|
| | 2010 | 2009 |
| Revenues: | | |
| Software licenses | \$ 8,449 | \$ 10,756 |
| Subscriptions | 5,253 | 3,976 |
| Software services | 17,056 | 19,232 |
| Maintenance | 33,416 | 29,138 |
| Appraisal services | 4,275 | 4,892 |
| Hardware and other | 1,371 | 1,571 |
| Total revenues | 69,820 | 69,565 |
| Cost of revenues: | | |
| Software licenses | 707 | 1,276 |
| Acquired software | 398 | 315 |
| Software services, maintenance and subscriptions | 34,881 | 33,087 |
| Appraisal services | 2,877 | 3,363 |
| Hardware and other | 938 | 1,232 |
| Total cost of revenues | 39,801 | 39,273 |
| Gross profit | 30,019 | 30,292 |
| Selling, general and administrative expenses | 17,561 | 17,410 |
| Research and development expense | 3,516 | 2,235 |
| Amortization of customer and trade name intangibles | 806 | 672 |
| Operating income | 8,136 | 9,975 |
| Other expense, net | (42) | (14) |
| Income before income taxes | 8,094 | 9,961 |
| Income tax provision | 3,222 | 3,955 |
| Net income | \$ 4,872 | \$ 6,006 |
| Earnings per common share: | | |
| Basic | \$ 0.14 | \$ 0.17 |

| | | |
|--|---------|---------|
| Diluted | \$ 0.13 | \$ 0.16 |
| Basic weighted average common shares outstanding | 35,101 | 35,497 |
| Diluted weighted average common shares outstanding | 36,655 | 36,747 |
| <i>See accompanying notes.</i> | | |

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

| | March 31, 2010 (Unaudited) | December 31, 2009 |
|--|----------------------------------|-------------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 4,051 | \$ 9,696 |
| Restricted cash equivalents | 5,000 | 6,000 |
| Short-term investments available-for-sale | | 50 |
| Accounts receivable (less allowance for losses of \$1,977 in 2010 and \$2,389 in 2009) | 63,076 | 81,245 |
| Prepaid expenses | 7,814 | 7,921 |
| Other current assets | 1,493 | 1,437 |
| Deferred income taxes | 3,279 | 3,338 |
| Total current assets | 84,713 | 109,687 |
| Accounts receivable, long-term portion | 1,109 | 1,018 |
| Property and equipment, net | 36,190 | 35,750 |
| Non-current investments available-for-sale | 2,145 | 1,976 |
| Other assets: | | |
| Goodwill | 92,831 | 90,258 |
| Customer related intangibles, net | 30,184 | 25,490 |
| Software, net | 4,276 | 4,218 |
| Other acquisition related intangibles, net | 1,972 | 2,063 |
| Sundry | 235 | 210 |
| | \$ 253,655 | \$ 270,670 |
| LIABILITIES AND SHAREHOLDERS EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$ 3,067 | \$ 3,807 |
| Accrued liabilities | 17,369 | 26,110 |
| Deferred revenue | 85,828 | 99,116 |
| Income taxes payable | 1,384 | 220 |
| Total current liabilities | 107,648 | 129,253 |
| Deferred income taxes | 7,059 | 7,059 |
| Commitments and contingencies | | |
| Shareholders equity: | | |
| Preferred stock, \$10.00 par value; 1,000,000 shares authorized, none issued | 481 | 481 |

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| | | |
|--|------------|------------|
| Common stock, \$0.01 par value; 100,000,000 shares authorized; 48,147,969 shares issued in 2010 and 2009 | | |
| Additional paid-in capital | 155,039 | 153,734 |
| Accumulated other comprehensive loss, net of tax | (296) | (405) |
| Retained earnings | 82,376 | 77,504 |
| Treasury stock, at cost; 13,113,799 and 13,027,838 shares in 2010 and 2009, respectively | (98,652) | (96,956) |
| Total shareholders' equity | 138,948 | 134,358 |
| | \$ 253,655 | \$ 270,670 |

See accompanying notes.

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

| | Three months ended March | |
|--|--------------------------|-------------|
| | 2010 | 31, 2009 |
| Cash flows from operating activities: | | |
| Net income | \$ 4,872 | \$ 6,006 |
| Adjustments to reconcile net income to net cash provided by operations: | | |
| Depreciation and amortization | 2,649 | 2,332 |
| Share-based compensation expense | 1,465 | 1,127 |
| Excess tax benefit from exercises of share-based arrangements | (48) | (148) |
| Changes in operating assets and liabilities, exclusive of effects of acquired companies: | | |
| Accounts receivable | 18,078 | 11,298 |
| Income tax payable | 1,215 | 2,830 |
| Prepaid expenses and other current assets | 180 | (162) |
| Accounts payable | (740) | 827 |
| Accrued liabilities | (7,448) | (3,173) |
| Deferred revenue | (13,289) | (8,731) |
| Net cash provided by operating activities | 6,934 | 12,206 |
| Cash flows from investing activities: | | |
| Proceeds from sale of investments | 50 | 775 |
| Cost of acquisitions, net of cash acquired | (9,623) | (525) |
| Additions to property and equipment | (2,238) | (2,333) |
| Decrease in restricted investments | 1,000 | |
| Increase in other | (25) | (6) |
| Net cash used by investing activities | (10,836) | (2,089) |
| Cash flows from financing activities: | | |
| Purchase of treasury shares | (2,317) | (10,096) |
| Net payments on revolving line of credit | | (500) |
| Contributions from employee stock purchase plan | 447 | 322 |
| Proceeds from exercise of stock options | 79 | 558 |
| Excess tax benefit from exercises of share-based arrangements | 48 | 148 |
| Net cash used by financing activities | (1,743) | (9,568) |
| Net (decrease) increase in cash and cash equivalents | (5,645) | 549 |
| Cash and cash equivalents at beginning of period | 9,696 | 1,762 |

| | | |
|--|----------|----------|
| Cash and cash equivalents at end of period | \$ 4,051 | \$ 2,311 |
|--|----------|----------|

See accompanying notes.

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Tyler Technologies, Inc.
Notes to Condensed Financial Statements
(Unaudited)
(Tables in thousands, except per share data)

(1) Basis of Presentation

We prepared the accompanying condensed 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 March 31, 2010 and December 31, 2009 and operating result amounts are for the three months ended March 31, 2010 and 2009, 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, 2009. 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.

(2) Revenue Recognition

Software Arrangements:

We earn revenue from software licenses, subscriptions, software services, post-contract customer support (PCS or maintenance), 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 the Construction Type and Production Type Contracts as discussed in ASC 605-35.

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. collectability 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 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 determine that 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, in compliance with ASC 985-605, Software Revenue Recognition, 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.

Table of Contents**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 collectability 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 collectability 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 because 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.

Subscription-Based Services

Subscription-based services primarily consist of revenues derived from application service provider (ASP) arrangements and other hosted service offerings, software subscriptions and disaster recovery services.

We recognize revenue for ASP and other hosting services, software subscriptions, term license arrangements with renewal periods of twelve months or less and disaster recovery ratably over the period of the applicable agreement as services are provided. Disaster recovery agreements and other hosting services are typically renewable annually. ASP and software subscriptions are typically for periods of three to six years and automatically renew unless either party cancels the agreement. The majority of the ASP and other hosting services and software subscriptions also include professional services as well as maintenance and support. In certain ASP arrangements, the customer also acquires a license to the software.

For ASP and other hosting arrangements, we evaluate whether the customer has the contractual right to take possession of our software at any time during the hosting period without significant penalty and whether the customer can feasibly maintain the software on the customer's hardware or enter into another arrangement with a third party to host the software. If we determine that the customer has the contractual right to take possession of our software at any time during the hosting period without significant penalty and can feasibly maintain the software on the customer's hardware or enter into another arrangement with a third party to host the software, we recognize the license, professional services and hosting services revenues pursuant to ASC 985-605, Software Revenue Recognition. For ASP and other hosting arrangements that do not meet the criteria for recognition under ASC 985-605, we account for the elements under ASC 605-25, Multiple Element Arrangements using all applicable facts and circumstances,

including whether (i) the element has stand-alone value, (ii) there is a general right of return and (iii) the revenue is contingent on delivery of other elements. We allocate revenue to each element of the arrangement that qualifies for treatment as a separate element based on VSOE, and if VSOE is not available, third party evidence, and if third party evidence is unavailable, estimated selling price. For professional services associated with ASP and hosting arrangements that we determine do not have stand-alone value to the customer or are contingent on delivery of other elements, we recognize the services revenue ratably over

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the remaining contractual period once hosting has gone live and we may begin billing for the hosting services. We record amounts that have been invoiced in accounts receivable and in deferred revenue or revenues, depending on whether the revenue recognition criteria have been met.

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.

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.

Allocation of Revenue in Statement of Income

In our statements of income, we allocate revenue to software licenses, software services, maintenance and hardware and other based on the VSOE of fair value for elements in each revenue arrangement and the application of the residual method for arrangements in which we have established VSOE of fair value for all undelivered elements. In arrangements where we are not able to establish VSOE of fair value for all undelivered elements, revenue is first allocated to any undelivered elements for which VSOE of fair value has been established. We then allocate revenue to any undelivered elements for which VSOE of fair value has not been established based upon management's best estimate of fair value of those undelivered elements and apply a residual method to determine the license fee. Management's best estimate of fair value of undelivered elements for which VSOE of fair value has not been established is based upon the VSOE of similar offerings and other objective criteria.

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, subscription-based services, 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

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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 January 2010 we acquired all the assets of Wiznet, Inc. (Wiznet) for a cash purchase price of \$9.5 million. Wiznet provides electronic document filing solutions for courts and law offices throughout the United States and is integrated with our primary courts and justice solution.

In connection with this transaction we acquired total tangible assets of approximately \$867,000. We recorded goodwill of approximately \$2.6 million, all of which is expected to be deductible for tax purposes, and other intangible assets of approximately \$6.1 million. The \$6.1 million of intangible assets is attributable to customer relationships and acquired software that will be amortized over a weighted average period of approximately 9.5 years. Our balance sheet as of March 31, 2010 reflects the allocation of the purchase price to the assets acquired based on their estimated fair values at the dates of acquisition.

The operating results of this acquisition are included in our results of operations since the date of acquisition.

(4) Financial Instruments

Assets recorded at fair value in the balance sheet as of March 31, 2010 are categorized based upon the level of judgment associated with the inputs used to measure their fair value. Hierarchical levels, defined by 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 March 31, 2010 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) |
|--|-----------|--|---|--|
| Cash and cash equivalents | \$ 9,051 | \$ 9,051 | \$ | \$ |
| Non-current investments available-for-sale | 2,145 | | | 2,145 |
| Total | \$ 11,196 | \$ 9,051 | \$ | \$ 2,145 |

Cash and cash equivalents consist primarily of money market funds with original maturity dates of three months or less, for which we determine fair value through quoted market prices. 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 22 to 33 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 very small partial redemptions at par in the period from July 2009 through February 2010. As of March 31, 2010 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)

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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 ARS as of March 31, 2010 are as follows:

| | Par Value | Temporary Impairment | Carrying Value |
|--------------------------------|-----------|----------------------|----------------|
| Investments available-for-sale | \$2,600 | \$ 455 | \$2,145 |

In association with this estimate of fair value, we have recorded an after-tax temporary unrealized gain on our non-current ARS of \$109,000, net of related tax effects of \$60,000 in the three months ending March 31, 2010, 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 temporary decline in fair value is due entirely to liquidity issues, 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 AAA. 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 very small partial redemptions at par in the period July 2009 through February 2010. Based on our cash and cash equivalents balance of \$9.1 million and expected operating cash flows, 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 three months ended March 31, 2010:

| | |
|---|----------|
| Balance as of December 31, 2009 | \$ 1,976 |
| Transfers into level 3 | |
| Transfers out of level 3 | |
| Unrealized gains included in accumulated other comprehensive loss | 169 |
| Balance as of March 31, 2010 | \$ 2,145 |

(5) Shareholders' Equity

The following table details activity in our common stock:

| | Three months ended March 31, | | | |
|-------------------------------|------------------------------|-----------|--------|-----------|
| | 2010 | | 2009 | |
| | Shares | Amount | Shares | Amount |
| Purchases of common stock | (129) | \$(2,411) | (707) | \$(8,832) |
| Stock option exercises | 18 | 79 | 120 | 558 |
| Employee stock plan purchases | 25 | 425 | 35 | 362 |

As of March 31, 2010 we have authorization from our board of directors to repurchase up to 2.1 million additional shares of Tyler common stock.

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In October 2008, we entered into a revolving bank credit agreement (the Credit Facility) and a related pledge and security agreement which originally matured October 19, 2009. We amended and extended the related pledge and security agreement in October 2009. The Credit Facility matures October 18, 2010 and provides for total borrowings of up to \$25.0 million and a \$10.0 million Letter of Credit facility which can either be cash collateralized or issued using availability under the Credit Facility. Borrowings under the Credit Facility bear interest at a rate of either the Wall Street Journal prime rate minus .5% or the 30, 60 or 90-day LIBOR rate plus 2%; however, a minimum interest rate of 3.25% will apply. As of March 31, 2010, our effective average interest rate for borrowings during the three months ended March 31, 2010 was 3.25%. The Credit Facility is secured by substantially all of our assets. 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, restricts the amount of our common stock we may purchase and limits incurrence of additional indebtedness and liens. As of March 31, 2010, we were in compliance with those covenants.

As of March 31, 2010, we had no outstanding borrowings and unused available borrowing capacity of \$21.7 million under the Credit Facility. In addition, as of March 31, 2010, our bank had issued outstanding letters of credit totaling \$8.3 million to secure surety bonds required by some of our customer contracts. These letters of credit have been collateralized by restricted cash balances of \$5.0 million and \$3.3 million of our available borrowing capacity and expire through January 2011. The carrying amount of the Credit Facility approximates fair value due to the short-term nature of the instrument.

(7) Income Tax Provision

For the three months ended March 31, 2010, we had an effective income tax rate of 39.8%, compared to 39.7% for the three months ended March 31, 2009. 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 \$2.0 million in the three months ended March 31, 2010, compared to \$1.2 million in net payments for the same period of the prior year.

(8) Earnings Per Share

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

| | Three months ended March 31, | |
|---|---------------------------------|----------|
| | 2010 | 2009 |
| Numerator for basic and diluted earnings per share: | | |
| Net income | \$ 4,872 | \$ 6,006 |
| Denominator: | | |
| Weighted-average basic common shares outstanding | 35,101 | 35,497 |
| Assumed conversion of dilutive securities: | | |
| Stock options | 1,554 | 1,250 |
| Denominator for diluted earnings per share Adjusted weighted-average shares | 36,655 | 36,747 |
| Earnings per common share: | | |
| Basic | \$ 0.14 | \$ 0.17 |

Diluted

\$ 0.13

\$ 0.16

For the three months ended March 31, 2010 and the three months ended March 31, 2009, stock options representing the right to purchase common stock of 2.1 million shares and 2.7 million shares, respectively, were not included in the computation of diluted earnings per share because their inclusion would have had an anti-dilutive effect.

Table of Contents**(9) Share-Based Compensation**

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

| | Three months ended March 31, | |
|--|---------------------------------|-----------------|
| | 2010 | 2009 |
| Cost of software services, maintenance and subscriptions | \$ 165 | \$ 120 |
| Selling, general and administrative expense | 1,300 | 1,007 |
| Total share-based compensation expense | \$ 1,465 | \$ 1,127 |

(10) Commitments and Contingencies

On November 3, 2008, a putative collective action complaint was filed against us in the United States District Court for the Eastern District of Texas (the Court) on behalf of current and former telephone and remote customer support personnel (Category 1), computer hardware and software set up and maintenance personnel (Category 2), implementation personnel (Category 3), sales support personnel (Category 4), and quality assurance analysts (Category 5). The petition alleges that we misclassified these groups of employees as exempt rather than non-exempt under the Fair Labor Standards Act and that we therefore failed to properly pay overtime wages. The suit was initiated by six former employees working out of our Longview, Texas, office and seeks to recover damages in the form of lost overtime pay, liquidated damages equal to the amount of lost overtime pay, interest, costs, and attorneys' fees.

On June 23, 2009, the Court issued an Order granting Plaintiffs' motion for conditional certification for the purpose of providing notice to potential plaintiffs about the litigation. Accordingly, notice was sent to all current and former employees who worked in the foregoing job classifications during the applicable time periods. On October 26, 2009, the opt in period for plaintiffs and potential plaintiffs closed. In 2010, a number of plaintiffs voluntarily withdrew their claims. Currently, there are a total of 61 plaintiffs in the litigation consisting of the following: 24 in Category 1; 3 in Category 2; 32 in Category 3; 0 in Category 4; and 2 in Category 5. We intend to vigorously defend the action. Given the preliminary nature of the alleged claims and the inherent unpredictability of litigation, we cannot at this time estimate the possible outcome of any such action.

Other than ordinary course, routine litigation incidental to our business and except as described in this Quarterly Report, there are no material legal proceedings pending to which we are party or to which any of our properties are subject.

(11) Recent Accounting Pronouncements

Effective January 1, 2010, we adopted the provisions of Accounting Standards Update (ASU) 2009-13, Multiple Element Arrangements. ASU 2009-13 updates the existing multiple-element revenue arrangements guidance currently included in Accounting Standards Codification (ASC) 605-25, Multiple Element Arrangements. The revised guidance provides for two significant changes to the existing multiple-element revenue guidance for arrangements that are not accounted for under ASC 985-605, Software Revenue Recognition. The first change relates to the determination of when the individual deliverables included in a multiple-element arrangement may be treated as separate units of accounting. The second change modifies the manner in which the transaction consideration is allocated across the separately identified deliverables. Together, these changes will result in earlier recognition of service revenue for certain of our ASP and hosting arrangements than under previous guidance. The adoption of this ASU did not have a material impact on our financial condition or results of operations.

Effective January 1, 2010, we adopted the provisions of ASU 2010-06, Improving Disclosures about Fair Value Measurements. ASU 2010-06 updates the existing fair value measurements and disclosures guidance currently included in ASC 820, Fair Value Measurements and Disclosures. ASU 2010-06 requires new disclosures about significant transfers in and out of Levels 1 and 2 fair value measurements and separate disclosures about purchases, sales, issuances and settlements relating to Level 3 fair value measurements. The ASU also clarifies existing disclosure requirements regarding inputs and valuation techniques, as well as the level of disaggregation for each class

of assets and liabilities for which separate fair value measurements should be disclosed. The adoption of this ASU did not have a material impact on our financial condition or results of operations.

Table of Contents**(12) 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:
financial management and education software solutions;

financial management and municipal courts and justice 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 and municipal courts and justice 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. The Enterprise Software Solutions 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 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, share-based compensation expense, 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.

For the three months ended March 31, 2010

| | Enterprise Software Solutions | Appraisal and Tax Software Solutions and Services | Corporate | Totals |
|--------------------------|-------------------------------------|---|-----------|----------|
| Revenues | | | | |
| Software licenses | \$ 7,922 | \$ 527 | \$ | \$ 8,449 |
| Subscriptions | 5,174 | 79 | | 5,253 |
| Software services | 14,555 | 2,501 | | 17,056 |
| Maintenance | 29,709 | 3,707 | | 33,416 |
| Appraisal services | | 4,275 | | 4,275 |
| Hardware and other | 1,364 | 7 | | 1,371 |
| Intercompany | 325 | | (325) | |
| Total revenues | \$59,049 | \$ 11,096 | \$ (325) | \$69,820 |
| Segment operating income | \$11,262 | \$ 1,793 | \$(3,715) | \$ 9,340 |

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For the three months ended March 31, 2009

| | Enterprise Software Solutions | Appraisal and Tax Software Solutions and Services | Corporate | Totals |
|--------------------------|-------------------------------------|---|------------|-----------|
| Revenues | | | | |
| Software licenses | \$ 10,215 | \$ 541 | \$ | \$ 10,756 |
| Subscriptions | 3,895 | 81 | | 3,976 |
| Software services | 16,853 | 2,379 | | 19,232 |
| Maintenance | 25,812 | 3,326 | | 29,138 |
| Appraisal services | | 4,892 | | 4,892 |
| Hardware and other | 1,235 | | 336 | 1,571 |
| Intercompany | 407 | | (407) | |
| Total revenues | \$ 58,417 | \$ 11,219 | \$ (71) | \$ 69,565 |
| Segment operating income | \$ 12,401 | \$ 1,370 | \$ (2,809) | \$ 10,962 |

For the three months ended March
31,
2010 2009

Reconciliation of reportable segment operating income to the Company's consolidated totals:

| | | |
|---|----------|-----------|
| Total segment operating income | \$ 9,340 | \$ 10,962 |
| Amortization of acquired software | (398) | (315) |
| Amortization of customer and trade name intangibles | (806) | (672) |
| Other expense, net | (42) | (14) |
| Income before income taxes | \$ 8,094 | \$ 9,961 |

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, could or other similar words. 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) economic, political and market conditions, including the recent global economic and financial crisis, and the general tightening of access to debt or equity capital; (2) 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; (3) changes in the budgets or regulatory environments of our

customers, primarily local and state governments, that could negatively impact information technology spending; (4) technological and market risks associated with the development of new products or services or of new versions of existing or acquired products or services; (5) 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; (6) 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; (7) 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 (8) 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

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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 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. 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 application service provider arrangements and other hosting services as well as 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 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.

In January 2010 we acquired all the assets of Wiznet, Inc. (Wiznet) for a cash purchase price of \$9.5 million. Wiznet provides electronic document filing solutions for courts and law offices throughout the United States and is integrated with our primary courts and justice solution.

As of March 31, 2010, our total employee count increased to 2,034 from 1,991 at March 31, 2009.

Outlook

The financial market crisis has continued to disrupt credit and equity markets worldwide. Broad economic conditions remain uncertain and public sector entities continue to experience pressures that are reflected in longer than normal decision processes, postponement of purchasing decisions and overall caution exercised by existing and prospective customers as a result of continued challenges posed by the weak economic environment. Local and state governments may face financial pressures that could in turn affect our growth rate in the second quarter of 2010 and for the calendar year. While market conditions are not robust, we have stability from our foundation of recurring revenues and high customer retention. Our base of recurring revenues from maintenance and support and subscription-based services was approximately 55% of total revenues for the three months ended March 31, 2010. We expect that in excess of 60% of our annual earnings will occur in the second half of 2010.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The discussion and analysis of our financial condition and results of operations are based upon our condensed financial statements. These condensed 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, 2009. 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, 2009.

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ANALYSIS OF RESULTS OF OPERATIONS

| | Percentage of Total Revenue | |
|--|-----------------------------|-------|
| | First Quarter | |
| | 2010 | 2009 |
| Revenue: | | |
| Software licenses | 12.1% | 15.5% |
| Subscriptions | 7.5 | 5.7 |
| Software services | 24.4 | 27.6 |
| Maintenance | 47.9 | 41.9 |
| Appraisal services | 6.1 | 7.0 |
| Hardware and other | 2.0 | 2.3 |
| Total revenue | 100.0 | 100.0 |
| Operating Expenses: | | |
| Cost of software licenses and acquired software | 1.6 | 2.3 |
| Cost of software services, maintenance and subscriptions | 50.0 | 47.6 |
| Cost of appraisal services | 4.1 | 4.8 |
| Cost of hardware and other | 1.3 | 1.8 |
| Selling, general and administrative expenses | 25.1 | 25.0 |
| Research and development expense | 5.0 | 3.2 |
| Amortization of customer base and trade name intangibles | 1.2 | 1.0 |
| Operating income | 11.7 | 14.3 |
| Other income | (0.1) | (0.0) |
| Income before income taxes | 11.6 | 14.3 |
| Income tax provision | 4.6 | 5.7 |
| Net income | 7.0% | 8.6% |

Revenues*Software licenses.*

Software license revenues consist of the following components for the periods presented as of March 31:

| | First Quarter | | Change | |
|---|---------------|----------|-----------|-------|
| | 2010 | 2009 | \$ | % |
| Software license revenue | | | | |
| Enterprise Software Solutions | \$7,922 | \$10,215 | \$(2,293) | (22)% |
| Appraisal and Tax Software Solutions and Services | 527 | 541 | (14) | (3) |
| Total software license revenue | \$8,449 | \$10,756 | \$(2,307) | (21)% |

In the three months ended March 31, 2010, we signed 16 new large contracts with average software license fees of approximately \$406,000 compared to 15 new large contracts signed in the three months ended March 31, 2009 with average software license fees of approximately \$397,000. We consider contracts with a license fee component of \$100,000 or more to be large. 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 Notes to the Unaudited Condensed Financial Statements.

ESS software license revenue represented approximately 94% of our total software license revenue in the periods presented. For the three months ended March 31, 2010, ESS software license revenue declined substantially compared to the prior year period. The decrease in software license fees is mainly attributable to longer sales cycles to negotiate and close contracts that have reached

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the request for proposal phase and postponement of purchasing decisions mainly due to budgetary constraints related to economic conditions. The software installation period for most of our financial management and education solutions which, comprise over 60% of ESS software license revenue, is relatively short and delays in the timing of signing new contracts will impact our results in the short term.

Subscriptions.

| | First Quarter | | Change | |
|---|---------------|---------|---------|-----|
| | 2010 | 2009 | \$ | % |
| Subscriptions revenue | | | | |
| Enterprise Software Solutions | \$5,174 | \$3,895 | \$1,279 | 33% |
| Appraisal and Tax Software Solutions and Services | 79 | 81 | (2) | (2) |
| Total subscriptions revenue | \$5,253 | \$3,976 | \$1,277 | 32% |

Subscription-based services revenue primarily consists of revenues derived from ASP arrangements and other hosted service offerings, software subscriptions and disaster recovery services. Subscription revenue grew by 15%, excluding the impact of acquisitions. ASP and other software subscriptions agreements are typically for periods of three to six years and automatically renew unless either party cancels the agreement. Disaster recovery and miscellaneous other hosted service agreements are typically renewable annually. Existing customers who converted to our ASP model as well as new customers for ASP and other hosted service offerings provided the majority of the subscription revenue increase with the remaining increase due to new disaster recovery customers and slightly higher rates for disaster recovery services.

Software services.

| | First Quarter | | Change | |
|---|---------------|----------|-----------|-------|
| | 2010 | 2009 | \$ | % |
| Software services revenue | | | | |
| Enterprise Software Solutions | \$14,555 | \$16,853 | \$(2,298) | (14)% |
| Appraisal and Tax Software Solutions and Services | 2,501 | 2,379 | 122 | 5 |
| Total software services revenue | \$17,056 | \$19,232 | \$(2,176) | (11)% |

Software services revenues primarily consists of personnel costs related to installation of our software, conversion of customer data, training customer personnel and consulting. New customers who purchase our proprietary software licenses, generally also contract with us to provide for the related software services as well. Existing customers also periodically purchase additional training, consulting and minor programming services. The decline in software services revenues for the three months ended March 31, 2010 is principally due to lower software license revenue arrangements due to weak economic conditions.

Maintenance.

| | First Quarter | | Change | |
|---|---------------|----------|---------|-----|
| | 2010 | 2009 | \$ | % |
| Maintenance revenue | | | | |
| Enterprise Software Solutions | \$29,709 | \$25,812 | \$3,897 | 15% |
| Appraisal and Tax Software Solutions and Services | 3,707 | 3,326 | 381 | 11 |
| Total maintenance revenue | \$33,416 | \$29,138 | \$4,278 | 15% |

We provide maintenance and support services for our software products and third party software. Maintenance revenues increased 15% for the three months ended March 31, 2010, compared to the prior year periods. Maintenance and support services grew 14%, excluding the impact of acquisitions completed in the prior twelve months. This increase was due to growth in our installed customer base and maintenance rate increases on most of our product lines.

Table of Contents*Appraisal services.*

| | First Quarter | | Change | |
|---|---------------|---------|---------|-------|
| | 2010 | 2009 | \$ | % |
| Appraisal services revenue | | | | |
| Enterprise Software Solutions | \$ | \$ | \$ | % |
| Appraisal and Tax Software Solutions and Services | 4,275 | 4,892 | (617) | (13) |
| Total appraisal services revenue | \$4,275 | \$4,892 | \$(617) | (13)% |

Appraisal services revenue declined 13% for the three months ended March 31, 2010 compared to the prior year period. The appraisal services business is somewhat cyclical and driven in part by scheduled revaluation cycles in various states. We substantially completed one large complex appraisal project in mid-2009. We began implementing several new revaluation contracts in late 2009. However, these projects are smaller and less complex and as a result the average rates are slightly lower than 2009.

Cost of Revenues and Gross Margins

The following table sets forth a comparison of the key components of our cost of revenues for the periods presented:

| (\$ in thousands) | First Quarter | | Change | |
|--|---------------|----------|--------|-------|
| | 2010 | 2009 | \$ | % |
| Software licenses | \$ 707 | \$ 1,276 | (569) | (45)% |
| Acquired software | 398 | 315 | 83 | 26 |
| Software services, maintenance and subscriptions | 34,881 | 33,087 | 1,794 | 5 |
| Appraisal services | 2,877 | 3,363 | (486) | (14) |
| Hardware and other | 938 | 1,232 | (294) | (24) |
| Total cost of revenues | \$39,801 | \$39,273 | 528 | 1% |

The following table sets forth a comparison of gross margin percentage by revenue type for the periods presented as of March 31:

| (\$ in thousands) | First Quarter | | Change % |
|--|---------------|-------|-------------|
| | 2010 | 2009 | |
| Software licenses and acquired software | 86.9% | 85.2% | 1.7% |
| Software services, maintenance and subscriptions | 37.4 | 36.8 | 0.6 |
| Appraisal services | 32.7 | 31.3 | 1.4 |
| Hardware and other | 31.6 | 21.6 | 10.0 |
| Overall gross margin | 43.0% | 43.5% | (0.5)% |

Software licenses. Costs of software license consist of third party software costs, amortization expense for capitalized development costs on certain software products and amortization expense for software acquired through acquisitions. For the three months ended March 31, 2010 and 2009, approximately 53% and 65%, respectively, of the costs of software license relates to third party software costs. Amortization expense for capitalized development costs on certain software products comprises approximately 11% to 15% of our cost of software license revenues. Once a product is released, we begin to amortize the costs associated with its development over the estimated useful life of the product. 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.

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For the three months ended March 31, 2010 and 2009, amortization expense for software acquired through acquisitions comprises approximately 36% and 20%, respectively, of our cost of software license revenues. We completed several acquisitions in the period 2007 through the first quarter of 2010 and these costs are being amortized over a weighted average period of approximately 5 years.

For the three months ended March 31, 2010, our software license gross margin percentage increased slightly because the product mix included less third party software. Third party software has a lower gross margin than proprietary software solutions.

Software services, maintenance and subscription-based services. Cost of software services, maintenance and subscriptions primarily consists of personnel costs related to installation of our software, conversion of customer data, training customer personnel and support activities and various other services such as ASP and disaster recovery. For the three months ended March 31, 2010, the software services, maintenance and subscriptions gross margin was flat compared to the prior year period principally due to lower software services revenues. We believe this decline is temporary and due to weak economic conditions. We have increased our implementation and support staff by 26 employees since March 31, 2009.

Appraisal services. Our appraisal services gross margin increased slightly in the three months ended March 31, 2010. A high portion of the costs of appraisal services revenue are variable, as we often employ temporary employees to assist in appraisal projects whose term of employment generally ends with the projects completion. In the prior year our appraisal project mix included several contracts that required additional staffing as well as an unusually large complex re-appraisal project that ended in mid- 2009. As a result of the completion of these contracts the appraisal staff declined by 53 employees since March 31, 2009.

Our blended gross margin for the three months ended March 31, 2010 was slightly lower than the prior year primarily due to a product mix that included less software license revenue. Software license revenue inherently has higher gross margins than other revenues such as services and hardware.

Selling, General and Administrative Expenses

Selling, general and administrative (SG&A) expenses consist primarily of salaries, employee benefits, travel, share-based compensation expense, commissions and related overhead costs for administrative and sales and marketing employees as well as, professional fees, trade show activities, advertising costs and other marketing related costs. The following table sets forth a comparison of our SG&A expenses for the periods presented as of March 31:

| (\$ in thousands) | First Quarter | | Change | |
|--|---------------|----------|--------|----|
| | 2010 | 2009 | \$ | % |
| Selling, general and administrative expenses | \$17,561 | \$17,410 | 151 | 1% |

SG&A as a percentage of revenues for the three months ended March 31, 2010 was flat compared to the prior year period. The increase in SGA expenses was mainly comprised of share-based compensation.

Research and Development Expense

The following table sets forth a comparison of our research and development expense for the periods presented as of March 31:

| (\$ in thousands) | First Quarter | | Change | |
|----------------------------------|---------------|---------|---------|-----|
| | 2010 | 2009 | \$ | % |
| Research and development expense | \$3,516 | \$2,235 | \$1,281 | 57% |

Research and development expense consist mainly of costs associated with development of new products and new software platforms for which we do not currently generate revenue. These include the Microsoft Dynamics AX project, as well as other new product development efforts. We have increased our development staff by 59 employees since March 31, 2009. In January 2007, we entered into a Software Development and License Agreement, which provides for 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, Tyler and Microsoft signed an amendment to the Software Development and License Agreement, which grants Microsoft intellectual property rights in and to certain portions of the software

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code provided and developed by Tyler into Microsoft Dynamics AX products to be marketed and sold outside of the public sector in exchange for reimbursement payments to partially offset the research and development costs. For the three months ended March 31, 2010 and 2009, we offset our research and development expense by \$1.2 million and \$857,000, respectively, which were the amounts earned under the terms of our agreement with Microsoft. In September 2008, Tyler and Microsoft signed a statement of work under the Amended Software Development and License Agreement for which we currently expect to recognize offsets to our research and development expense by approximately \$850,000 each quarter through the end of 2010. In addition, in October 2009, the scope of the project was further expanded which will result in additional offsets to research and development expense, varying in amount from quarter to quarter, with the first payment to be invoiced on August 31, 2010 and invoiced quarterly through March 31, 2012 for a total of approximately \$6.2 million. The actual amount and timing of future research and development costs and related reimbursements and whether they are capitalized or expensed may vary.

Amortization of Customer and Trade Name Intangibles

Acquisition intangibles are composed 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 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 March 31:

| (\$ in thousands) | First Quarter | | Change | |
|---|---------------|-------|--------|-----|
| | 2010 | 2009 | \$ | % |
| Amortization of customer and trade name intangibles | \$806 | \$672 | 134 | 20% |

In the first quarter of 2010 we completed one acquisition, which increased amortizable customer and trade name intangibles by \$5.5 million. This amount will be amortized over 10 years.

Income Tax Provision

The following table sets forth comparison of our income tax provision for the periods presented as of March 31:

| (\$ in thousands) | First Quarter | | Change | |
|---------------------------|---------------|---------|---------|-------|
| | 2010 | 2009 | \$ | % |
| Income tax provision | \$3,222 | \$3,955 | \$(733) | (19)% |
| Effective income tax rate | 39.8% | 39.7% | | |

The effective income tax rates for the three months ended March 31, 2010 and 2009 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.

FINANCIAL CONDITION AND LIQUIDITY

As of March 31, 2010 we had cash and cash equivalents (including restricted cash equivalents) of \$9.1 million and investments of \$2.1 million, compared to cash and cash equivalents (including restricted cash equivalents) of \$15.7 million and investments of \$2.0 million at December 31, 2009. As of March 31, 2010, we had no outstanding borrowings and unused borrowing capacity of \$21.7 million under our revolving line of credit. In addition, as of March 31, 2010, we had issued outstanding letters of credit totaling \$8.3 million to secure surety bonds required by some of our customer contracts. These letters of credit have been collateralized by restricted cash balances of \$5.0 million and \$3.3 million of our available borrowing capacity and expire through January 2011.

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The following table sets forth a summary of cash flows for the three months ended March 31:

| (\$ in thousands) | 2010 | 2009 |
|--|------------|-----------|
| Cash flows provided by (used by): | | |
| Operating activities | \$ 6,934 | \$ 12,206 |
| Investing activities | (10,836) | (2,089) |
| Financing activities | (1,743) | (9,568) |
| Net (decrease) increase in cash and cash equivalents | \$ (5,645) | \$ 549 |

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, public and private issuances of debt and equity securities, and bank borrowings. The capital and credit markets have become more volatile and tight as a result of adverse conditions that have caused the failure and near failure of a number of large financial services companies. It is possible that our ability to access the capital and credit markets may be limited by these or other factors. Notwithstanding the foregoing, at this time we believe that cash provided by operating activities, cash on hand and our revolving line of credit are sufficient to fund our working capital requirements, capital expenditures, income tax obligations, and share repurchases for the foreseeable future.

Operating Activities

For the three months ended March 31, 2010, operating activities provided net cash of \$6.9 million, primarily generated from net income of \$4.9 million, non-cash depreciation and amortization charges of \$2.6 million, non-cash share-based compensation expense of \$1.5 million. These increases were somewhat by an increase in working capital of \$2.0 million. In the three months ended March 31, 2010, we adopted a new company-wide vacation policy and as a result paid approximately \$1.8 million to reduce accrued vacation balances in connection with changing the policy. Working capital also increased due to lower accounts payable and accrued liabilities pertaining to timing of payments on vendor invoices. These increases to working capital were offset somewhat by the collection of annual maintenance renewals that were billed near the end of December.

In general changes in deferred revenue are cyclical and primarily driven by the timing of our maintenance renewal billings. Our renewal dates occur throughout the year but our heaviest renewal cycles occur in the second and fourth quarters.

Our days sales outstanding (DSO) was 81 days at March 31, 2010, compared to 98 days at December 31, 2009 and 85 days at March 31, 2009. Our maintenance billing cycles typically peak at their highest level in December and June of each year and are followed by collections in the subsequent quarter. As a result our DSO usually declines in the first quarter compared to the fourth quarter. DSO is calculated based on quarter-end accounts receivable divided by the quotient of annualized quarterly revenues divided by 360 days.

Non-current 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 22 to 33 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 very small partial redemptions at par in the period from July 2009 through February 2010. As of December 31, 2009 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.

In association with this estimate of fair value, we have recorded an after-tax temporary unrealized gain on our non-current ARS of \$109,000, net of related tax effects of \$60,000 in the three months ended March 31, 2010, which is included in accumulated other comprehensive loss on our balance sheet.

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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 temporary decline in fair value is due entirely to liquidity issues, 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 AAA. 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 very small partial redemptions at par in the period July 2009 through February 2010. Based on our cash and cash equivalents balance of \$9.1 million and expected operating cash flows, 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.

Investing activities used cash of \$10.8 million in the three months ending March 31, 2010 compared to \$2.1 million for the same period in 2009. In January 2010, we completed the acquisition for the assets of Wiznet, Inc. for \$9.5 million in cash. Also, in connection with plans to consolidate workforces and support planned long-term growth, we paid \$1.2 million in the three months ended March 31, 2010 compared to \$1.5 million in the three months ended March 31, 2009, for construction of an office building in Lubbock, Texas. We expect to pay the remaining final retainage of approximately \$600,000 in the next three months to complete this construction. In the three months ended March 31, 2010, we also liquidated \$50,000 of investments in ARS for cash at par. In the three months ended March 31, 2009, we completed the acquisitions of PulseMark, LLC for \$525,000 in cash and liquidated \$775,000 of short-term investments in ARS for cash at par. Capital expenditures and acquisitions were funded from cash generated from operations.

Financing activities used cash of \$1.7 million in the three months ended March 31, 2010 compared to \$9.6 million in the same period for 2009. Cash used in financing activities was primarily comprised of purchases of treasury shares, net of proceeds from stock option exercises and employee stock purchase plan activity. These purchases were funded by short-term borrowings as well as cash from operations.

During the three months ended March 31, 2010, we purchased 129,000 shares of our common stock for an aggregate purchase price of \$2.4 million. At March 31, 2010, we had authorization to repurchase up to 2.1 million additional shares of Tyler common stock. A summary of the repurchase activity during the three months ended March 31, 2010 is as follows:

| | Total number of shares repurchased | Additional number of shares that may be repurchased | Average price paid per share | Maximum number of shares that may be repurchased under current authorization |
|---|---|---|---------------------------------------|---|
| (Shares in thousands) | | | | |
| January 1 through January 31 | | | \$ | 2,263 |
| February 1 through February 28 | 69 | | 18.66 | 2,194 |
| March 1 through March 31 | 60 | | 18.85 | 2,134 |
| Total three months ended March 31, 2010 | 129 | | \$ 18.75 | |

The repurchase program, which was approved by our board of directors, was announced in October 2002, and was amended in April and July 2003, October 2004, October 2005, May 2007, May 2008 and May 2009. 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 \$2.0 million in the three months ended March 31, 2010 compared to \$1.2 million in the comparable prior year.

Excluding acquisitions and final retainage payment for an office building, we anticipate that 2010 capital spending will be between \$3.7 million and \$4.2 million. Our 2010 expenditures are primarily related to computer equipment and software for infrastructure expansions. We currently do not expect to capitalize significant amounts related to software development in 2010, but the actual amount and timing of those costs, and whether they are capitalized or expensed may result in additional capitalized software development. Capital spending in 2010 is expected to be funded from existing cash balances, cash flows from operations and our revolving line of credit.

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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 to 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.

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. Our investments available-for-sale consist of auction rate municipal securities (ARS) which are collateralized debt obligations supported by municipal agencies and do not include mortgage-backed securities.

All of our ARS are reflected at estimated fair value in the balance sheet at March 31, 2010. In prior periods, due to the auction process which took place approximately every 30 days for most ARS, quoted market prices were readily available, which would have qualified as Level 1 as discussed in ASC 820 Fair Value Measurements and Disclosures. However, due to the financial market crisis, the auction events for most of these securities have failed. Therefore, quoted prices in active markets are no longer available and we determined the estimated fair values of these securities as of March 31, 2010, utilizing a discounted trinomial model.

In association with this estimate of fair value, we have recorded an after-tax temporary unrealized gain on our non-current ARS of \$109,000, net of related tax effects of \$60,000 in the three months ended March 31, 2010, 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 temporary decline in fair value is due entirely to liquidity issues, 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 AAA. 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 very small partial redemptions at par in the period July 2009 through February 2010. Based on our cash and cash equivalents balance of \$9.1 million and expected operating cash flows, 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.

ITEM 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures. We maintain disclosure controls and procedures (as defined in Rule 13a-15(e) of the Securities Exchange Act) designed to provide reasonable assurance that the information required to be disclosed by us in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. These include controls and procedures designed to ensure that this information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosures. Management, with the participation of the Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Based on this evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were effective as of March 31, 2010.

Changes in Internal Control over Financial Reporting. There were no changes in our internal control over financial reporting (as defined in Rule 13a-15(f) of the Exchange Act) during the three months ended March 31, 2010, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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Part II. OTHER INFORMATION

ITEM 1. Legal Proceedings

On November 3, 2008, a putative collective action complaint was filed against us in the United States District Court for the Eastern District of Texas (the Court) on behalf of current and former telephone and remote customer support personnel (Category 1), computer hardware and software set up and maintenance personnel (Category 2), implementation personnel (Category 3), sales support personnel (Category 4), and quality assurance analysts (Category 5). The petition alleges that we misclassified these groups of employees as exempt rather than non-exempt under the Fair Labor Standards Act and that we therefore failed to properly pay overtime wages. The suit was initiated by six former employees working out of our Longview, Texas, office and seeks to recover damages in the form of lost overtime pay, liquidated damages equal to the amount of lost overtime pay, interest, costs, and attorneys' fees. On June 23, 2009, the Court issued an Order granting Plaintiffs' motion for conditional certification for the purpose of providing notice to potential plaintiffs about the litigation. Accordingly, notice was sent to all current and former employees who worked in the foregoing job classifications during the applicable time periods. On October 26, 2009, the opt in period for plaintiffs and potential plaintiffs closed. In 2010, a number of plaintiffs voluntarily withdrew their claims. Currently, there are a total of 61 plaintiffs in the litigation consisting of the following: 24 in Category 1; 3 in Category 2; 32 in Category 3; 0 in Category 4; and 2 in Category 5. We intend to vigorously defend the action. Given the preliminary nature of the alleged claims and the inherent unpredictability of litigation, we cannot at this time estimate the possible outcome of any such action.

Other than ordinary course, routine litigation incidental to our business and except as described in this Quarterly Report, 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

In addition to the other information set forth in this report, one should carefully consider the discussion of various risks and uncertainties contained in Part I, Item 1A. Risk Factors in our 2009 Annual Report on Form 10-K. We believe those risk factors are the most relevant to our business and could cause our results to differ materially from the forward-looking statements made by us. Please note, however, that those are not the only risk factors facing us. Additional risks that we do not consider material, or of which we are not currently aware, may also have an adverse impact on us. Our business, financial condition and results of operations could be seriously harmed if any of these risks or uncertainties actually occurs or materializes. In that event, the market price for our common stock could decline, and our shareholders may lose all or part of their investment. During the first three months of 2010, there were no material changes in the information regarding risk factors contained in our Annual Report on Form 10-K for the year ended December 31, 2009.

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

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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

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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
Executive Vice President and
Chief Financial Officer
(principal financial officer and
an authorized signatory)

Date: April 28, 2010