

TYLER TECHNOLOGIES INC

Form 10-Q

October 27, 2011

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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 September 30, 2011**

**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

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 October 21, 2011 was 29,714,000.

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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<br>September 30, |                 | Nine months ended<br>September 30, |                  |
|---|-------------------------------------|-----------------|------------------------------------|------------------|
|   | 2011                                | 2010            | 2011                               | 2010             |
| Revenues:   |                                     |                 |                                    |                  |
| Software licenses                                   | \$ 7,631                            | \$ 9,260        | \$ 22,761                          | \$ 26,444        |
| Subscriptions                                       | 7,989                               | 6,020           | 22,230                             | 17,080           |
| Software services                                   | 17,644                              | 16,718          | 52,400                             | 52,280           |
| Maintenance   | 37,011                              | 34,729          | 107,579                            | 101,357          |
| Appraisal services                                  | 5,761                               | 5,612           | 17,945                             | 14,812           |
| Hardware and other                                  | 1,148                               | 1,430           | 4,397                              | 4,216            |
| <b>Total revenues</b>                               | <b>77,184</b>                       | <b>73,769</b>   | <b>227,312</b>                     | <b>216,189</b>   |
| Cost of revenues:                                   |                                     |                 |                                    |                  |
| Software licenses                                   | 536                                 | 912             | 2,320                              | 2,471            |
| Acquired software                                   | 243                                 | 398             | 782                                | 1,194            |
| Software services, maintenance and subscriptions    | 35,689                              | 34,708          | 106,371                            | 104,184          |
| Appraisal services                                  | 3,776                               | 3,434           | 11,302                             | 9,442            |
| Hardware and other                                  | 808                                 | 1,110           | 3,645                              | 3,197            |
| <b>Total cost of revenues</b>                       | <b>41,052</b>                       | <b>40,562</b>   | <b>124,420</b>                     | <b>120,488</b>   |
| <b>Gross profit</b>                                 | <b>36,132</b>                       | <b>33,207</b>   | <b>102,892</b>                     | <b>95,701</b>    |
| Selling, general and administrative expenses        | 18,755                              | 17,337          | 54,509                             | 52,337           |
| Research and development expense                    | 4,196                               | 3,233           | 13,780                             | 10,493           |
| Amortization of customer and trade name intangibles | 801                                 | 806             | 2,408                              | 2,419            |
| <b>Operating income</b>                             | <b>12,380</b>                       | <b>11,831</b>   | <b>32,195</b>                      | <b>30,452</b>    |
| Other expense, net                                  | (562)                               | (568)           | (1,586)                            | (712)            |
| <b>Income before income taxes</b>                   | <b>11,818</b>                       | <b>11,263</b>   | <b>30,609</b>                      | <b>29,740</b>    |
| Income tax provision                                | 4,312                               | 4,540           | 11,751                             | 11,896           |
| <b>Net income</b>                                   | <b>\$ 7,506</b>                     | <b>\$ 6,723</b> | <b>\$ 18,858</b>                   | <b>\$ 17,844</b> |
| Earnings per common share:                          |                                     |                 |                                    |                  |
| Basic   | \$ 0.24                             | \$ 0.20         | \$ 0.60                            | \$ 0.52          |

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|  |         |         |         |         |
|--|---------|---------|---------|---------|
| Diluted  | \$ 0.23 | \$ 0.19 | \$ 0.57 | \$ 0.50 |
| Basic weighted average common shares outstanding   | 31,097  | 34,103  | 31,247  | 34,075  |
| Diluted weighted average common shares outstanding | 32,960  | 35,410  | 33,027  | 35,475  |

*See accompanying notes.*

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

|  | September<br>30,<br><br>2011<br>(Unaudited) | December<br>31,<br>2010 |
|--|---|-------------------------|
| <b>ASSETS</b>  |   |                         |
| Current assets:  |   |                         |
| Cash and cash equivalents  | \$ 5,280                                    | \$ 2,114                |
| Short-term investments available-for-sale  |   | 25                      |
| Accounts receivable (less allowance for losses of \$916 in 2011 and \$1,603 in 2010) | 75,456                                      | 81,860                  |
| Prepaid expenses   | 8,008                                       | 7,801                   |
| Other current assets   | 2,483                                       | 3,543                   |
| Deferred income taxes  | 3,106                                       | 3,106                   |
| <br>Total current assets   | <br>94,333                                  | <br>98,449              |
| <br>Accounts receivable, long-term portion   | <br>1,212                                   | <br>1,231               |
| Property and equipment, net  | 40,780                                      | 34,851                  |
| Non-current investments available-for-sale   | 2,101                                       | 2,126                   |
| <br>Other assets:  |   |                         |
| Goodwill   | 92,831                                      | 92,831                  |
| Other intangibles, net   | 28,812                                      | 32,307                  |
| Sundry   | 1,667                                       | 2,237                   |
|  | \$ 261,736                                  | \$ 264,032              |
| <br><b>LIABILITIES AND SHAREHOLDERS EQUITY</b>                                       |   |                         |
| Current liabilities:   |   |                         |
| Accounts payable   | \$ 3,736                                    | \$ 2,626                |
| Accrued liabilities  | 21,202                                      | 19,433                  |
| Deferred revenue   | 108,114                                     | 102,590                 |
| <br>Total current liabilities  | <br>133,052                                 | <br>124,649             |
| <br>Revolving line of credit   | <br>58,000                                  | <br>26,500              |
| Deferred income taxes  | 5,972                                       | 5,911                   |
| <br>Commitments and contingencies  |   |                         |
| <br>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 2011 and 2010 |            |            |
| Additional paid-in capital   | 153,766    | 153,576    |
| Accumulated other comprehensive loss, net of tax   | (275)      | (275)      |
| Retained earnings  | 121,416    | 102,558    |
| Treasury stock, at cost; 18,407,024 and 15,854,205 shares in 2011 and 2010, respectively                 | (210,676)  | (149,368)  |
| Total shareholders' equity   | 64,712     | 106,972    |
|  | \$ 261,736 | \$ 264,032 |

*See accompanying notes.*

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

|   | Nine months ended September<br>30, |           |
|---|------------------------------------|-----------|
|   | 2011                               | 2010      |
| Cash flows from operating activities:   |                                    |           |
| Net income  | \$ 18,858                          | \$ 17,844 |
| Adjustments to reconcile net income to net cash provided by operations:                     |                                    |           |
| Depreciation and amortization   | 7,778                              | 8,077     |
| Share-based compensation expense  | 4,585                              | 4,617     |
| Excess tax benefit from exercises of share-based arrangements                               | (1,721)                            | (1,209)   |
| Changes in operating assets and liabilities, exclusive of effects of<br>acquired companies: |                                    |           |
| Accounts receivable   | 6,423                              | 3,837     |
| Income tax payable  | 3,225                              | (78)      |
| Prepaid expenses and other current assets   | (655)                              | 425       |
| Accounts payable  | 1,110                              | (1,939)   |
| Accrued liabilities   | (22)                               | (3,551)   |
| Deferred revenue  | 5,524                              | (759)     |
| Net cash provided by operating activities   | 45,105                             | 27,264    |
| Cash flows from investing activities:   |                                    |           |
| Proceeds from sale of investments   | 50                                 | 75        |
| Cost of acquisitions, net of cash acquired  |                                    | (9,661)   |
| Additions to property and equipment   | (9,926)                            | (4,197)   |
| Decrease in restricted investments  |                                    | 6,000     |
| Decrease (increase) in other  | 199                                | (3)       |
| Net cash used by investing activities   | (9,677)                            | (7,786)   |
| Cash flows from financing activities:   |                                    |           |
| Purchase of treasury shares   | (68,525)                           | (41,674)  |
| Increase in net borrowings on revolving line of credit                                      | 31,500                             | 16,500    |
| Contributions from employee stock purchase plan   | 1,472                              | 1,404     |
| Proceeds from exercise of stock options   | 1,570                              | 1,863     |
| Debt issuance costs   |                                    | (2,027)   |
| Excess tax benefit from exercises of share-based arrangements                               | 1,721                              | 1,209     |
| Net cash used by financing activities   | (32,262)                           | (22,725)  |
| Net increase (decrease) in cash and cash equivalents  | 3,166                              | (3,247)   |
| Cash and cash equivalents at beginning of period  | 2,114                              | 9,696     |



|  |    |       |    |       |
|--|----|-------|----|-------|
| Cash and cash equivalents at end of period | \$ | 5,280 | \$ | 6,449 |
|--|----|-------|----|-------|

*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 September 30, 2011 and December 31, 2010 and operating result amounts are for the three and nine months ended September 30, 2011 and 2010, 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, 2010. 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) Financial Instruments**

Assets recorded at fair value in the balance sheet as of September 30, 2011 are categorized based upon the level of judgment associated with the inputs used to measure their fair value. Hierarchical levels, defined by Accounting Standards Codification ( ASC ) 820, Fair Value Measurements and Disclosures, which are directly related to the amount of subjectivity associated with the inputs to fair valuation of these assets, are as follows:

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

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

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

As of September 30, 2011 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<br>in<br>active markets<br>for<br>identical<br>assets<br>(Level 1) | Significant<br>other<br>observable<br>inputs<br>(Level 2) | Significant<br>unobservable<br>inputs<br>(Level 3) |
|--------------------------------|----------|--|---|--|
| Cash and cash equivalents      | \$ 5,280 | \$ 5,280   | \$  | \$   |
| Investments available-for-sale | 2,101    |  |   | 2,101  |
| Total                          | \$ 7,381 | \$ 5,280   | \$  | \$ 2,101   |

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 of 21 and 31 years, for which the interest rate is designed to be reset through Dutch auctions approximately every 30 days. However, due to events in the credit markets, auctions for these securities have not occurred since February 2008. Both of our ARS have had a series of very small partial redemptions at par in the period from July 2009 through July 2011. As of September 30, 2011 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.

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The par and carrying values, and related cumulative unrealized loss for our non-current investments available-for-sale as of September 30, 2011 are as follows:

|           |                      |                |
|-----------|----------------------|----------------|
| Par Value | Temporary Impairment | Carrying Value |
| \$ 2,525  | \$ 424               | \$ 2,101       |

We consider the impairment in our ARS as temporary because we do not have the intent to sell, nor is it more-likely-than-not that we will be required to sell these securities before recovery of their cost basis. We believe that this decline in fair value is temporary, because the underlying assets of these securities are supported by municipal agencies and do not include mortgage-backed securities, have redemption features which call for redemption at 100% of par value and have a current credit rating of A or AA. The ratings on the ARS take into account credit support through insurance policies guaranteeing each of the bonds' payment of principal and accrued interest, if it becomes necessary. In addition, both ARS have had a series of very small partial redemptions at par in the period July 2009 through July 2011. We did not record any unrealized gains or losses on our ARS in the nine months ended September 30, 2011. Based on our cash and cash equivalents balance of \$5.3 million, expected operating cash flows and a \$150.0 million credit line, we do not believe a lack of liquidity associated with our ARS will adversely affect our ability to conduct business, and believe we have the ability to hold the securities throughout the currently estimated recovery period. We will continue to evaluate any changes in the market value of our ARS and in the future, depending upon existing market conditions, we may be required to record an other-than-temporary decline in market value.

The following table reflects the activity for assets measured at fair value using Level 3 inputs for the nine months ended September 30, 2011:

|  |          |
|--|----------|
| Balance as of December 31, 2010                                    | \$ 2,126 |
| Transfers into level 3   |          |
| Transfers out of level 3   |          |
| Unrealized gains included in accumulated other comprehensive loss  |          |
| Balance as of March 31, 2011                                       | 2,126    |
| Transfers into level 3   |          |
| Transfers out of level 3   | (25)     |
| Unrealized losses included in accumulated other comprehensive loss |          |
| Balance as of June 30, 2011  | 2,101    |
| Transfers into level 3   |          |
| Transfers out of level 3   |          |
| Unrealized gains included in accumulated other comprehensive loss  |          |
| Balance as of September 30, 2011                                   | \$ 2,101 |

**(3) Shareholders' Equity**

The following table details activity in our common stock:

|                           | Nine months ended September 30, |             |         |             |
|---------------------------|---------------------------------|-------------|---------|-------------|
|                           | 2011                            |             | 2010    |             |
|                           | Shares                          | Amount      | Shares  | Amount      |
| Purchases of common stock | (2,951)                         | \$ (70,480) | (3,350) | \$ (61,549) |

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|                               |     |       |     |       |
|-------------------------------|-----|-------|-----|-------|
| Stock option exercises        | 325 | 1,570 | 367 | 1,863 |
| Employee stock plan purchases | 73  | 1,472 | 91  | 1,371 |

On September 9, 2011 our board of directors authorized the repurchase of up to an additional 2.0 million shares of Tyler common stock. As of September 30, 2011, we had authorization from our board of directors to repurchase up to 1.8 million additional shares of Tyler common stock.

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In August 2010, we entered into a \$150.0 million Credit Agreement (the "Credit Facility") and a related pledge and security agreement with a group of seven financial institutions, with Bank of America, N.A., as Administrative Agent. The Credit Facility provides for a revolving credit line of \$150.0 million (which may be increased up to \$200.0 million subject to our obtaining commitments for such increase), with a \$25.0 million sublimit for letters of credit. The Credit Facility matures on August 11, 2014. Borrowings under the Credit Facility may be used for general corporate purposes, including working capital requirements, acquisitions and share repurchases. Borrowings under the Credit Facility bear interest at a rate of either (1) Bank of America's prime rate plus a margin of 1.50% to 2.75% or (2) the 30, 60, 90 or 180-day LIBOR rate plus a margin of 2.50% to 3.75%, with the margin determined by our consolidated leverage ratio. As of September 30, 2011, our effective average interest rate for borrowings during the three and nine months ended September 30, 2011 was 3.39% and 3.29%, respectively. As of September 30, 2011, our interest rate was 3.23%. The Credit Facility is secured by substantially all of our assets, excluding real property. The Credit Facility requires us to maintain certain financial ratios and other financial conditions and prohibits us from making certain investments, advances, cash dividends or loans, and limits incurrence of additional indebtedness and liens. As of September 30, 2011, we were in compliance with those covenants. As of September 30, 2011, we had \$58.0 million in outstanding borrowings and unused available borrowing capacity of \$83.7 million under the Credit Facility. In addition, as of September 30, 2011, 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 reduce our available borrowing capacity and expire through mid-2012.

**(5) Income Tax Provision**

For the three and nine months ended September 30, 2011, we had an effective income tax rate of 36.5% and 38.4%, respectively compared to 40.3% and 40.0% for the three and nine months ended September 30, 2010, respectively. 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, research and development tax credit and non-deductible meals and entertainment costs.

We made federal and state income tax payments, net of refunds, of \$8.5 million in the nine months ended September 30, 2011, compared to \$12.0 million in net payments for the same period of the prior year.

**(6) Earnings Per Share**

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

|   | Three months ended<br>September 30, |          | Nine months ended<br>September 30, |           |
|---|-------------------------------------|----------|------------------------------------|-----------|
|   | 2011                                | 2010     | 2011                               | 2010      |
| Numerator for basic and diluted earnings per share:                           |                                     |          |                                    |           |
| Net income  | \$ 7,506                            | \$ 6,723 | \$ 18,858                          | \$ 17,844 |
| Denominator:  |                                     |          |                                    |           |
| Weighted-average basic common shares outstanding                              | 31,097                              | 34,103   | 31,247                             | 34,075    |
| Assumed conversion of dilutive securities:                                    |                                     |          |                                    |           |
| Stock options   | 1,863                               | 1,307    | 1,780                              | 1,400     |
| Denominator for diluted earnings per share - Adjusted weighted-average shares | 32,960                              | 35,410   | 33,027                             | 35,475    |

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Earnings per common share:

|         |         |         |         |         |
|---------|---------|---------|---------|---------|
| Basic   | \$ 0.24 | \$ 0.20 | \$ 0.60 | \$ 0.52 |
| Diluted | \$ 0.23 | \$ 0.19 | \$ 0.57 | \$ 0.50 |

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For the three and nine months ended September 30, 2011, stock options representing the right to purchase common stock of approximately 764,000 shares and 781,000 shares, respectively, were not included in the computation of diluted earnings per share because their inclusion would have had an anti-dilutive effect. For the three and nine months ended September 30, 2010, stock options representing the right to purchase common stock of approximately 1.5 million shares and 2.0 million shares, respectively, were not included in the computation of diluted earnings per share because their inclusion would have had an anti-dilutive effect.

**(7) 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<br>September 30, |          | Nine months ended<br>September 30, |          |
|--|-------------------------------------|----------|------------------------------------|----------|
|  | 2011                                | 2010     | 2011                               | 2010     |
| Cost of software services, maintenance and subscriptions | \$ 239                              | \$ 184   | \$ 649                             | \$ 529   |
| Selling, general and administrative expense              | 1,377                               | 1,360    | 3,936                              | 4,088    |
| Total share-based compensation expense                   | \$ 1,616                            | \$ 1,544 | \$ 4,585                           | \$ 4,617 |

**(8) Segment and Related Information**

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

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

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

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

We evaluate performance based on several factors, of which the primary financial measure is business segment operating income. We define segment operating income as income before noncash amortization of intangible assets associated with their acquisition, 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. Segment operating income for corporate also includes our company-wide customer conference revenues and associated expenses.



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For the three months ended September 30, 2011

|                          | ESS       | ATSS      | Corporate  | Totals    |
|--------------------------|-----------|-----------|------------|-----------|
| Revenues                 |           |           |            |           |
| Software licenses        | \$ 7,081  | \$ 550    | \$         | \$ 7,631  |
| Subscriptions            | 7,800     | 189       |            | 7,989     |
| Software services        | 15,199    | 2,445     |            | 17,644    |
| Maintenance              | 33,152    | 3,859     |            | 37,011    |
| Appraisal services       |           | 5,761     |            | 5,761     |
| Hardware and other       | 1,148     |           |            | 1,148     |
| Intercompany             | 599       |           | (599)      |           |
| Total revenues           | \$ 64,979 | \$ 12,804 | \$ (599)   | \$ 77,184 |
| Segment operating income | \$ 14,165 | \$ 2,514  | \$ (3,255) | \$ 13,424 |

For the nine months ended September 30, 2011

|                          | ESS        | ATSS      | Corporate   | Totals     |
|--------------------------|------------|-----------|-------------|------------|
| Revenues                 |            |           |             |            |
| Software licenses        | \$ 20,930  | \$ 1,831  | \$          | \$ 22,761  |
| Subscriptions            | 21,726     | 504       |             | 22,230     |
| Software services        | 45,087     | 7,313     |             | 52,400     |
| Maintenance              | 96,099     | 11,480    |             | 107,579    |
| Appraisal services       |            | 17,945    |             | 17,945     |
| Hardware and other       | 3,300      |           | 1,097       | 4,397      |
| Intercompany             | 1,469      |           | (1,469)     |            |
| Total revenues           | \$ 188,611 | \$ 39,073 | \$ (372)    | \$ 227,312 |
| Segment operating income | \$ 38,933  | \$ 7,556  | \$ (11,104) | \$ 35,385  |

For the three months ended September 30, 2010

|                          | ESS       | ATSS      | Corporate  | Totals    |
|--------------------------|-----------|-----------|------------|-----------|
| Revenues                 |           |           |            |           |
| Software licenses        | \$ 8,613  | \$ 647    | \$         | \$ 9,260  |
| Subscriptions            | 5,943     | 77        |            | 6,020     |
| Software services        | 14,199    | 2,519     |            | 16,718    |
| Maintenance              | 30,987    | 3,742     |            | 34,729    |
| Appraisal services       |           | 5,612     |            | 5,612     |
| Hardware and other       | 1,431     | (1)       |            | 1,430     |
| Intercompany             | 602       |           | (602)      |           |
| Total revenues           | \$ 61,775 | \$ 12,596 | \$ (602)   | \$ 73,769 |
| Segment operating income | \$ 14,211 | \$ 2,611  | \$ (3,787) | \$ 13,035 |

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For the nine months ended September 30, 2010

|                          | ESS        | ATSS      | Corporate   | Totals     |
|--------------------------|------------|-----------|-------------|------------|
| Revenues                 |            |           |             |            |
| Software licenses        | \$ 24,781  | \$ 1,663  | \$          | \$ 26,444  |
| Subscriptions            | 16,840     | 240       |             | 17,080     |
| Software services        | 44,613     | 7,667     |             | 52,280     |
| Maintenance              | 90,202     | 11,155    |             | 101,357    |
| Appraisal services       |            | 14,812    |             | 14,812     |
| Hardware and other       | 4,075      | 6         | 135         | 4,216      |
| Intercompany             | 1,388      |           | (1,388)     |            |
| Total revenues           | \$ 181,899 | \$ 35,543 | \$ (1,253)  | \$ 216,189 |
| Segment operating income | \$ 38,733  | \$ 6,358  | \$ (11,026) | \$ 34,065  |

|   | For the three months ended |           | For the nine months ended |           |
|---|----------------------------|-----------|---------------------------|-----------|
|   | September 30,              |           | September 30,             |           |
|   | 2011                       | 2010      | 2011                      | 2010      |
| Reconciliation of reportable segment operating income to the Company's consolidated totals: |                            |           |                           |           |
| Total segment operating income  | \$ 13,424                  | \$ 13,035 | \$ 35,385                 | \$ 34,065 |
| Amortization of acquired software   | (243)                      | (398)     | (782)                     | (1,194)   |
| Amortization of customer and trade name intangibles   | (801)                      | (806)     | (2,408)                   | (2,419)   |
| Other expense, net  | (562)                      | (568)     | (1,586)                   | (712)     |
| Income before income taxes  | \$ 11,818                  | \$ 11,263 | \$ 30,609                 | \$ 29,740 |

**(9) Commitments and Contingencies**

As of September 30, 2011, our accounts receivable balance includes \$4.2 million associated with one customer that terminated its arrangement with us for convenience and, in addition, has disputed certain amounts we invoiced the customer prior to the termination of the arrangement. We believe the receivable is a valid and enforceable claim under the terms of the arrangement, and we intend to aggressively pursue collection.

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.

**(10) New Accounting Pronouncements**

Accounting Standards Update (ASU) 2011-08 amends existing guidance by giving an entity the option to first assess qualitative factors to determine whether it is more likely than not (that is, a likelihood of more than 50%) that the fair value of a reporting unit is less than its carrying amount. If this is the case, companies will need to perform a more detailed two-step goodwill impairment test which is used to identify potential goodwill impairments and to measure the amount of goodwill impairment losses to be recognized, if any. ASU 2011-08 will be effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, which for us will be in our 2012 second quarter, with early adoption permitted. We do not believe the adoption of this update will have a material impact on our financial statements.

**(11) Subsequent Events**

On October 14, 2011, we acquired all of the capital stock of Windsor Management Group, L.L.C. (Windsor) for a cash purchase price of \$16.3 million, net of cash acquired of \$7.2 million. Windsor provides an integrated suite of financial and human capital management solutions to the K-12 education market, primarily in the Southwest. We have not finalized the allocation of the purchase price.



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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) changes in the budgets or regulatory environments of our customers, primarily local and state governments, that could negatively impact information technology spending; (2) our ability to 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) economic, political and market conditions, including the global economic and financial crisis, and the general tightening of access to debt or equity capital; (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 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 (ASP) arrangements, electronic document filing solutions for courts and law offices 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 (ATSS) segment provides systems and software that automate the appraisal and assessment of real and personal property as well as property appraisal outsourcing services for local governments and taxing authorities. Property appraisal outsourcing services include: the physical inspection of commercial and residential properties; data collection and processing; computer analysis for property valuation; preparation of tax rolls; community education; and arbitration between taxpayers and the assessing jurisdiction.

On October 14, 2011, we acquired all of the capital stock of Windsor Management Group, L.L.C. (Windsor) for a cash purchase price of \$16.3 million, net of cash acquired of \$7.2 million. Windsor provides an integrated suite of financial and human capital management solutions to the K-12 education market, primarily in the Southwest.

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During the nine months ended September 30, 2011, we purchased approximately 3.0 million shares of our common stock for an aggregate purchase price of \$70.5 million.

In March 2011, we paid \$6.6 million for approximately 27 acres of land and a building in Plano, Texas.

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Our total employee count declined from 2,069 at September 30, 2010 to 2,011 at September 30, 2011.

**Outlook**

Consistent with 2010, we are continuing to invest aggressively in product development in 2011. We believe that our competitive position is strong and that we are well-positioned to take advantage of an eventual return to a stronger economic environment. However, until we see signs of sustained improvement, we are expecting that the new business environment in 2011 will continue to be both challenging and unpredictable, and that growth will come primarily from recurring revenues.

**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, 2010. 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, 2010.

**ANALYSIS OF RESULTS OF OPERATIONS**

|  | Percentage of Total Revenues |       |             |       |
|--|------------------------------|-------|-------------|-------|
|  | Third Quarter                |       | Nine Months |       |
|  | 2011                         | 2010  | 2011        | 2010  |
| Revenues:  |                              |       |             |       |
| Software licenses  | 9.9%                         | 12.5% | 10.0%       | 12.2% |
| Subscriptions  | 10.3                         | 8.2   | 9.8         | 7.9   |
| Software services  | 22.9                         | 22.7  | 23.1        | 24.2  |
| Maintenance  | 48.0                         | 47.1  | 47.3        | 46.9  |
| Appraisal services                                       | 7.5                          | 7.6   | 7.9         | 6.8   |
| Hardware and other                                       | 1.4                          | 1.9   | 1.9         | 2.0   |
| Total revenues   | 100.0                        | 100.0 | 100.0       | 100.0 |
| Operating Expenses:                                      |                              |       |             |       |
| Cost of software licenses and acquired software          | 1.0                          | 1.8   | 1.4         | 1.7   |
| Cost of software services, maintenance and subscriptions | 46.3                         | 47.0  | 46.8        | 48.2  |
| Cost of appraisal services                               | 4.9                          | 4.7   | 5.0         | 4.3   |
| Cost of hardware and other                               | 1.0                          | 1.5   | 1.6         | 1.5   |
| Selling, general and administrative expenses             | 24.3                         | 23.5  | 24.0        | 24.2  |
| Research and development expense                         | 5.5                          | 4.4   | 6.0         | 4.9   |
| Amortization of customer base and trade name intangibles | 1.0                          | 1.1   | 1.0         | 1.1   |
| Operating income   | 16.0                         | 16.0  | 14.2        | 14.1  |
| Other expenses, net                                      | (0.7)                        | (0.8) | (0.7)       | (0.3) |
| Income before income taxes                               | 15.3                         | 15.2  | 13.5        | 13.8  |
| Income tax provision                                     | 5.6                          | 6.1   | 5.2         | 5.5   |
| Net income   | 9.7%                         | 9.1%  | 8.3%        | 8.3%  |



**Table of Contents**Revenues*Software licenses.*

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

| (\$ in thousands)               | Third Quarter |          | Change     |       | Nine Months |           | Change     |       |
|---------------------------------|---------------|----------|------------|-------|-------------|-----------|------------|-------|
|                                 | 2011          | 2010     | \$         | %     | 2011        | 2010      | \$         | %     |
| ESS                             | \$ 7,081      | \$ 8,613 | \$ (1,532) | (18)% | \$ 20,930   | \$ 24,781 | \$ (3,851) | (16)% |
| ATSS                            | 550           | 647      | (97)       | (15)  | 1,831       | 1,663     | 168        | 10    |
| Total software license revenues | \$ 7,631      | \$ 9,260 | \$ (1,629) | (18)% | \$ 22,761   | \$ 26,444 | \$ (3,683) | (14)% |

For the three and nine months ended September 30, 2011, the decline in ESS software license revenues recognized was primarily attributable to longer sales cycles and postponement of customer purchasing decisions mainly due to budgetary constraints related to economic conditions as well as extended implementation timetables on some signed business. In addition, a portion of the decline was due to a number of customers choosing our subscription-based options, rather than purchasing the software under a traditional perpetual software arrangement. Subscription-based arrangements result in no software license revenues in the initial year as compared to traditional perpetual software license arrangements but generate higher overall subscription-based revenue over the term of the contract. We had 12 and 38 new customers enter into subscription-based arrangements in the three and nine months ending September 30, 2011, respectively, compared to two and 10 new customers in the three and nine months ended September 30, 2010, respectively. Most new customers for subscription-based arrangements were ESS customers. We currently expect ESS software license revenues for the full year 2011 to be moderately lower than 2010.

In the three months ended September 30, 2011, we signed 18 new large contracts with average software license fees of approximately \$277,000 compared to 15 new large contracts signed in the three months ended September 30, 2010 with average software license fees of approximately \$280,000. In the nine months ended September 30, 2011, we signed 43 new large contracts with average software license fees of approximately \$346,000 compared to 48 new large contracts signed in the nine months ended September 30, 2010 with average software license fees of approximately \$373,000. 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 1 in the Notes to the Financial Statements included in our Form 10-K for the year ended December 31, 2010.

*Subscriptions.*

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

| (\$ in thousands)            | Third Quarter |          | Change   |     | Nine Months |           | Change   |     |
|------------------------------|---------------|----------|----------|-----|-------------|-----------|----------|-----|
|                              | 2011          | 2010     | \$       | %   | 2011        | 2010      | \$       | %   |
| ESS                          | \$ 7,800      | \$ 5,943 | \$ 1,857 | 31% | \$ 21,726   | \$ 16,840 | \$ 4,886 | 29% |
| ATSS                         | 189           | 77       | 112      | 145 | 504         | 240       | 264      | 110 |
| Total subscriptions revenues | \$ 7,989      | \$ 6,020 | \$ 1,969 | 33% | \$ 22,230   | \$ 17,080 | \$ 5,150 | 30% |

Subscription-based services revenue primarily consists of revenues derived from ASP arrangements and other hosted service offerings, software subscriptions and disaster recovery services. We also provide electronic document filing solutions (e-filings) for courts and law offices which simplify the filing and management of court related documents.



Revenues for e-filings are generally derived from transaction fees. ASP and other software subscription agreements are typically for initial 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. 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. In the three months ending September 30, 2011, we added 12 new customers and 17 existing customers elected to convert to our ASP model. In the nine months ended September 30, 2011, we added 38 new customers and 28 existing customers elected to convert to our ASP model.

**Table of Contents***Software services.*

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

| (\$ in thousands)                | Third Quarter |           | Change   |     | Nine Months |           | Change |     |
|----------------------------------|---------------|-----------|----------|-----|-------------|-----------|--------|-----|
|                                  | 2011          | 2010      | \$       | %   | 2011        | 2010      | \$     | %   |
| ESS                              | \$ 15,199     | \$ 14,199 | \$ 1,000 | 7%  | \$ 45,087   | \$ 44,613 | \$ 474 | 1%  |
| ATSS                             | 2,445         | 2,519     | (74)     | (3) | 7,313       | 7,667     | (354)  | (5) |
| Total software services revenues | \$ 17,644     | \$ 16,718 | \$ 926   | 6%  | \$ 52,400   | \$ 52,280 | \$ 120 | 0%  |

Software services revenues primarily consists of professional services billed in connection with the 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. Existing customers also periodically purchase additional training, consulting and minor programming services. In the three months ended September 30, 2011, software services revenue included services to build certain software interfaces associated with a state wide contract.

*Maintenance.*

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

| (\$ in thousands)          | Third Quarter |           | Change   |    | Nine Months |            | Change   |    |
|----------------------------|---------------|-----------|----------|----|-------------|------------|----------|----|
|                            | 2011          | 2010      | \$       | %  | 2011        | 2010       | \$       | %  |
| ESS                        | \$ 33,152     | \$ 30,987 | \$ 2,165 | 7% | \$ 96,099   | \$ 90,202  | \$ 5,897 | 7% |
| ATSS                       | 3,859         | 3,742     | 117      | 3  | 11,480      | 11,155     | 325      | 3  |
| Total maintenance revenues | \$ 37,011     | \$ 34,729 | \$ 2,282 | 7% | \$ 107,579  | \$ 101,357 | \$ 6,222 | 6% |

We provide maintenance and support services for our software products and third party software. Maintenance and support revenues increased due to growth in our installed customer base from new software license sales and maintenance rate increases on most of our product lines. Our maintenance revenue growth rate has been reduced somewhat by the effect of existing installed customers converting to our hosted offering, which results in a loss of maintenance revenue offset by a larger increase in subscription revenue. New customers choosing our subscription-based options, rather than purchasing the software under a traditional perpetual software license arrangement also negatively impact our maintenance revenue growth rate.

*Appraisal services.*

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

| (\$ in thousands) | Third Quarter |       | Change |   | Nine Months |        | Change |    |
|-------------------|---------------|-------|--------|---|-------------|--------|--------|----|
|                   | 2011          | 2010  | \$     | % | 2011        | 2010   | \$     | %  |
| ESS               | \$            | \$    | \$     | % | \$          | \$     | \$     | %  |
| ATSS              | 5,761         | 5,612 | 149    | 3 | 17,945      | 14,812 | 3,133  | 21 |

|                                   |          |          |        |    |           |           |          |     |
|-----------------------------------|----------|----------|--------|----|-----------|-----------|----------|-----|
| Total appraisal services revenues | \$ 5,761 | \$ 5,612 | \$ 149 | 3% | \$ 17,945 | \$ 14,812 | \$ 3,133 | 21% |
|-----------------------------------|----------|----------|--------|----|-----------|-----------|----------|-----|

The appraisal services business is somewhat cyclical and driven in part by legislated revaluation cycles in various states. We began work on several new large revaluation contracts in late 2009 and mid-2010 which provided the majority of the increase in appraisal services revenues for the nine months ended September 30, 2011. We expect appraisal revenues for the full year 2011 to be moderately higher than 2010.

**Table of Contents**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 as of September 30:

| (\$ in thousands)                                | Third Quarter |           | Change   |       | Nine Months |            | Change   |      |
|--|---------------|-----------|----------|-------|-------------|------------|----------|------|
|  | 2011          | 2010      | \$       | %     | 2011        | 2010       | \$       | %    |
| Software licenses                                | \$ 536        | \$ 912    | \$ (376) | (41)% | \$ 2,320    | \$ 2,471   | \$ (151) | (6)% |
| Acquired software                                | 243           | 398       | (155)    | (39)  | 782         | 1,194      | (412)    | (35) |
| Software services, maintenance and subscriptions | 35,689        | 34,708    | 981      | 3     | 106,371     | 104,184    | 2,187    | 2    |
| Appraisal services                               | 3,776         | 3,434     | 342      | 10    | 11,302      | 9,442      | 1,860    | 20   |
| Hardware and other                               | 808           | 1,110     | (302)    | (27)  | 3,645       | 3,197      | 448      | 14   |
| Total cost of revenues                           | \$ 41,052     | \$ 40,562 | \$ 490   | 1%    | \$ 124,420  | \$ 120,488 | \$ 3,932 | 3%   |

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

| Gross margin percentage                          | Third Quarter |       | Change % | Nine Months |       | Change % |
|--|---------------|-------|----------|-------------|-------|----------|
|  | 2011          | 2010  |          | 2011        | 2010  |          |
| Software license and acquired software           | 89.8%         | 85.9% | 3.9%     | 86.4%       | 86.1% | 0.3%     |
| Software services, maintenance and subscriptions | 43.0          | 39.6  | 3.4      | 41.6        | 39.0  | 2.6      |
| Appraisal services                               | 34.5          | 38.8  | (4.3)    | 37.0        | 36.3  | 0.7      |
| Hardware and other                               | 29.6          | 22.4  | 7.2      | 17.1        | 24.2  | (7.1)    |
| Overall gross margin                             | 46.8%         | 45.0% | 1.8%     | 45.3%       | 44.3% | 1.0%     |

*Software licenses and acquired software.* Costs of software license and acquired software is primarily comprised of third party software costs and amortization expense for software acquired through acquisitions. 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 five years. Cost of software licenses and acquired software also includes amortization expense for capitalized development costs on certain software products. Most of these development costs were fully amortized by late 2010.

For the three months ended September 30, 2011, our software license gross margin percentage increased because the product mix included lower third party software costs. In addition, several acquired software solutions became fully amortized in mid-2011.

*Software services, maintenance and subscription services.* Cost of software services, maintenance and subscriptions primarily consists of personnel costs related to installation of our software, conversion of customer data, on-going software development efforts, training customer personnel and support activities and various other services such as ASP and disaster recovery. For the three and nine months ended September 30, 2011, the software services, maintenance and subscriptions gross margin percentage increased compared to the prior year period in part because maintenance and various other services such as ASP and disaster recovery costs typically grow at a slower rate than related revenues due to leverage in the utilization of our personnel and economies of scale, as well as slightly higher rates on certain services. We are also managing costs and staff levels to ensure they are in line with demand for

professional services. Our software services, maintenance and subscription staff has declined by 42 employees since September 30, 2010.

*Appraisal services.* Our appraisal services gross margin percentage declined for the three months ended September 30, 2011 compared to the prior year period as several large revaluation contracts with relatively high margins, which had begun in mid-2010 reached completion in the third quarter of 2011. We often hire temporary employees to assist in appraisal projects whose term of employment generally ends with the project's completion. We have decreased our appraisal services staff by 24 employees since September 30, 2010 in connection with the completion of several revaluation contracts which began in late 2009 and mid-2010.

Our blended gross margin percentage increased 1.8% and 1.0% for the three and nine months ended September 30, 2011, respectively, compared to the prior year periods. The gross margin for both periods benefited from leverage in the utilization of our support and maintenance staff and economies of scale and slightly higher rates on certain services. For the three months ended September 30, 2011 the gross margin was offset somewhat by the completion in mid-2011 of several large revaluation contracts

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that had relatively high margins. The gross margin for the nine months ended September 30, 2011 was also slightly reduced by expenses we incurred in connection with a company-wide customer conference held in the second quarter of 2011. We did not have a similar conference in 2010.

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 September 30:

| (\$ in thousands)                            | Third Quarter |           | Change   |    | Nine Months |           | Change   |    |
|--|---------------|-----------|----------|----|-------------|-----------|----------|----|
|  | 2011          | 2010      | \$       | %  | 2011        | 2010      | \$       | %  |
| Selling, general and administrative expenses | \$ 18,755     | \$ 17,337 | \$ 1,418 | 8% | \$ 54,509   | \$ 52,337 | \$ 2,172 | 4% |

SG&A as a percentage of revenues for the three and nine months ended September 30, 2011 was 24.3% and 24.0%, respectively compared to 23.5% and 24.2% for the three and nine months ended September 30, 2010, respectively. In the three months ended September 30, 2011, SG&A expenses include moving costs associated with consolidating office space in our Yarmouth, Maine facility and other facilities related costs.

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   |     |
|----------------------------------|---------------|----------|--------|-----|-------------|-----------|----------|-----|
|                                  | 2011          | 2010     | \$     | %   | 2011        | 2010      | \$       | %   |
| Research and development expense | \$ 4,196      | \$ 3,233 | \$ 963 | 30% | \$ 13,780   | \$ 10,493 | \$ 3,287 | 31% |

Research and development expense consist mainly of costs associated with development of new products and new software platforms from 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 staff associated with development of new products and new software platforms by seven employees since September 30, 2010. 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 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. In April 2011, Tyler and Microsoft entered into an amended and superseded Master Software Development and License Agreement, which among other things, grants Microsoft intellectual property rights in the remaining portions of the software code developed by Tyler in exchange for certain other concessions. Under the new agreement, Tyler will continue to receive the previously agreed to reimbursement payments. In addition, Tyler has agreed to commit certain resources to the development of the next version of Dynamics AX and will receive software and maintenance royalties on direct and indirect sales of the solutions co-developed under this arrangement.

Our research and development expense increased \$963,000 and \$3.3 million for the three and nine months ended September 30, 2011, respectively, compared to the prior year periods. The increase is mainly due to lower reimbursements from Microsoft in the first nine months of 2011. In the three and nine months ended September 30,

2011 we offset our research and development expense by \$885,000 and \$1.3 million, respectively, which were the amounts earned under the terms of our agreement with Microsoft compared to \$1.5 million and \$3.8 million for the three and nine months ended September 30, 2010. Prior to December 31, 2010, we received offsets from Microsoft to our research and development expense of approximately \$850,000 each quarter from mid-2008 through the end of 2010 as specified in a statement of work under the Amended Software Development and License Agreement with Microsoft. 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 through mid-2012 for a total of approximately \$6.2 million. As of September 30, 2011, we have recorded \$2.9 million in offsets from Microsoft and we currently expect to record the remaining \$3.3 million through mid-2012. The actual amount and timing of future research and development costs and related reimbursements and whether they are capitalized or expensed may vary. We expect the rate at which we recognize offsets

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to our research and development expense to decline compared to 2010 due to changes in the timing of deployment of resources and we believe most of the offsets relating to 2011 efforts will be recognized in the fourth quarter.

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 September 30:

| (\$ in thousands)                                   | Third Quarter |        | Change |      | Nine Months |          | Change  |      |
|---|---------------|--------|--------|------|-------------|----------|---------|------|
|   | 2011          | 2010   | \$     | %    | 2011        | 2010     | \$      | %    |
| Amortization of customer and trade name intangibles | \$ 801        | \$ 806 | \$ (5) | (1)% | \$ 2,408    | \$ 2,419 | \$ (11) | (0)% |

Other Expense, Net

The following table sets forth a comparison of our other expense, net for the periods presented as of September 30:

| (\$ in thousands)  | Third Quarter |          | Change |    | Nine Months |          | Change   |        |
|--------------------|---------------|----------|--------|----|-------------|----------|----------|--------|
|                    | 2011          | 2010     | \$     | %  | 2011        | 2010     | \$       | %      |
| Other expense, net | \$ (562)      | \$ (568) | \$ 6   | 1% | \$ (1,586)  | \$ (712) | \$ (874) | (123)% |

The majority of other expense is comprised of interest expense, non-usage and other fees associated with our revolving credit agreement. Interest expense in the nine months ended September 30, 2011 was higher than the prior year period due to higher debt levels associated with a series of stock repurchases that began in early 2010 and continued through the third quarter of 2011. The effective interest rate for the three and nine months ended September 30, 2011 was 3.39% and 3.29%, respectively compared to 4.36% and 3.89% in the prior year periods.

Income Tax Provision

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

| (\$ in thousands)         | Third Quarter |          | Change   |      | Nine Months |           | Change   |      |
|---------------------------|---------------|----------|----------|------|-------------|-----------|----------|------|
|                           | 2011          | 2010     | \$       | %    | 2011        | 2010      | \$       | %    |
| Income tax provision      | \$ 4,312      | \$ 4,540 | \$ (228) | (5)% | \$ 11,751   | \$ 11,896 | \$ (145) | (1)% |
| Effective income tax rate | 36.5%         | 40.3%    |          |      | 38.4%       | 40.0%     |          |      |

The effective income tax rates for the three and nine months ended September 30, 2011 and 2010 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, research and development tax credit and non-deductible meals and entertainment costs.



**Table of Contents****FINANCIAL CONDITION AND LIQUIDITY**

As of September 30, 2011 we had cash and cash equivalents of \$5.3 million and investments of \$2.1 million, compared to cash and cash equivalents of \$2.1 million and investments of \$2.2 million at December 31, 2010. As of September 30, 2011, we had \$58.0 million in outstanding borrowings and unused borrowing capacity of \$83.7 million under our revolving line of credit. In addition, as of September 30, 2011, we had outstanding letters of credit totaling \$8.3 million to secure surety bonds required by some of our customer contracts. Letters of credit are issued under our revolving line of credit and reduce our available borrowing capacity. These letters of credit expire through mid-2012. We believe our \$150.0 million revolving line of credit provides us with sufficient flexibility to meet our long-term financial needs.

The following table sets forth a summary of cash flows for the nine months ended September 30:

| (\$ in thousands)                                    | 2011      | 2010       |
|--|-----------|------------|
| Cash flows provided (used) by:                       |           |            |
| Operating activities                                 | \$ 45,105 | \$ 27,264  |
| Investing activities                                 | (9,677)   | (7,786)    |
| Financing activities                                 | (32,262)  | (22,725)   |
| Net increase (decrease) in cash and cash equivalents | \$ 3,166  | \$ (3,247) |

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. It is possible that our ability to access the capital and credit markets in the future may be limited by economic conditions or other factors. We currently believe that cash provided by operating activities, cash on hand and available credit are sufficient to fund our working capital requirements, capital expenditures, income tax obligations, and share repurchases for at least the next twelve months.

For the nine months ended September 30, 2011, operating activities provided net cash of \$45.1 million, primarily generated from net income of \$18.9 million, non-cash depreciation and amortization charges of \$7.8 million and non-cash share-based compensation expense of \$4.6 million. Working capital, excluding cash, declined \$15.6 million due to collections of annual maintenance renewals billed near the end of June and higher customer deposits mainly due to new maintenance and subscription customers. Our maintenance billing cycle typically peaks at its highest level in June with cash related to those billings collected in the third quarter. Timing of payments on vendor invoices and income tax liabilities also contributed to the working capital decline.

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 88 days at September 30, 2011, compared to 102 days at December 31, 2010 and 94 days at September 30, 2010. Our maintenance billing cycle typically peaks at its highest level in June and second highest level in December of each year and is followed by collections in the subsequent quarter. As a result our DSO is usually lower in the third quarter than the fourth quarter. DSO is calculated based on quarter-end accounts receivable divided by the quotient of annualized quarterly revenues divided by 360 days.

Investing activities used cash of \$9.7 million in the nine months ending September 30, 2011 compared to \$7.8 million for the same period in 2010. In March 2011 we paid \$6.6 million for approximately 27 acres of land and a building in Plano, Texas. In January 2010, we completed the acquisition of the assets of Wiznet, Inc. for \$9.5 million in cash. Also, we paid \$1.3 million in the nine months ended September 30, 2010, for construction of an office building in Lubbock, Texas. Capital expenditures and the acquisition were funded from cash generated from operations.

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 of 21 and 31 years, for which the interest rate is designed to be reset

through Dutch auctions approximately every 30 days. However, due to events in the credit markets, auctions for these securities have not occurred since February 2008. Both of our ARS have had a series of very small partial redemptions at par in the period from July 2009 through July 2011. As of September 30, 2011 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.

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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.

We consider the impairment in our ARS as temporary because we do not have the intent to sell, nor is it more-likely-than-not that we will be required to sell these securities before recovery of their cost basis. We believe that this decline in fair value is temporary because the underlying assets of these securities are supported by municipal agencies and do not include mortgage-backed securities, have redemption features which call for redemption at 100% of par value and have a current credit rating of A or AA. The ratings on the ARS take into account credit support through insurance policies guaranteeing each of the bonds' payment of principal and accrued interest, if it becomes necessary. In addition, both ARS have had a series of very small partial redemptions at par in the period July 2009 through July 2011. We did not record any unrealized gains or losses on our ARS in the nine months ended September 30, 2011. Based on our cash and cash equivalents balance of \$5.3 million, expected operating cash flows and a \$150.0 million revolving credit line, 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.

Financing activities used cash of \$32.3 million in the nine months ended September 30, 2011 compared \$22.7 million in the same period for 2010. Cash used by financing activities in 2011 was primarily comprised of purchases of 3.0 million shares of our common stock for \$70.5 million, of which \$2.0 million was included in accrued liabilities at September 30, 2011. These purchases were funded by borrowings under our revolving credit line and cash from operations. In the nine months ended September 30, 2011, we collected \$3.0 million from stock option exercises and employee stock purchase plan activity.

On September 9, 2011 our board of directors authorized the repurchase of up to an additional 2.0 million shares of Tyler common stock. At September 30, 2011, we had authorization to repurchase up to 1.8 million additional shares of Tyler common stock. A summary of the repurchase activity during the nine months ended September 30, 2011 is as follows:

|  | Total<br>number<br>of shares<br>repurchased | Additional<br>number<br>of shares<br>authorized<br>that may be<br>repurchased | Average<br>price<br>paid per<br>share | Maximum<br>number of<br>shares that may<br>be<br>repurchased<br>under<br>current<br>authorization |
|--|---|---|---------------------------------------|---|
| (Shares in thousands)                              |   |   |                                       |   |
| January 1 through January 31                       | 335   |   | \$ 20.43                              | 2,369   |
| February 1 through February 28                     |   |   |                                       | 2,369   |
| March 1 through March 31                           |   |   |                                       | 2,369   |
| April 1 through April 30                           | 67  |   | 23.90                                 | 2,302   |
| May 1 through May 31                               | 119   |   | 24.30                                 | 2,183   |
| June 1 through June 30                             | 392   |   | 24.34                                 | 1,791   |
| July 1 through July 31                             |   |   |                                       | 1,791   |
| August 1 through August 31                         | 1,097                                       |   | 24.11                                 | 694   |
| Additional authorization by the board of directors |   | 2,000   |                                       | 2,694   |
| September 1 through September 30                   | 941   |   | 24.60                                 | 1,753   |

|  |       |       |    |       |
|--|-------|-------|----|-------|
| Total nine months ended September 30, 2011 | 2,951 | 2,000 | \$ | 23.88 |
|--|-------|-------|----|-------|

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, May 2009, July and October 2010 and September 2011. 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.

Subsequent to September 30, 2011 and through October 21, 2011 we purchased approximately 53,000 shares of our common stock for an aggregate cash purchase price of \$1.3 million.

Our Credit Agreement (the "Credit Facility") provides for a revolving credit line of \$150.0 million (which may be increased up to \$200.0 million subject to our obtaining commitments for such increase), with a \$25.0 million sublimit for letters of credit. The Credit Facility matures on August 11, 2014. Borrowings under the Credit Facility may be used for general corporate purposes, including working capital requirements, acquisitions and share repurchases.

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Borrowings under the Credit Facility bear interest at a rate of either (1) Bank of America's prime rate plus a margin of 1.50% to 2.75% or (2) the 30, 60, 90 or 180-day LIBOR rate plus a margin of 2.50% to 3.75%, with the margin determined by our consolidated leverage ratio. As of September 30, 2011, our effective average interest rate for borrowings during the three months and nine months ended September 30, 2011 was 3.39% and 3.29%, respectively. The Credit Facility is secured by substantially all of our assets, excluding real property. The Credit Facility requires us to maintain certain financial ratios and other financial conditions and prohibits us from making certain investments, advances, cash dividends or loans, and limits incurrence of additional indebtedness and liens. As of September 30, 2011, we were in compliance with those covenants.

We made federal and state income tax payments, net of refunds, of \$8.5 million in the nine months ended September 30, 2011 compared to \$12.0 million in the prior year.

On October 14, 2011, we acquired all of the capital stock of Windsor Management Group, L.L.C. ( Windsor ) for a cash purchase price of \$16.3 million, net of cash acquired of \$7.2 million. Windsor provides an integrated suite of financial and human capital management solutions to the K-12 education market, primarily in the Southwest.

Excluding acquisitions, we anticipate that 2011 capital spending will be between \$11.7 million and \$12.2 million. Capital expenditures in 2011 include the purchase of approximately 27 acres of land and a building for \$6.6 million. For the remainder of the year we expect the majority of our capital expenditures will consist of computer equipment and software for infrastructure replacements and expansion. We currently do not expect to capitalize significant amounts related to software development in 2011, 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 2011 is expected to be funded from existing cash balances and cash flows from operations.

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.

Non-current investments available-for-sale consist of two ARS with stated maturities ranging from 21 to 31 years, for which the interest rate is designed to be reset through Dutch auctions approximately every 30 days which would have qualified as Level 1 under ASC 820, Fair Value Measurements. However, due to events in the credit markets, auctions for these securities have not occurred since February 2008. Therefore, quoted prices in active markets are no longer available and we determined the estimated fair values of these securities as of September 30, 2011 utilizing a discounted trinomial model.

We consider the impairment in our ARS as temporary because we do not have the intent to sell, nor is it more-likely-than-not that we will be required to sell these securities before recovery of their cost basis. We believe that this decline in fair value is temporary, because the underlying assets of these securities are supported by municipal agencies and do not include mortgage-backed securities, have redemption features which call for redemption at 100% of par value and have a current credit rating of A or AA. The ratings on the ARS take into account credit support through insurance policies guaranteeing each of the bonds' payment of principal and accrued interest, if it becomes necessary. In addition, both ARS have had a series of very small partial redemptions at par in the period July 2009 through July 2011. Based on our cash and cash equivalents balance of \$5.3 million, expected operating cash flows and a \$150.0 million revolving credit line, 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 fair 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.

As of September 30, 2011 we had \$58.0 million in outstanding borrowings under the Credit Facility. These borrowings bear interest at a rate of either (1) Bank of America's prime rate plus a margin of 1.50% to 2.75% or (2) the

30, 60, 90 or 180-day LIBOR rate plus a margin of 2.50% to 3.75%, with the margin determined by our consolidated leverage ratio. As of September 30, 2011 our interest rate was 3.23%. Assuming borrowings of \$58.0 million, a hypothetical 10% increase in our interest rate at September 30, 2011 for a one year period would result in approximately \$187,000 of additional interest rate expense.

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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 September 30, 2011.

*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 September 30, 2011, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**Part II. OTHER INFORMATION**

ITEM 1. Legal Proceedings

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 2010 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 three months ended September 30, 2011, 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, 2010.

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

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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

Exhibit 101 Instance Document

Exhibit 101 Schema Document

Exhibit 101 Calculation Linkbase Document

Exhibit 101 Labels Linkbase Document

Exhibit 101 Presentation Linkbase Document



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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: October 27, 2011