TYLER TECHNOLOGIES INC
Form 10-Q
April 26, 2007

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

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

For the quarterly period ended March 31, 2007

OR

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

Commission File Number 1-10485
TYLER TECHNOLOGIES, INC.
(Exact name of registrant as specified in its charter)

DELAWARE	75-2303920
(State or other jurisdiction of incorporation or organization)	(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 þ No o

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 o Accelerated filer þ Non-accelerated filer o

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

Number of shares of common stock of registrant outstanding at April 23, 2007: 38,944,283

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PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

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

	Three months ended March 31,	
	2007	2006
Revenues:		
Software licenses	$ 7,971	$ 7,571
Software services	15,064	13,120
Maintenance	19,939	17,657
Appraisal services	5,580	4,699
Hardware and other	1,778	1,811
Total revenues	50,332	44,858
Cost of revenues:		
Software licenses	1,960	2,676
Acquired software	394	301
Software services and maintenance	24,588	21,745
Appraisal services	3,996	3,406
Hardware and other	1,372	1,268
Total cost of revenues	32,310	29,396
Gross profit	18,022	15,462
Selling, general and administrative expenses	12,976	10,976
Research and development expense	1,223	902
Amortization of customer and trade name intangibles	347	322
Operating income	3,476	3,262
Other income, net	447	97
Income before income taxes	3,923	3,359
Income tax provision	1,522	1,347
Net income	$ 2,401	$ 2,012
Earnings per common share:		
Basic	$ 0.06	$ 0.05

Diluted	$ 0.06	$ 0.05
Basic weighted average common shares outstanding	38,813	39,114
Diluted weighted average common shares outstanding	42,066	41,894

See accompanying notes.

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

	March 31, 2007 (Unaudited)	December 31, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	$ 15,111	$ 17,212
Restricted cash equivalents	4,462	4,962
Short-term investments available-for-sale	20,774	19,543
Accounts receivable (less allowance for losses of $1,924 in 2007 and $2,971 in 2006)	47,219	58,188
Prepaid expenses	7,083	6,864
Other current assets	2,360	2,326
Deferred income taxes	2,579	2,579
Total current assets	99,588	111,674
Accounts receivable, long-term portion	1,137	1,675
Property and equipment, net	8,506	7,390
Other assets:		
Goodwill	68,357	66,127
Customer related intangibles, net	17,821	17,502
Software, net	14,767	14,554
Trade name, net	1,160	1,188
Sundry	155	166
	$ 211,491	$ 220,276
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 3,121	$ 5,063
Accrued liabilities	14,714	17,735
Deferred revenue	57,399	62,387
Income taxes payable	1,078	
Total current liabilities	76,312	85,185
Deferred income taxes	8,854	9,216
Commitments and contingencies		
Shareholders equity:		
Preferred stock, $10.00 par value; 1,000,000 shares authorized, none issued		

Common stock, $0.01 par value; 100,000,000 shares authorized; 48,147,969 shares issued in 2007 and 2006	481	481
Additional paid-in capital	149,398	151,627
Accumulated other comprehensive loss, net of tax	(17)	(10)
Retained earnings	20,532	18,131
Treasury stock, at cost; 9,228,593 and 9,255,783 shares in 2007 and 2006, respectively	(44,069)	(44,354)
Total shareholders equity	126,325	125,875
	$ 211,491	$ 220,276

See accompanying notes.

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

	Three months ended March 31, 2007	2006
Cash flows from operating activities:		
Net income	$ 2,401	$ 2,012
Adjustments to reconcile net income to net cash provided by operations:		
Depreciation and amortization	2,549	2,647
Share-based compensation expense	498	471
Purchased in-process research and development charge		140
Non-cash interest and other charges		159
Changes in operating assets and liabilities, exclusive of effects of acquired companies:		
Accounts receivable	11,791	12,352
Income tax payable	1,129	191
Prepaid expenses and other current assets	(559)	(700)
Accounts payable	(2,075)	(736)
Accrued liabilities	(3,244)	(2,655)
Deferred revenue	(5,618)	(3,877)
Net cash provided by operating activities	6,872	10,004
Cash flows from investing activities:		
Proceeds from sale of short-term investments	2,610	6,330
Purchases of short-term investments	(3,850)	(4,850)
Cost of acquisitions, net of cash acquired	(4,963)	(11,613)
Investment in software development costs	(25)	(73)
Additions to property and equipment	(741)	(955)
Decrease in restricted investments	500	
Other	38	34
Net cash used by investing activities	(6,431)	(11,127)
Cash flows from financing activities:		
Purchase of treasury shares	(3,943)	(2,191)
Contributions from employee stock purchase plan	268	222
Proceeds from exercise of stock options	936	859
Excess tax benefits from share-based compensation expense	197	95
Net cash used by financing activities	(2,542)	(1,015)
Net decrease in cash and cash equivalents	(2,101)	(2,138)

Cash and cash equivalents at beginning of period	17,212	20,733
Cash and cash equivalents at end of period	$ 15,111	$ 18,595

See accompanying notes.

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

(1) Basis of Presentation

We prepared the accompanying condensed consolidated financial statements following the requirements of the Securities and Exchange Commission (SEC) and accounting principles generally accepted in the United States, or GAAP, for interim reporting. As permitted under those rules, certain footnotes or other financial information that are normally required by GAAP can be condensed or omitted for interim periods. Balance sheet amounts are as of March 31, 2007 and December 31, 2006 and operating result amounts are for the three months ended March 31, 2007 and 2006, and include all normal and recurring adjustments that we considered necessary for the fair summarized presentation of our financial position and operating results. As these are condensed financial statements, one should also read the financial statements and notes included in our latest Form 10-K for the year ended December 31, 2006. Revenues, expenses, assets and liabilities can vary during each quarter of the year. Therefore, the results and trends in these interim financial statements may not be the same as those for the full year.

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

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

(2) Revenue Recognition

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

Software Arrangements:

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

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

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

i. persuasive evidence of an arrangement exists;

ii. delivery has occurred;

iii. our fee is fixed or determinable; and

iv. collectibility is probable.

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

Software Licenses

We recognize the revenue allocable to software licenses and specified upgrades upon delivery of the software product or upgrade to the customer, unless the fee is not fixed or determinable or collectibility is not probable. If the fee is not fixed or determinable, including new customers whose payment terms are three months or more from shipment, revenue is generally recognized as payments become due from the customer. If collectibility is not considered probable, revenue is recognized when the fee is collected. Arrangements that include software services, such as training or installation, are evaluated to determine whether those services are essential to the product s functionality. A majority of our software arrangements involve off-the-shelf software. We consider software to be off-the-shelf software if it can be added to an arrangement with minor changes in the underlying code and it can be used by the customer for the customer s purpose upon installation. For off-the-shelf software arrangements, we recognize the software license fee as revenue after delivery has occurred, customer acceptance is reasonably assured, that portion of the fee represents a non-refundable enforceable claim and is probable of collection, and the remaining services such as training are not considered essential to the product s functionality.

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

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

Software Services

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

Computer Hardware Equipment

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

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Postcontract Customer Support

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

Appraisal Services:

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

Other:

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

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

(3) Acquisitions

In February 2007 we completed the acquisition of all of the capital stock of Advanced Data Systems, Inc. (ADS), which develops and sells fund accounting solutions, primarily in New England. The total purchase price, including transaction costs along with an office building used in the business, was approximately $4.2 million in cash. In January 2007 we also purchased certain software assets to enhance our courts and justice product line for approximately $756,000 in cash, including transaction costs. The operating results of these acquisitions are included in our results of operations since their respective dates of acquisition.

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

In connection with these two transactions we acquired total assets of approximately $1.4 million and assumed total liabilities of approximately $1.0 million. We recorded goodwill of $2.2 million, all of which is expected to be deductible for tax purposes, and other intangible assets of $2.4 million. The $2.4 million of intangible assets is attributable to acquired software and customer relationships that will be amortized over a weighted average period of approximately 7 years. Our consolidated balance sheet as of March 31, 2007 reflects the preliminary allocation of the purchase price to the assets acquired and liabilities assumed based on their estimated fair values at the dates of acquisition.

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(4) Shareholders Equity

The following table details activity in our common stock:

	Three months ended March 31,			
	2007		2006	
	Shares	Amount	Shares	Amount
Purchases of common stock	(290)	$(3,943)	(250)	$(2,191)
Stock option exercises	293	936	249	859
Employee stock plan purchases	24	282	30	222
Shares issued for acquisitions			325	2,891

As of March 31, 2007 we have authorization from our board of directors to repurchase up to 741,000 additional shares of Tyler common stock.

(5) Income Tax Provision

For the three months ended March 31, 2007, we had an effective income tax rate of 38.8%, compared to 40.1% for the three months ended March 31, 2006. The effective income tax rates for the periods presented were different from the statutory United States federal income tax rate of 35% primarily due to state income taxes, non-deductible share-based compensation expense, the qualified manufacturing activities deduction and non-deductible meals and entertainment costs. The qualified manufacturing activities deduction rate doubled in 2007 resulting in a lower effective tax rate.

We made federal and state income tax payments, net of refunds, of $228,000 in the three months ended March 31, 2007, compared to $1.1 million in net payments for the same period of the prior year.

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

We are subject to U.S. federal tax as well as income tax of multiple state and local jurisdictions. We are no longer subject to U. S. Federal income tax examinations for years before 2004 and are no longer subject to state and local income tax examinations by tax authorities for the years before 2002. The Internal Revenue Service commenced examination of our U. S. Federal tax return for 2005 in the first quarter of 2007. To date, there are no proposed adjustments that will have a material impact on our financial position or results of operations.

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(6) Earnings Per Share

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

	Three months ended March 31, 2007	Three months ended March 31, 2006
Numerator for basic and diluted earnings per share:		
Net income	$ 2,401	$ 2,012
Denominator:		
Weighted-average basic common shares outstanding	38,813	39,114
Assumed conversion of dilutive securities:		
Stock options	1,943	1,591
Warrants	1,310	1,189
Potentially dilutive common shares	3,253	2,780
Denominator for diluted earnings per share Adjusted weighted average shares	42,066	41,894
Earnings per common share:		
Basic	$ 0.06	$ 0.05
Diluted	$ 0.06	$ 0.05

(7) Share-Based Compensation

Share-based compensation plan

We have a stock option plan that provides for the grant of stock options to key employees, directors and non-employee consultants. Stock options vest after three to five years of continuous service from the date of grant and have a contractual term of ten years. Once options become exercisable, the employee can purchase shares of our common stock at the market price on the date we granted the option. Effective January 1, 2006, we adopted the provisions of SFAS No. 123R, Share-Based Payment, which establishes accounting for share-based awards exchanged for employee services, using the modified prospective application transition method. Under this transition method, compensation cost recognized in 2006 and 2007 includes the applicable amounts of: (a) compensation cost of all share-based payments granted prior to, but not yet vested as of, January 1, 2006 (based on the grant-date fair value estimated in accordance with the original provisions of SFAS No. 123, Accounting for Stock-Based Compensation, and previously presented in the pro forma footnote disclosures), and (b) compensation cost for all share-based payments granted subsequent to January 1, 2006 (based on the grant-date fair value estimated in accordance with the new provisions of SFAS No. 123R).

Determining Fair Value Under SFAS No. 123R

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

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

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

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

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

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

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model. We granted options for 250,000 shares and 20,000 shares for the three months ended March 31, 2007 and 2006, respectively.

The following weighted average assumptions were used for options granted:

	Three months ended March 31	
	2007	2006
Expected life (in years)	6.5	6.5
Expected volatility	43.1%	46.0%
Risk-free interest rate	4.5%	4.7%
Expected forfeiture rate	3%	3%

Share-Based Compensation Under SFAS No. 123R

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

	Three months ended March 31	
	2007	2006
Cost of software services and maintenance	$ 43	$ 31
Selling, general and administrative expense	455	440
Total share-based compensation expense	$ 498	$ 471

(8) Commitments and Contingencies

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

(9) Recent Accounting Pronouncements

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

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ITEM 2. Management s Discussion and Analysis of Financial Condition and Results of Operations
FORWARD-LOOKING STATEMENTS
The statements in this discussion that are not historical statements are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements include statements about our business, financial condition, business strategy, plans and the objectives of our management, and future prospects. In addition, we have made in the past and may make in the future other written or oral forward-looking statements, including statements regarding future operating performance, short- and long-term revenue and earnings growth, the timing of the revenue and earnings impact for new contracts, backlog, the value of new contract signings, business pipeline, and industry growth rates and our performance relative thereto. Any forward-looking statements may rely on a number of assumptions concerning future events and be subject to a number of uncertainties and other factors, many of which are outside our control, which could cause actual results to differ materially from such statements. These include, but are not limited to: our ability to improve productivity and achieve synergies from acquired businesses; technological risks associated with the development of new products and the enhancement of existing products; changes in the budgets and regulating environments of our government customers; competition in the industry in which we conduct business and the impact of competition on pricing, revenues and margins; with respect to customer contracts accounted for under the percentage-of-completion method of accounting, the performance of such contracts in accordance with our cost and revenue estimates; our ability to maintain health and other insurance coverage and capacity due to changes in the insurance market and the impact of increasing insurance costs on the results of operations; the costs to attract and retain qualified personnel, changes in product demand, the availability of products, economic conditions, costs of compliance with corporate governance and public disclosure requirements as issued by the Sarbanes-Oxley Act of 2002 and New York Stock Exchange rules, changes in tax risks and other risks indicated in our filings with the Securities and Exchange Commission. The factors described in this paragraph and other factors that may affect Tyler, its management or future financial results, as and when applicable, are discussed in Tyler s filings with the Securities and Exchange Commission, on its Form 10-K for the year ended December 31, 2006. Except to the extent required by law, we are not obligated to update or revise any forward-looking statements whether as a result of new information, future events or otherwise. When used in this Quarterly Report, the words believes, plans, estimates, expects, anticipates, intends, continue, may, will, should, projects, forecast, negative of such terms and similar expressions as they relate to Tyler or our management are intended to identify 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, training and for certain customers, product modifications, along with continuing maintenance and support for customers using our systems. We also provide property appraisal outsourcing services for taxing jurisdictions.
In the first quarter of 2007, we acquired one company, Advanced Data Systems, Inc. (ADS), as well as certain software assets to enhance our courts and justice product line. The combined purchase price for ADS and the software assets was approximately $5.0 million in cash and we assumed liabilities of approximately $1.0 million. See Note 3 in the Notes to the Unaudited Condensed Consolidated Financial Statements.
CRITICAL ACCOUNTING POLICIES AND ESTIMATES
The discussion and analysis of our financial condition and results of operations are based upon our condensed consolidated financial statements. These condensed consolidated financial statements have been prepared following the requirements of accounting principles generally accepted in the United States (GAAP) for interim periods and require us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates, including those related to revenue recognition and amortization and potential impairment of intangible assets and goodwill. As these are condensed financial statements, one should also read expanded information about our critical accounting policies and estimates provided in Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations, included in our Form 10-K for the year ended December 31, 2006. There have been no

material changes to our critical accounting policies and estimates from the information provided in our 10-K for the year ended December 31, 2006, except as follows:

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

ANALYSIS OF RESULTS OF OPERATIONS

Revenues

The following table sets forth the key components of our revenues for the periods presented as of March 31:

	First Quarter					
		% of		% of	Change	
($ in thousands)	2007	Total	2006	Total	$	%
Software licenses	$ 7,971	16%	$ 7,571	17%	$ 400	5%
Software services	15,064	30	13,120	29	1,944	15
Maintenance	19,939	40	17,657	39	2,282	13
Appraisal services	5,580	11	4,699	11	881	19
Hardware and other	1,778	3	1,811	4	(33)	(2)
Total revenues	$ 50,332	100%	$ 44,858	100%	$ 5,474	12%

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

Software license revenue related to financial products, which comprise over 65% of our software license revenues in the periods presented, declined moderately compared to the three months ended March 31, 2006. Most of the decline was a result of a product mix that required less third party software than in the prior year period. For the remainder of the year we anticipate software license revenue related to financial products to be slightly higher than 2006.

Software license revenues related to our other products in the aggregate experienced strong increases compared to the three months ended March 31, 2006. Our Odyssey courts and justice products provided the majority of the increase as a result of the products maturing following successful early implementations and leveraging our existing customer base. The remaining increases were related to a Java-based document management product released in mid-2005, as well as slightly higher appraisal software revenue.

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

Software services revenue related to financial products, which comprise more than half of our software services revenue in the periods presented, increased strongly compared to the three months ended March 31, 2006. This increase was driven in part by historically high software license sales in the last half of 2006 and by additions to our implementation staff over the last twelve months, which has enabled us to deliver our backlog at a faster rate. Typical contracts for software licenses include services such as installation of the software, converting the customers data to be compatible with the software and training customer personnel to use the software. Our application service provider hosting and disaster recovery services also contributed to the increase as a result of geographic expansion, primarily in the South in the aftermath of hurricane Katrina.

Software services revenue related to Odyssey courts and justice products experienced strong increases compared to the three months ended March 31, 2006, reflecting increased contract volume. We had 24 active Odyssey contracts in the first quarter of 2007 compared to 14 active Odyssey contracts in the first quarter of 2006.

Maintenance. We provide maintenance and support services for our software products and third party software. Maintenance revenues increased 13% due to growth in our installed customer base and slightly higher maintenance rates on most of our product lines.

Appraisal services. The appraisal services business is driven in part by revaluation cycles in various states. Appraisal services increased over the prior year due to activity related to Ohio s revaluation cycle, which occurs every six years, and a $4.0 million contract with Fulton County, Georgia which began late in 2006. The Ohio revaluation projects began with smaller counties late in the first quarter of 2006 and expanded to larger counties by the third quarter of 2006. We currently expect the Ohio revaluation projects to be substantially complete by the end of 2007. The level of appraisal services revenues for 2008 will depend on our ability to replace the appraisal services revenues associated with the Ohio revaluation.

Cost of Revenues and Gross Margins

The following table sets forth a comparison of the key components of our cost of revenues, and those components stated as a percentage of related revenues for the periods presented as of March 31:

	First Quarter					
		% of related		% of related	Change	
($ in thousands)	2007	revenues	2006	revenues	$	%
Software licenses	$ 1,960	25%	$ 2,676	35%	$ (716)	(27)%
Acquired software	394	5	301	4	93	31
Software services and maintenance	24,588	70	21,745	71	2,843	13
Appraisal services	3,996	72	3,406	72	590	17
Hardware and other	1,372	77	1,268	70	104	8
Total cost of revenues	$ 32,310	64%	$ 29,396	65%	$ 2,914	10%

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

	First Quarter		
Gross margin percentage	2007	2006	Change
Software licenses and acquired software	70.5%	60.7%	9.8%
Software services and maintenance	29.8	29.3	0.5
Appraisal services	28.4	27.5	0.9
Hardware and other	22.8	30.0	(7.2)
Overall gross margin	35.8%	34.5%	1.3%

Software license revenues. The main component of our cost of software license revenues is amortization expense for capitalized development costs on certain software products, with third party software costs making up the balance. Once a product is released, we begin to amortize the costs associated with its development over the estimated useful life of the product. Amortization expense is determined on a product-by-product basis at an annual rate not less than straight-line basis over the product s estimated life, which is generally five years. Development costs consist mainly of personnel costs, such as salary and benefits paid to our developers, and rent for related office space.

For the three months ended March 31, 2007, our software license gross margin percentage increased compared to the prior year period due to a product mix that included less third party software, which has higher associated costs than proprietary software. Additionally, amortization expense of software development costs declined because some products became fully amortized during the first quarter of 2006.

Software services and maintenance revenues. For the three months ended March 31, 2007, the software services and maintenance gross margin was unchanged from the prior year period because software services and maintenance revenues grew at the same rate as the related costs. Cost of software services and maintenance primarily consists of personnel costs related to installation of our software, conversion of customer data, training customer personnel and support activities. Maintenance costs typically grow at a slower rate than related revenues due to leverage in the utilization of our support and maintenance staff and economies of scale. In the three months ended March 31, 2007, this impact was offset because we added to our implementation and development staff in the fourth quarter of 2006 and the first quarter of 2007 to increase our capacity to deliver our Odyssey contract backlog. These additions had a negative effect on the gross margin percentage because of lower utilization and higher costs while we train and orient new personnel before they can be efficiently utilized to generate revenue.

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

Our blended gross margin for the three months ended March 31, 2007 was slightly higher than the prior year period primarily due to the higher software license gross margin described above.

Selling, General and Administrative Expenses

The following table sets forth a comparison of our selling, general and administrative (SG&A) expenses for the periods presented as of March 31:

	First Quarter				Change	
		% of		% of		
($ in thousands)	2007	revenues	2006	revenues	$	%
Selling, general and administrative expenses	$12,976	26%	$10,976	24%	$2,000	18%

For the three months ending March 31, 2007, health care costs rose by approximately $700,000 due to higher claims in our self-insured employee health plan. Excluding this increase, SG&A as a percentage of revenues for the three months ended March 31, 2007 is consistent with the prior year period.

Research and Development Expense

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

	First Quarter				Change	
		% of		% of		
($ in thousands)	2007	revenues	2006	revenues	$	%
Research and development expense	$1,223	2%	$902	2%	$321	36%

For the three months ended March 31, 2007, research and development expense included approximately $500,000 associated with the Microsoft Dynamics AX project in addition to costs associated with other new product development efforts. In January 2007 we entered into a strategic alliance with Microsoft Corporation to jointly develop core public sector functionality for Microsoft Dynamics AX to address the accounting needs of public sector organizations worldwide. We anticipate these costs will continue into 2009 however, the actual amount and timing of those costs, and whether they are capitalized or expensed may vary.

Amortization of Customer and Trade Name Intangibles

Acquisition intangibles are composed of the excess of the purchase price over the fair value of net tangible assets acquired that is allocated to acquired software and customer and trade name intangibles. The remaining excess purchase price is allocated to goodwill that is not subject to amortization. Amortization expense related to acquired software is included with cost of revenues while amortization expense of customer and trade name intangibles is recorded as a non-operating expense. The following table sets forth a comparison of amortization of customer and trade name intangibles for the periods presented as of March 31:

	First Quarter		Change	
($ in thousands)	2007	2006	$	%
Amortization of customer and trade name intangibles	$347	$322	$25	8%

In the first quarter of 2007 we completed two acquisitions which increased amortizable customer intangibles by $638,000. This amount will be amortized over 7 years.

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Income Tax Provision

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

	First Quarter		Change	
($ in thousands)	2007	2006	$	%
Income tax provision	$1,522	$1,347	$175	13%
Effective income tax rate	38.8%	40.1%		

The effective income tax rates for the three months ended March 31, 2007 and 2006 were different from the statutory United States federal income tax rate of 35% primarily due to state income taxes, non-deductible share-based compensation expense, the qualified manufacturing activities deduction, and non-deductible meals and entertainment costs. The qualified manufacturing activities deduction rate doubled in 2007, resulting in a lower effective tax rate.

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FINANCIAL CONDITION AND LIQUIDITY

As of March 31, 2007, we had cash and cash equivalents (including restricted cash equivalents) of $19.6 million and we had short-term investments of $20.8 million, compared to cash and cash equivalents (including restricted cash equivalents) of $22.2 million and short-term investments of $19.5 million at December 31, 2006. Cash provided by operating activities was $6.9 million in the first three months of 2007 compared to $10.0 million for the same period in 2006.

At March 31, 2007, our days sales outstanding (DSO) was 84 days compared to DSO of 102 days at December 31, 2006. Our maintenance billing cycle is at one of its highest points in December and the majority of the related cash payments are received in the first quarter of each year. As a result our DSO decreased in the first quarter compared to the fourth quarter. DSO is calculated based on accounts receivable divided by the quotient of annualized quarterly revenues divided by 360 days.

Investing activities used cash of $6.4 million in the first three months of 2007 compared to $11.1 million cash used for the same period in 2006. In February 2007, we acquired all of the capital stock of Advanced Data Systems, Inc. (ADS), along with an office building used in its business for approximately $4.2 million in cash. In January 2007, we also purchased certain software assets to enhance our courts and justice product line for approximately $756,000 in cash. Other investing activities in the first quarter of 2007 were primarily comprised of a net investment of $1.2 million in short term investments and investments of $741,000 in property and equipment. In the comparable prior year period, investing activities included the acquisitions of MazikUSA, Inc. and TACS, Inc. The combined purchase price, including transaction costs, for the two companies was approximately $14.5 million, comprised of approximately $11.6 million in cash and 325,000 shares of Tyler common stock. In addition, first quarter 2006 investing activities also included a liquidation of $1.5 million of short term investments and investments in software development and property and equipment. Capital expenditures and acquisitions were funded from cash generated from operations.

We maintain a $10.0 million Letter of Credit facility under which the bank issues cash collateralized letters of credit. As of March 31, 2007 we had outstanding letters of credit totaling $4.5 million to secure surety bonds required by some of our customer contracts.

Financing activities used cash of $2.5 million in the first three months of 2007 compared to $1.0 million in the same period for 2006. Cash used in financing activities was primarily comprised of purchases of treasury shares, net of proceeds from stock option exercises and employee stock purchase plan activity.

During the three months ended March 31, 2007, we purchased 290,000 shares of our common stock for an aggregate purchase price of $3.9 million. At March 31, 2007, we had authorization to repurchase up to 741,000 additional shares of Tyler common stock. A summary of the repurchase activity during the first quarter of 2007 is as follows:

Period	Total number of shares repurchased	Average price paid per share	Maximum number of shares that may be repurchased under current authorization
January 1 through January 31	131	$ 13.92	900
February 1 through February 28	92	13.63	808
March 1 through March 31	67	13.05	741
Total first quarter	290	$ 13.62	

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 and October 2005. There is no expiration date specified for the authorization and we intend to repurchase stock under the plan from time to time in the future.

We made federal and state income tax payments, net of refunds of $228,000 in the three months ended March 31, 2007 compared to $1.1 million in the comparable prior year.

From time to time we engage in discussions with potential acquisition candidates. In order to consummate any such opportunities, which could require significant commitments of capital, we may be required to incur debt or to issue additional potentially dilutive

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securities in the future. No assurance can be given as to our future acquisitions and how such acquisitions may be financed. In the absence of future acquisitions, we believe our current cash balances and expected future cash flows from operations will be sufficient to meet our anticipated cash needs for working capital, capital expenditures and other activities through the next twelve months. If operating cash flows are not sufficient to meet our needs, we believe that credit would be available to us.

ITEM 3. Quantitative and Qualitative Disclosures About Market Risk

Market risk represents the risk of loss that may affect us due to adverse changes in financial market prices and interest rates. As of March 31, 2007, we had funds invested in auction rate municipal securities and state and municipal bonds, which were accounted for in accordance with SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities. These investments were treated as available-for-sale under SFAS No. 115. The carrying value of these investments approximates fair market value. Due to the nature of this investment, we are not subject to significant market rate risk.

We have no outstanding debt at March 31, 2007, and are therefore not subject to any interest rate risk.

ITEM 4. Evaluation of Disclosure Controls and Procedures

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

Part II. OTHER INFORMATION

ITEM 1. Legal Proceedings

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

ITEM 1A. Risk Factors

No material changes.

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

None

ITEM 3. Defaults Upon Senior Securities

None

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

None

ITEM 5. Other Information

None

ITEM 6. Exhibits

Exhibit 31.1	Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
Exhibit 31.2	Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
Exhibit 32.1	Certifications Pursuant to 18 U.S.C. Section 1350, as adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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

Date: April 24, 2007

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