

TYLER TECHNOLOGIES INC  
Form 10-Q  
July 25, 2008

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 June 30, 2008

OR

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

Commission File Number 1-10485

TYLER TECHNOLOGIES, INC.  
(Exact name of registrant as specified in its charter)

DELAWARE  
(State or other jurisdiction of  
incorporation or organization)

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

5949 SHERRY LANE, SUITE 1400

DALLAS, TEXAS  
75225  
(Address of principal executive offices)  
(Zip code)

(972) 713-3700  
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

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

Indicated 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 July 22, 2008 was 38,521,219.



## PART I. FINANCIAL INFORMATION

## ITEM 1. Financial Statements

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

|   | Three months ended<br>June 30, |                 | Six months ended<br>June 30, |                 |
|---|--------------------------------|-----------------|------------------------------|-----------------|
|   | 2008                           | 2007            | 2008                         | 2007            |
| <b>Revenues:</b>                                    |                                |                 |                              |                 |
| Software licenses                                   | \$ 11,905                      | \$ 8,354        | \$ 20,274                    | \$ 16,286       |
| Subscriptions                                       | 3,712                          | 2,468           | 6,977                        | 4,713           |
| Software services                                   | 19,848                         | 15,392          | 36,373                       | 28,341          |
| Maintenance   | 25,900                         | 20,455          | 50,749                       | 40,394          |
| Appraisal services                                  | 4,378                          | 6,007           | 8,960                        | 11,587          |
| Hardware and other                                  | 1,826                          | 1,436           | 3,587                        | 3,123           |
| <b>Total revenues</b>                               | <b>67,569</b>                  | <b>54,112</b>   | <b>126,920</b>               | <b>104,444</b>  |
| <b>Cost of revenues:</b>                            |                                |                 |                              |                 |
| Software licenses                                   | 2,564                          | 1,974           | 4,767                        | 3,932           |
| Acquired software                                   | 461                            | 427             | 897                          | 821             |
| Software services, maintenance and subscriptions    | 31,123                         | 26,239          | 61,567                       | 50,882          |
| Appraisal services                                  | 3,004                          | 4,096           | 6,171                        | 8,092           |
| Hardware and other                                  | 1,328                          | 1,039           | 2,626                        | 2,358           |
| <b>Total cost of revenues</b>                       | <b>38,480</b>                  | <b>33,775</b>   | <b>76,028</b>                | <b>66,085</b>   |
| <b>Gross profit</b>                                 | <b>29,089</b>                  | <b>20,337</b>   | <b>50,892</b>                | <b>38,359</b>   |
| <b>Selling, general and administrative expenses</b> |                                |                 |                              |                 |
| Research and development expense                    | 15,418                         | 12,781          | 30,170                       | 25,757          |
| Amortization of customer and trade name intangibles | 2,253                          | 1,404           | 4,069                        | 2,627           |
| Non-cash legal settlement related to warrants       | 591                            | 356             | 1,158                        | 703             |
|   | 9,045                          | -               | 9,045                        | -               |
| <b>Operating income</b>                             | <b>1,782</b>                   | <b>5,796</b>    | <b>6,450</b>                 | <b>9,272</b>    |
| <b>Other income, net</b>                            | <b>244</b>                     | <b>364</b>      | <b>646</b>                   | <b>811</b>      |
| <b>Income before income taxes</b>                   | <b>2,026</b>                   | <b>6,160</b>    | <b>7,096</b>                 | <b>10,083</b>   |
| <b>Income tax provision</b>                         | <b>1,780</b>                   | <b>2,410</b>    | <b>3,724</b>                 | <b>3,932</b>    |
| <b>Net income</b>                                   | <b>\$ 246</b>                  | <b>\$ 3,750</b> | <b>\$ 3,372</b>              | <b>\$ 6,151</b> |
| <b>Earnings per common share:</b>                   |                                |                 |                              |                 |
| Basic   | \$ 0.01                        | \$ 0.10         | \$ 0.09                      | \$ 0.16         |
| Diluted   | \$ 0.01                        | \$ 0.09         | \$ 0.09                      | \$ 0.15         |

|  |        |        |        |        |
|--|--------|--------|--------|--------|
| Basic weighted average common shares outstanding   | 38,087 | 38,540 | 37,945 | 38,571 |
| Diluted weighted average common shares outstanding | 39,633 | 41,448 | 39,471 | 41,651 |

See accompanying notes.

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

|  | June 30,<br>2008<br>(Unaudited) | December<br>31,<br>2007 |
|--|---------------------------------|-------------------------|
| <b>ASSETS</b>  |                                 |                         |
| Current assets:  |                                 |                         |
| Cash and cash equivalents  | \$ 33,012                       | \$ 9,642                |
| Restricted cash equivalents  | 5,082                           | 4,462                   |
| Short-term investments available-for-sale  | 50                              | 41,590                  |
| Accounts receivable (less allowance for losses of \$1,568 in 2008 and \$1,851 in 2007)                   | 77,633                          | 63,965                  |
| Warrants settlement receivable   | 2,005                           | -                       |
| Prepaid expenses   | 8,787                           | 7,726                   |
| Other current assets   | 3,594                           | 1,324                   |
| Deferred income taxes  | 1,922                           | 2,355                   |
| <b>Total current assets</b>  | <b>132,085</b>                  | <b>131,064</b>          |
| Accounts receivable, long-term portion   | 460                             | 398                     |
| Property and equipment, net  | 13,220                          | 9,826                   |
| Non-current investments available-for-sale   | 5,650                           | -                       |
| Other assets:  |                                 |                         |
| Goodwill   | 82,459                          | 71,677                  |
| Customer related intangibles, net  | 25,047                          | 17,706                  |
| Software, net  | 7,882                           | 9,588                   |
| Trade name, net  | 1,294                           | 1,074                   |
| Sundry   | 191                             | 175                     |
|  | <b>\$ 268,288</b>               | <b>\$ 241,508</b>       |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>  |                                 |                         |
| Current liabilities:   |                                 |                         |
| Accounts payable   | \$ 2,765                        | \$ 3,323                |
| Accrued liabilities  | 21,183                          | 18,905                  |
| Deferred revenue   | 92,973                          | 73,714                  |
| Income taxes payable   | -                               | 632                     |
| <b>Total current liabilities</b>   | <b>116,921</b>                  | <b>96,574</b>           |
| Deferred income taxes  | 9,069                           | 7,723                   |
| 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 2008 and 2007 | 481                             | 481                     |

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|  |            |            |
|--|------------|------------|
| Additional paid-in capital   | 161,356    | 149,568    |
| Retained earnings  | 39,004     | 35,632     |
| Treasury stock, at cost; 10,292,858 and 9,528,467 shares in 2008<br>and 2007, respectively | (58,543)   | (48,470)   |
| Total shareholders' equity   | 142,298    | 137,211    |
|  | \$ 268,288 | \$ 241,508 |

See accompanying notes.

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

|  | Six months ended June<br>30, |          |
|--|------------------------------|----------|
|  | 2008                         | 2007     |
| Cash flows from operating activities:  |                              |          |
| Net income   | \$ 3,372                     | \$ 6,151 |
| Adjustments to reconcile net income to net cash provided by operations:                  |                              |          |
| Depreciation and amortization  | 5,921                        | 5,154    |
| Non-cash legal settlement related to warrants  | 9,045                        | -        |
| Share-based compensation expense   | 1,621                        | 1,073    |
| Changes in operating assets and liabilities, exclusive of effects of acquired companies: |                              |          |
| Accounts receivable  | (12,686)                     | (2,585)  |
| Income tax (receivable) payable  | (3,039)                      | 455      |
| Prepaid expenses and other current assets  | (368)                        | 374      |
| Accounts payable   | (676)                        | (1,590)  |
| Accrued liabilities  | (854)                        | (2,112)  |
| Deferred revenue   | 15,603                       | 1,861    |
| Net cash provided by operating activities  | 17,939                       | 8,781    |
| Cash flows from investing activities:  |                              |          |
| Proceeds from sales of short-term investments  | 44,515                       | 7,806    |
| Purchases of short-term investments  | (8,625)                      | (9,600)  |
| Cost of acquisitions, net of cash acquired   | (13,923)                     | (5,086)  |
| Investment in software development costs   | -                            | (105)    |
| Additions to property and equipment  | (4,912)                      | (1,598)  |
| (Increase) decrease in restricted investments  | (620)                        | 500      |
| Decrease in other  | 9                            | 43       |
| Net cash provided by (used by) investing activities                                      | 16,444                       | (8,040)  |
| Cash flows from financing activities:  |                              |          |
| Purchase of treasury shares  | (12,646)                     | (11,131) |
| Contributions from employee stock purchase plan  | 574                          | 570      |
| Proceeds from exercise of stock options  | 692                          | 1,268    |
| Excess tax benefits from share-based compensation expense                                | 367                          | 265      |
| Net cash used by financing activities  | (11,013)                     | (9,028)  |
| Net increase (decrease) in cash and cash equivalents                                     | 23,370                       | (8,287)  |
| Cash and cash equivalents at beginning of period   | 9,642                        | 17,212   |
| Cash and cash equivalents at end of period   | \$ 33,012                    | \$ 8,925 |

See accompanying notes.





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 June 30, 2008 and December 31, 2007 and operating result amounts are for the three and six months ended June 30, 2008 and 2007, 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, 2007. 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

Software Arrangements:

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

We typically enter into multiple element arrangements, which include software licenses, software services, PCS and occasionally hardware. The majority of our software arrangements are multiple element arrangements, but for those arrangements that involve significant production, modification or customization of the software, or where software services are otherwise considered essential to the functionality of the software in the customer’s environment, we use contract accounting and apply the provisions of Statement of Position (“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 because we have the ability to produce reasonably dependable estimates of contract billings and contract costs. We use the level of profit margin that is most likely to occur on a contract. If the most likely profit margin cannot be precisely determined, the lowest probable level of profit in the range of estimates is used until the results can be estimated more precisely. These arrangements are often implemented over an extended time period and occasionally require us to revise total cost estimates. Amounts recognized in revenue are calculated using the progress-to-completion measurement after giving effect to any changes in our cost estimates. Changes to total estimated contract costs, if any, are recorded in the period they are determined. Estimated losses on uncompleted contracts are recorded in the period in which we first determine that a loss is apparent.

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

## Subscription-Based Services

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

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

For ASP and other hosting arrangements, we evaluate whether each of the elements in these arrangements represents a separate unit of accounting, as defined by Emerging Issues Task Force ("EITF") 00-21, using all applicable facts and circumstances, including whether (i) we sell or could readily sell the element unaccompanied by the other elements,

(ii) the element has stand-alone value to the customer, (iii) there is objective reliable evidence of the fair value of the undelivered item, and (iv) there is a general right of return. We consider the applicability of EITF No. 00-03, “Application of SOP 97-2 to Arrangements That Include the Right to Use Software Stored on Another Entity’s Hardware” on a contract-by-contract basis. In hosted term-based agreements, where the customer does not have the contractual right to take possession of the software, hosting fees are recognized on a monthly basis over the term of the contract commencing when the customer has access to the software. For professional services associated with hosting arrangements that we determine do not have stand-alone value to the customer, we recognize the services revenue ratably over the remaining contractual period once hosting has gone live and we may begin billing for the hosting services. We record amounts that have been invoiced in accounts receivable and in deferred revenue or revenues, depending on whether the revenue recognition criteria have been met.

If we determine that the customer has the contractual right to take possession of our software at any time during the hosting period without significant penalty, and can feasibly maintain the software on the customer's hardware or enter into another arrangement with a third party to host the software, we recognize the license, professional services and hosting services revenues pursuant to SOP 97-2.

#### Software Services

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

#### Computer Hardware Equipment

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

#### Postcontract Customer Support

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

#### Appraisal Services:

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

#### Other:

The majority of deferred revenue consists of unearned support and maintenance revenue that has been billed based on contractual terms in the underlying arrangement with the remaining balance consisting of payments received in advance of revenue being earned under software licensing, subscription-based services, software and appraisal services and hardware installation. Unbilled revenue is not billable at the balance sheet date but is recoverable over the remaining life of the contract through billings made in 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.

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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 the first quarter of 2008, we completed the acquisitions of all of the capital stock of VersaTrans Solutions Inc. (“VersaTrans”) and certain assets of Olympia Computing Company, Inc. d/b/a Schoolmaster (“Schoolmaster”). VersaTrans is a provider of student transportation management software solutions for school districts and school transportation providers across North America, including solutions for school bus routing and planning, redistricting, GPS fleet tracking, fleet maintenance and field trip planning. Schoolmaster provides a full suite of student information systems, which manage such functions as grading, attendance, scheduling, guidance, health, admissions and fund raising. The combined purchase price for these transactions excluding cash acquired and including transaction costs, was approximately \$13.9 million in cash and approximately 126,000 shares of Tyler common stock valued at \$1.7 million. 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 expanding our presence in the education market 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 tangible assets of approximately \$1.8 million and assumed total liabilities of approximately \$7.0 million. We recorded goodwill of \$10.7 million, \$1.5 million of which is expected to be deductible for tax purposes, and other intangible assets of \$10.1 million. The \$10.1 million of intangible assets is attributable to acquired software, customer relationships and trade name that will be amortized over a weighted average period of approximately 10 years. Our balance sheet as of June 30, 2008 reflects the allocation of the purchase price to the assets acquired and liabilities assumed based on their estimated fair values at the dates of acquisition.

### (4) Financial Instruments

Assets recorded at fair value in the balance sheet as of June 30, 2008 are categorized based upon the level of judgment associated with the inputs used to measure their fair value. Hierarchical levels, defined by SFAS 157 “Fair Value Measurements” 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 developed using estimates and assumptions developed by management, which reflect those that a market participant would use.

We measure the following financial assets at fair value on a recurring basis. The fair value of these financial assets was determined using the following inputs at June 30, 2008:

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

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|   |    |        |    |        |    |       |    |   |
|---|----|--------|----|--------|----|-------|----|---|
| Cash and cash equivalents (1)                     | \$ | 38,094 | \$ | 38,094 | \$ | -     | \$ | - |
| Short-term investments<br>available-for-sale (2)  |    | 50     |    | -      |    | 50    |    | - |
| Non-current investments<br>available-for-sale (2) |    | 5,650  |    | -      |    | 5,650 |    | - |
| Total   | \$ | 43,794 | \$ | 38,094 | \$ | 5,700 | \$ | - |

(1) 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.

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(2) Investments available-for-sale consists of auction rate municipal securities (“ARS”). We have included our investments related to ARS in the Level 2 category, as we believe there are significant observable inputs associated with these investments discussed below. ARS are long-term variable rate bonds tied to short-term interest rates that are reset through a “Dutch Auction” process that occurs every 28 to 35 days. We have the option to participate in the auction and sell ARS to prospective buyers through a broker-dealer. We do not have the right to put the security back to the issuer. Our investments in ARS all had AAA credit ratings at the time of purchase and represent interests in collateralized debt obligations supported by municipal and state agencies. 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 the past, the auction process has allowed investors to obtain immediate liquidity if so desired by selling the securities at their face amounts. However, as has been recently reported in the financial press, the current disruptions in the credit markets have adversely affected the auction market for these types of securities. ARS auctions “fail” when there are not enough buyers to absorb the amount of securities available for sale for that particular auction period. Historically, ARS auctions have rarely failed since the investment banks and broker dealers have been willing to purchase the securities when investor demand was weak. However, beginning in mid-February 2008, due to uncertainty in the global credit and capital markets and other factors, investment banks and broker dealers have been less willing to support ARS and many ARS auctions have failed. We will not be able to access non-current investments until future auctions for these ARS are successful, or until we sell the securities in a secondary market which currently is not active, although there have been instances of redemptions at par to date by municipalities through refinance of new debt.

Our ARS investment as of March 31, 2008 was \$7.9 million of which we were able to liquidate \$2.2 million in the three months ending June 30, 2008. As of June 30, 2008, we had \$5.7 million of principal invested in ARS that had experienced failed auctions. Of this amount, we were able to liquidate \$50,000 for cash at par during the period July 1, 2008 through July 18, 2008. Accordingly, as of June 30, 2008, we classified the remaining \$5.6 million in ARS as non-current because it is unknown if we will be able to liquidate these securities within one year. Although we have uncertainty with regard to the short-term liquidity of these securities, we continue to believe that the par value represents the fair value of these investments. Our broker dealers have received estimated market values from an independent pricing service for substantially all of our investments as of the balance sheet date which carry these investments at par value, due to the overall quality of the underlying investments and taking into account credit support through insurance policies guaranteeing each of the bonds’ payment of principal and accrued interest, and the anticipated future market for such investments. Further evidence includes the fact that these investments consist solely of collateralized debt obligations supported by municipal and state agencies and do not include mortgage-backed securities, have redemption features which call for redemption at 100% of par value, have a current credit rating of A or AAA, and that we have the ability to hold these securities to maturity. Based on our cash and cash equivalents balance of \$38.1 million, expected operating cash flows and the liquidation of \$2.2 million of ARS during the three months ended June 30, 2008, 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. All such items represent significant other observable inputs which are consistent with Level 2 assessments. We will continue to evaluate any changes in the market value of the failed ARS that have not been liquidated subsequent to quarter-end and in the future, depending upon existing market conditions, we may be required to record an other-than-temporary decline in market value. We are not certain how long we may be required to hold each security. However, given our current cash position, liquid cash equivalents and cash flow from operations we believe we have the ability and we intend to hold the failed ARS as long-term investments until the market stabilizes.

## (5) Shareholders' Equity

The following table details activity in our common stock:

|                                | Six months ended June 30, |             |        |             |
|--------------------------------|---------------------------|-------------|--------|-------------|
|                                | 2008                      |             | 2007   |             |
|                                | Shares                    | Amount      | Shares | Amount      |
| Purchases of common stock      | (1,097)                   | \$ (14,419) | (889)  | \$ (11,131) |
| Stock option exercises         | 156                       | 692         | 362    | 1,268       |
| Employee stock plan purchases  | 51                        | 574         | 49     | 551         |
| Shares issued for acquisitions | 126                       | 1,719       | -      | -           |

As of June 30, 2008 we have authorization from our board of directors to repurchase up to 2.7 million additional shares of Tyler common stock.

On June 27, 2008, we settled outstanding litigation related to two Stock Purchase Warrants owned by Bank of America, N. A. ("BANA"). In July 2008, as a result of this settlement, BANA paid us \$2.0 million and we issued to BANA 801,883 restricted shares of Tyler common stock. See Note 9 – Commitments and Contingencies for further information.

## (6) Income Tax Provision

For the three and six months ended June 30, 2008, we had an effective income tax rate of 87.9% and 52.5%, respectively, compared to 39.1% and 39.0% for the three months and six months ended June 30, 2007. Our effective income tax rose compared to the prior year periods due to a non-cash legal settlement related to warrants charge of \$9.0 million, which was not deductible. 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 a non-cash legal settlement related to warrants charge which was not deductible, state income taxes, non-deductible share-based compensation expense, the qualified manufacturing activities deduction and non-deductible meals and entertainment costs.

We made federal and state income tax payments, net of refunds, of \$6.5 million in the six months ended June 30, 2008, compared to \$3.3 million in net payments for the same period of the prior year.

## (7) Earnings Per Share

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

|   | Three months ended<br>June 30, |          | Six months ended<br>June 30, |          |
|---|--------------------------------|----------|------------------------------|----------|
|   | 2008                           | 2007     | 2008                         | 2007     |
| Numerator for basic and diluted earnings per share:                           |                                |          |                              |          |
| Net income  | \$ 246                         | \$ 3,750 | \$ 3,372                     | \$ 6,151 |
| Denominator:  |                                |          |                              |          |
| Weighted-average basic common shares outstanding                              | 38,087                         | 38,540   | 37,945                       | 38,571   |
| Assumed conversion of dilutive securities:                                    |                                |          |                              |          |
| Stock options   | 1,546                          | 1,631    | 1,526                        | 1,787    |
| Warrants  | -                              | 1,277    | -                            | 1,293    |
| Potentially dilutive common shares  | 1,546                          | 2,908    | 1,526                        | 3,080    |
| Denominator for diluted earnings per share - Adjusted weighted-average shares | 39,633                         | 41,448   | 39,471                       | 41,651   |
| Earnings per common share:  |                                |          |                              |          |
| Basic   | \$ 0.01                        | \$ 0.10  | \$ 0.09                      | \$ 0.16  |
| Diluted   | \$ 0.01                        | \$ 0.09  | \$ 0.09                      | \$ 0.15  |

## (8) Share-Based Compensation

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

|  | Three months ended<br>June 30, |        | Six months ended<br>June 30, |          |
|--|--------------------------------|--------|------------------------------|----------|
|  | 2008                           | 2007   | 2008                         | 2007     |
| Cost of software services, maintenance and subscriptions | \$ 81                          | \$ 56  | \$ 150                       | \$ 99    |
| Selling, general and administrative expense              | 824                            | 519    | 1,471                        | 974      |
| Total share-based compensation expense                   | \$ 905                         | \$ 575 | \$ 1,621                     | \$ 1,073 |

## (9) Commitments and Contingencies

On June 27, 2008, we settled outstanding litigation related to two Stock Purchase Warrants (the "Warrants") owned by Bank of America, N. A. ("BANA"). As disclosed in prior SEC filings, the Warrants entitled BANA to acquire 1.6

million shares of Tyler common stock at an exercise price of \$2.50 per share. The Warrants expired on September 10, 2007. Prior to their expiration, BANA attempted to exercise the Warrants; however, the parties disputed whether or not BANA's exercise was effective. We filed suit for declaratory judgment seeking a court's determination on the matter, and BANA asserted numerous counterclaims against us, including breach of contract and misrepresentation.

Following court-ordered mediation, in July 2008, BANA paid us \$2.0 million and we issued to BANA 801,883 restricted shares of Tyler common stock. Accordingly, as a result of the settlement, we recorded a non-cash legal settlement related to warrants charge of \$9.0 million, which is not tax deductible, during the three months ended June 30, 2008. In addition, our balance sheet at June 30, 2008, includes a \$2.0 million receivable from BANA and an increase to additional paid-in capital of \$11.0 million to reflect our obligation to issue 801,883 restricted shares of common stock.

In February 2008 our board of directors authorized negotiations to purchase a building in Falmouth, Maine that we currently lease from a related party. We expect to purchase this building for approximately \$10.0 million in the second half of 2008.

(10)Recent Accounting Pronouncements

In December 2007, the Financial Accounting Standards Board issued SFAS No. 141(R) "Business Combinations." SFAS No. 141(R) changes the accounting for business combinations including the measurement of acquirer shares issued in consideration for a business combination, the recognition of contingent consideration, the accounting for pre-acquisition gain and loss contingencies, the recognition of capitalized in-process research and development, the accounting for acquisition-related restructuring cost accruals, the treatment of acquisition related transaction costs and the recognition of changes in the acquirer's income tax valuation allowance. SFAS No. 141(R) is effective for fiscal years beginning after December 15, 2008, with early adoption prohibited. We are currently evaluating the impact of the pending adoption of SFAS 141(R) on our financial statements.

## 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, 2007. 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," "might," "could" or the 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 subscription-based services such as application service provider arrangements and other hosting services as well as property appraisal outsourcing services for taxing jurisdictions.

On June 27, 2008, we settled outstanding litigation related to two Stock Purchase Warrants (the "Warrants") owned by Bank of America, N. A. ("BANA"). As disclosed in prior SEC filings, the Warrants entitled BANA to acquire 1.6 million shares of Tyler common stock at an exercise price of \$2.50 per share. Following court-ordered mediation, in July 2008, BANA paid us \$2.0 million and we issued to BANA 801,883 restricted shares of Tyler common stock. Accordingly, we recorded a non-cash legal settlement related to warrants charge of \$9.0 million, which is not tax deductible, during the three months ended June 30, 2008. In addition, our balance sheet at June 30, 2008, includes a \$2.0 million receivable from BANA and an increase to additional paid-in capital of \$11.0 million to reflect our obligation to issue 801,883 restricted shares of common stock.

In the first quarter of 2008, we acquired all of the capital stock of VersaTrans Solutions Inc. and certain assets of Olympia Computing Company, Inc. d/b/a Schoolmaster. The combined purchase price, excluding cash acquired and including transaction costs, was approximately \$13.9 million in cash and approximately 126,000 shares of Tyler common stock valued at \$1.7 million. See Note 3 in the Notes to the Unaudited Condensed Financial Statements.

As of June 30, 2008, our total full-time equivalent employee count increased to 1,856 from 1,594 at June 30, 2007. Approximately 60% of these additions or 156 full-time equivalent employees were added as a result of several acquisitions completed since June 30, 2007.

## 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, 2007. 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, 2007.

## ANALYSIS OF RESULTS OF OPERATIONS

## Revenues

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

| (\$<br>in thousands) | Second Quarter |               |           |                                    |                | Six Months |               |            |                                    |                |
|----------------------|----------------|---------------|-----------|------------------------------------|----------------|------------|---------------|------------|------------------------------------|----------------|
|                      | 2008           | Total<br>% of | 2007      | Total (Decrease)<br>% of Increase/ | % of Increase/ | 2008       | Total<br>% of | 2007       | Total (Decrease)<br>% of Increase/ | % of Increase/ |
| Software licenses    | \$ 11,905      | 18%           | \$ 8,354  | 15%                                | 43%            | \$ 20,274  | 16%           | \$ 16,286  | 16%                                | 24%            |
| Subscription         | 3,712          | 5             | 2,468     | 5                                  | 50             | 6,977      | 5             | 4,713      | 4                                  | 48             |
| Software services    | 19,848         | 30            | 15,392    | 28                                 | 29             | 36,373     | 29            | 28,341     | 27                                 | 28             |
| Maintenance          | 25,900         | 38            | 20,455    | 38                                 | 27             | 50,749     | 40            | 40,394     | 39                                 | 26             |
| Appraisal services   | 4,378          | 6             | 6,007     | 11                                 | (27)           | 8,960      | 7             | 11,587     | 11                                 | (23)           |
| Hardware and other   | 1,826          | 3             | 1,436     | 3                                  | 27             | 3,587      | 3             | 3,123      | 3                                  | 15             |
| Total revenues       | \$ 67,569      | 100%          | \$ 54,112 | 100%                               | 25%            | \$ 126,920 | 100%          | \$ 104,444 | 100%                               | 22%            |

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

| (\$<br>in thousands)               | Second Quarter |               |          |                                    |                | Six Months |               |           |                                    |                |
|------------------------------------|----------------|---------------|----------|------------------------------------|----------------|------------|---------------|-----------|------------------------------------|----------------|
|                                    | 2008           | Total<br>% of | 2007     | Total (Decrease)<br>% of Increase/ | % of Increase/ | 2008       | Total<br>% of | 2007      | Total (Decrease)<br>% of Increase/ | % of Increase/ |
| Financial management and education | \$ 8,624       | 72%           | \$ 6,197 | 74%                                | 39%            | \$ 14,571  | 72%           | \$ 11,369 | 70%                                | 28%            |



|                                 |           |      |          |      |     |           |      |           |      |     |
|---------------------------------|-----------|------|----------|------|-----|-----------|------|-----------|------|-----|
| Courts and justice              | 2,282     | 19   | 1,592    | 19   | 43  | 3,840     | 19   | 3,073     | 19   | 25  |
| Appraisal and tax and other     | 999       | 9    | 565      | 7    | 77  | 1,863     | 9    | 1,844     | 11   | 1   |
| Total software license revenues | \$ 11,905 | 100% | \$ 8,354 | 100% | 43% | \$ 20,274 | 100% | \$ 16,286 | 100% | 24% |

In the three months ended June 30, 2008, we signed 16 new material contracts with average software license fees of approximately \$422,000 compared to 17 new material contracts signed in the three months ended June 30, 2007 with average software license fees of approximately \$696,000. The prior year period included one unusually large courts and justice contract with a substantial amount of software license. In the six months ended June 30, 2008, we signed 34 new material contracts with average software license fees of approximately \$355,000 compared to 33 new material contracts signed in the six months ended June 30, 2007 with average software license fees of approximately \$548,000. We consider contracts with a license fee component of \$100,000 or more to be material. Although a contract is signed in a particular quarter, the period in which the revenue is recognized may be different because we recognize revenue according to our revenue recognition policy as described in Note 2 in the Notes to the Unaudited Condensed Financial Statements.

Changes in software license revenues consist of the following components:

- Software license revenue related to our financial management and education solutions for three and six months ended June 30, 2008 increased 39% and 28% compared to the prior year periods mainly due to contract arrangements that included more software license revenue than in the past. The average software license fees for new material financial management and education solutions contracts signed in the six months ended June 30, 2008 was approximately \$415,000 compared to approximately \$260,000 of average software license fees signed for the year 2007 and approximately \$290,000 of average software license fees signed for the year 2006. 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.

Revenue from student information and management solutions as well as student transportation management solutions acquired in the last twelve months also contributed to increases in the three and six months ended June 30, 2008.

- Software license revenue related to our courts and justice software solutions for three and six months ended June 30, 2008 increased 43% and 25% compared to the prior year periods. In late 2007 we increased our sales efforts relating to municipal courts software solutions and public safety software solutions which contributed the majority of the increase in both periods.

Subscriptions. Subscription-based services revenue primarily consists of revenues derived from application service provider (“ASP”) arrangements and other hosted service offerings, software subscriptions and disaster recovery services. ASP and other software subscriptions agreements are typically for periods of three to six years and automatically renew unless either party cancels the agreement. Disaster recovery and miscellaneous other hosted service agreements are typically renewable annually. New ASP customers provided approximately two-thirds of the subscription revenue increase with the remaining increase due to new disaster recovery customers and slightly higher rates for disaster recovery services. In June 2008, as a result of changes in its technology organization, one customer terminated its ASP arrangement with us and elected, as provided in the ASP contract, to purchase the software instead. This contract contributed approximately \$450,000 of subscription revenue in each of the first two quarters of 2008.

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

- Software services revenue related to financial management and education solutions, which comprise approximately half of our software services revenue in the periods presented, increased substantially compared to the three and six months ended June 30, 2007. This increase was driven in part by larger and more complex contracts, which include more programming and project management services. In addition, we acquired a student transportation management solution in January 2008 which contributed approximately \$1.3 million and \$1.8 million to software service revenues for the three and six months ended June 30, 2008, respectively. The period from April to July historically has been the peak training season for school systems in their effort to prepare for the new school year.
- Software services revenue related to courts and justice solutions experienced substantial increases compared to the three and six months ended June 30, 2007, reflecting increased capacity to deliver backlog following additions to our implementation and support staff over the last twelve to fourteen months. In addition, increased contract volume for municipal courts software solutions and public safety software solutions also generated higher related services revenue.

Maintenance. We provide maintenance and support services for our software products and third party software. Maintenance revenues increased 27% and 26% for the three and six months ended June 30, 2008, respectively compared to the prior year periods. Maintenance and support services grew 16% for the three and six months ended

June 30, 2008, excluding the impact of acquisitions completed in the prior twelve months. This increase was due to growth in our installed customer base and slightly higher maintenance rates on most of our product lines.

Appraisal services. Appraisal services revenue declined 27% and 23% for the three and six months ended June 30, 2008, respectively, compared to the prior year periods. The appraisal services business is driven in part by revaluation cycles in various states. In 2007, we substantially completed several projects related to the Ohio revaluation cycle, which occurs every six years, as well as a few other large contracts. We have not yet fully replaced these appraisal contracts and expect appraisal revenue for the full year 2008 to decline moderately compared to 2007.

## 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 June 30:

| (\$ in thousands)                                | Second Quarter |                       |           |                       | Six Months |                       |           |                       |
|--|----------------|-----------------------|-----------|-----------------------|------------|-----------------------|-----------|-----------------------|
|  | 2008           | % of Related Revenues | 2007      | % of Related Revenues | 2008       | % of Related Revenues | 2007      | % of Related Revenues |
| Software licenses                                | \$ 2,564       | 22%                   | \$ 1,974  | 24%                   | \$ 4,767   | 24%                   | \$ 3,932  | 24%                   |
| Acquired software                                | 461            | 4                     | 427       | 5                     | 897        | 4                     | 821       | 5                     |
| Software services, maintenance and subscriptions | 31,123         | 63                    | 26,239    | 68                    | 61,567     | 65                    | 50,882    | 69                    |
| Appraisal services                               | 3,004          | 69                    | 4,096     | 68                    | 6,171      | 69                    | 8,092     | 70                    |
| Hardware and other                               | 1,328          | 73                    | 1,039     | 72                    | 2,626      | 73                    | 2,358     | 76                    |
| Total cost of revenue                            | \$ 38,480      | 57%                   | \$ 33,775 | 62%                   | \$ 76,028  | 60%                   | \$ 66,085 | 63%                   |

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

| Gross Margin percentages                         | Second Quarter |       |        | Six Months |       |        |
|--|----------------|-------|--------|------------|-------|--------|
|  | 2008           | 2007  | Change | 2008       | 2007  | Change |
| Software licenses and acquired software          | 74.6%          | 71.3% | 3.3%   | 72.1%      | 70.8% | 1.3%   |
| Software services, maintenance and subscriptions | 37.1           | 31.5  | 5.6    | 34.6       | 30.7  | 3.9    |
| Appraisal services                               | 31.4           | 31.8  | (0.4)  | 31.1       | 30.2  | 0.9    |
| Hardware and other                               | 27.3           | 27.6  | (0.3)  | 26.8       | 24.5  | 2.3    |
| Overall gross margin                             | 43.1%          | 37.6% | 5.5%   | 40.1%      | 36.7% | 3.4%   |

Software licenses. 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 and six months ended June 30, 2008, our software license gross margin percentage rose compared to the prior year periods due to strong license fee revenue increases. The year-to-date gross margin grew at a slightly slower rate because the first quarter product mix included more third party software, which has higher associated costs than proprietary software.

Software services, maintenance and subscription-based services. Cost of software services, maintenance and subscriptions primarily consists of personnel costs related to installation of our software, conversion of customer data, training customer personnel and support activities and various other services such as ASP and disaster recovery. For the three and six months ended June 30, 2008, the software services, maintenance and subscriptions gross margin increased 5.6% and 3.9%, respectively from the prior year periods partly 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 support and maintenance staff and economies of scale. We have increased our implementation and support staff by 240 full-time equivalent employees since June 30, 2007 in order to expand our capacity to train and implement our contract backlog. This increase includes 121 full-time equivalent employees related to acquisitions completed since June 30, 2007.

In addition, approximately 1.7% and 0.9% of the gross margin increase for the three and six months ended June 30, 2008, respectively, reflects the impact of revenue which had been deferred pending final acceptance on a certain contract. There were no related costs associated with this revenue in 2008.

Appraisal services. A high proportion of the costs of appraisal services revenue are variable, as we often hire temporary employees to assist in appraisal projects whose term of employment generally ends with the projects' completion. Our appraisal gross margin for the six months ended June 30, 2008 is slightly higher than the prior year period due to more inclement weather in the first three months of the prior year, which depressed productivity.

Our blended gross margin for the three and six months ended June 30, 2008 was higher than the prior year periods in part due to leverage in the utilization of our support and maintenance staff and economies of scale. The blended gross margin for the three months ended June 30, 2008 also benefitted from a product mix that included more software license revenue, which inherently has higher gross margins, and less appraisal services revenue.

#### 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 June 30:

| (\$ in thousands)                            | Second Quarter |           | Change   |     | Six Months |           | Change   |     |
|--|----------------|-----------|----------|-----|------------|-----------|----------|-----|
|  | 2008           | 2007      | \$       | %   | 2008       | 2007      | \$       | %   |
| Selling, general and administrative expenses | \$ 15,418      | \$ 12,781 | \$ 2,637 | 21% | \$ 30,170  | \$ 25,757 | \$ 4,413 | 17% |
| Percent of revenues                          | 22.8%          | 23.6%     |          |     | 23.8%      | 24.7%     |          |     |

SG&A as a percentage of revenues for the three and six months ended June 30, 2008 grew at a slower rate than the prior year periods due to significantly higher revenues and leverage in the utilization of our administrative and sales staff. Excluding the impact of acquisitions, our full-time equivalent SG&A employee count grew only 4% from June 30, 2007.

#### Research and Development Expense

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

| (\$ in thousands)                | Second Quarter |          | Change |     | Six Months |          | Change   |     |
|----------------------------------|----------------|----------|--------|-----|------------|----------|----------|-----|
|                                  | 2008           | 2007     | \$     | %   | 2008       | 2007     | \$       | %   |
| Research and development expense | \$ 2,253       | \$ 1,404 | \$ 849 | 60% | \$ 4,069   | \$ 2,627 | \$ 1,442 | 55% |
| Percent of revenues              | 3.3%           | 2.6%     |        |     | 3.2%       | 2.5%     |          |     |

Research and development expense consist mainly of costs associated with the Microsoft Dynamics AX project, in addition to costs associated with other new product development efforts. In January 2007, we entered into a strategic alliance with Microsoft Corporation to jointly develop core public sector functionality for Microsoft Dynamics AX to address the accounting needs of public sector organizations worldwide. Research and development costs increased over the prior year periods because the Microsoft Dynamics AX development effort was not fully staffed until mid-2007. In the six months ended June 30, 2008, we offset our research and development expense by \$130,000, which was the amount earned under the terms of our agreement with Microsoft. We did not receive any reimbursements from Microsoft in the six months ended June 30, 2007. We anticipate these costs will continue throughout 2008; however, the actual amount and timing of those costs and related reimbursements, if any, and whether they are capitalized or expensed may vary.

## Non-Cash Legal Settlement Related to Warrants

On June 27, 2008, we settled outstanding litigation related to two Stock Purchase Warrants (the “Warrants”) owned by Bank of America, N. A. (“BANA”). As disclosed in prior SEC filings, the Warrants entitled BANA to acquire 1.6 million shares of Tyler common stock at an exercise price of \$2.50 per share. Following court-ordered mediation, in July 2008, BANA paid us \$2.0 million and we issued to BANA 801,883 restricted shares of Tyler common stock. Accordingly, we recorded a non-cash legal settlement related to warrants charge of \$9.0 million, which is not tax deductible during the three months ended June 30, 2008. In addition, our balance sheet at June 30, 2008, includes a \$2.0 million receivable from BANA and an increase to additional paid-in capital of \$11.0 million to reflect our obligation to issue 801,883 restricted shares of common stock.

## 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 June 30:

| (\$ in thousands)                                   | Second Quarter |        | Change |     | Six Months |        | Change |     |
|---|----------------|--------|--------|-----|------------|--------|--------|-----|
|   | 2008           | 2007   | \$     | %   | 2008       | 2007   | \$     | %   |
| Amortization of customer and trade name intangibles | \$ 591         | \$ 356 | \$ 235 | 66% | \$ 1,158   | \$ 703 | \$ 455 | 65% |

In the first quarter of 2008, we completed two acquisitions, which increased amortizable customer and trade name intangibles by \$8.7 million. This amount will be amortized over approximately 11 years.

## Income Tax Provision

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

| (\$ in thousands)         | Second Quarter |          | Change   |       | Six Months |          | Change   |      |
|---------------------------|----------------|----------|----------|-------|------------|----------|----------|------|
|                           | 2008           | 2007     | \$       | %     | 2008       | 2007     | \$       | %    |
| Income tax provision      | \$ 1,780       | \$ 2,410 | \$ (630) | (26)% | \$ 3,724   | \$ 3,932 | \$ (208) | (5)% |
| Effective income tax rate | 87.9%          | 39.1%    |          |       | 52.5%      | 39.0%    |          |      |

Our effective income tax rose compared to the prior year periods due to a non-cash legal settlement related to warrants charge of \$9.0 million, which was not deductible. The effective income tax rates for the three and six months ended June 30, 2008 and 2007 were different from the statutory United States federal income tax rate of 35% primarily due to a non-cash legal settlement related to warrants charge which was not deductible, as well as state income taxes,



non-deductible share-based compensation expense, the qualified manufacturing activities deduction, and non-deductible meals and entertainment costs.

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## FINANCIAL CONDITION AND LIQUIDITY

As of June 30, 2008, we had cash and cash equivalents (including restricted cash equivalents) of \$38.1 million and current and non-current investments of \$5.7 million, compared to cash and cash equivalents (including restricted cash equivalents) of \$14.1 million and short-term investments of \$41.6 million at December 31, 2007. As of June 30, 2008 we had outstanding letters of credit totaling \$5.1 million to secure surety bonds required by some of our customer contracts. These letters of credit expire through May 2009.

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

| Six months ended June 30,                            | 2008      | 2007       |
|--|-----------|------------|
| Cash flows provided by (used by):                    |           |            |
| Operating activities                                 | \$ 17,939 | \$ 8,781   |
| Investing activities                                 | 16,444    | (8,040)    |
| Financing activities                                 | (11,013)  | (9,028)    |
| Net increase (decrease) in cash and cash equivalents | \$ 23,370 | \$ (8,287) |

## Operating Activities

Net cash provided by operating activities continues to be our primary source of funds to finance operating needs and capital expenditures. Other capital resources include cash on hand and access to the capital markets. For the six months ended June 30, 2008, operating activities provided net cash of \$17.9 million, primarily generated from net income of \$3.4 million, non-cash legal settlement related to warrants charge of \$9.0 million, non-cash depreciation and amortization charges of \$5.9 million, non-cash share-based compensation expense of \$1.6 million, offset by a small increase in net operating assets of \$2.0 million. Net operating assets increased mainly due to higher estimated income tax payments.

Our short-term and non-current investments are comprised of auction rate municipal securities (“ARS”). ARS are long-term variable rate bonds tied to short-term interest rates that are reset through a “Dutch Auction” process that occurs every 28 to 35 days. We have the option to participate in the auction and sell ARS to prospective buyers through a broker-dealer. We do not have the right to put the security back to the issuer. Our investments in ARS all had AAA credit ratings at the time of purchase and represent interests in collateralized debt obligations supported by municipal and state agencies. Our ARS investment as of March 31, 2008 was \$7.9 million of which we were able to liquidate \$2.2 million in the three months ending June 30, 2008. As of June 30, 2008, we had \$5.7 million of principal invested in ARS that had experienced failed auctions. Of this amount, we were able to liquidate \$50,000 for cash at par during the period July 1, 2008 through July 18, 2008. Accordingly, as of June 30, 2008, we classified the remaining \$5.6 million in ARS as non-current because it is unknown if we will be able to liquidate these securities within one year. Based on our cash and cash equivalents at June 30, 2008 and our expected operating cash flows, we do not anticipate the current lack of liquidity of these investments will have a material effect on our ability to conduct business.

Our days sales outstanding (“DSO”) was 103 days at June 30, 2008 and 95 days at December 31, 2007. Our maintenance billing cycle typically peaks at its highest level in June. The majority of the cash is collected in the third quarter of each year. As a result, our DSO increased in the second quarter compared to the fourth quarter. DSO is calculated based on quarter-end accounts receivable divided by the quotient of annualized quarterly revenues divided by 360 days.

Investing activities provided cash of \$16.4 million in the six months ending June 30, 2008 compared to \$8.0 million cash used for the same period in 2007. In the six months ended June 30, 2008, we liquidated \$35.9 million of short-term investments in ARS for cash at par, and we completed the acquisitions of all of the capital stock of VersaTrans Solutions Inc. and certain assets of Olympia Computing Company, Inc. d/b/a Schoolmaster that expanded our presence in the education market. The combined purchase price, excluding cash acquired and including transaction costs, was approximately \$13.9 million in cash and approximately 126,000 shares of Tyler common stock valued at \$1.7 million. We also paid approximately \$2.2 million for land in Lubbock, Texas in connection with a planned office development and purchased software for internal use for approximately \$600,000. In the comparable prior year period, we acquired all of the capital stock of Advanced Data Systems, Inc., along with an office building used in its business, for approximately \$4.2 million in cash. Other investing activities in the six months ended June 30, 2007 were primarily comprised of a net investment of \$1.8 million in short term investments and investments of \$1.6 million in property and equipment. Capital expenditures and acquisitions were funded from cash generated from operations.

Financing activities used cash of \$11.0 million, in the six months ending June 30, 2008 compared to \$9.0 million in the same period for 2007. 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 six months ended June 30, 2008, we purchased 1.1 million shares of our common stock for an aggregate purchase price of \$14.4 million. At June 30, 2008, we had authorization to repurchase up to 2.7 million additional shares of Tyler common stock. A summary of the repurchase activity during the six months ended June 30, 2008 is as follows:

| Period   | Total number of shares repurchased | Additional number of shares authorized that may be repurchased | Average price paid per share | Maximum number of shares that may be repurchased under current authorization |
|--|------------------------------------|--|------------------------------|--|
| January 1 through January 31                       | 814                                | -  | \$ 12.92                     | 967  |
| February 1 through February 29                     | -                                  | -  | -                            | 967  |
| March 1 through March 31                           | -                                  | -  | -                            | 967  |
| April 1 through April 30                           | -                                  | -  | -                            | 967  |
| Additional authorization by the board of directors | -                                  | 2,000  | -                            | 2,967  |
| May 1 through May 31                               | -                                  | -  | -                            | 2,967  |
| June 1 through June 30                             | 283                                | -  | 13.80                        | 2,684  |
| Total six months ended June 30, 2008               | 1,097                              | 2,000  | \$ 13.15                     |  |

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 and May 2008. 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.

During the second quarter of 2008, we began construction of an office development located in Lubbock, Texas to consolidate our Lubbock based workforce and support planned long-term growth. The office development is scheduled for completion in early 2010 and expected to cost approximately \$12.0 million to \$13.0 million. As of June 30, 2008, we have paid \$2.2 million primarily for land. We expect to capitalize additional costs of approximately \$2.5 million in 2008, related to the construction of this facility.

In July 2008 we paid \$12.7 million for an office building and land in Yarmouth, Maine as part of a plan to consolidate our workforce in the Portland, Maine area and support long-term growth. This building will be leased to third-party tenants through July 2011, at which time we expect to begin occupying the facility.

We also expect to purchase for approximately \$10.0 million an office building in Falmouth, Maine that we currently lease from a related party. The building purchase is expected to close in the second half of 2008.

None of these real estate investments are expected to preclude us from taking advantage of other opportunities to invest our cash in growing our business, and it is possible that we will leverage these facilities in the future.

We made federal and state income tax payments, net of refunds of \$6.5 million in the six months ended June 30, 2008 compared to \$3.3 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 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 or access to capital through issuance of equity 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. We are exposed to risk related to our investments in ARS. Liquidity for ARS is typically provided by an auction process that resets the applicable interest rate at pre-determined intervals, usually every 28 to 35 days. Because of the short interest rate reset period, we have historically recorded ARS as short-term investments available-for-sale. The liquidity of ARS has been negatively impacted by the uncertainty in the credit markets and the exposure of these securities to the financial condition of bond insurance companies. As of June 30, 2008, we had \$5.7 million of principal invested in ARS that had experienced failed auctions. Of this amount, we were able to liquidate \$50,000 for cash at par during the period July 1, 2008 through July 18, 2008. Accordingly, as of June 30, 2008, we classified the remaining \$5.6 million in ARS as non-current because it is unknown if we will be able to liquidate these securities within one year. These ARS had been subject to auction processes for which there had been insufficient bidders on the scheduled rollover dates. We will not be able to liquidate any of our non-current ARS until a future auction is successful, the issuer calls the security, a buyer is found outside the auction process or the securities are redeemed. Moreover, if the issuers are unable to successfully close future auctions and their credit ratings deteriorate, we may in the future be required to record an impairment charge on these investments. Maturity dates for these ARS investments range from 2017 to 2042.

We have no outstanding debt at June 30, 2008, 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 Securities and Exchange Commission within the required time periods.

## Part II. OTHER INFORMATION

### ITEM 1. Legal Proceedings

On June 27, 2008, we settled outstanding litigation related to two Stock Purchase Warrants (the "Warrants") owned by Bank of America, N. A. ("BANA"). As disclosed in prior SEC filings, the Warrants entitled BANA to acquire 1.6 million shares of Tyler common stock at an exercise price of \$2.50 per share. The Warrants expired on September 10, 2007. Prior to their expiration, BANA attempted to exercise the Warrants; however, the parties disputed whether or not BANA's exercise was effective. We filed suit for declaratory judgment seeking a court's determination on the matter, and BANA asserted numerous counterclaims against us, including breach of contract and misrepresentation.

Following court-ordered mediation, in July 2008, BANA paid us \$2.0 million and we issued to BANA 801,883 restricted shares of Tyler common stock. Accordingly, we recorded a non-cash legal settlement related to warrants charge of \$9.0 million, which is not tax deductible during the three months ended June 30, 2008. In addition, our balance sheet at June 30, 2008, includes a \$2.0 million receivable from BANA and an increase to additional paid-in capital of \$11.0 million to reflect our obligation to issue 801,883 restricted shares of common stock.

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 2007 Annual Report on Form 10-K. We believe those risk factors are the most relevant to our business and could cause our results to differ materially from the forward-looking statements made by us. Please note, however, that those are not the only risk factors facing us. Additional risks that we do not consider material, or of which we are not currently aware, may also have an adverse impact on us. Our business, financial condition and results of operations could be seriously harmed if any of these risks or uncertainties actually occurs or materializes. In that event, the market price for our common stock could decline, and our shareholders may lose all or part of their investment. During the first six months of 2008, 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, 2007.

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

We held our annual meeting of stockholders on May 15, 2008. The results of the matters voted on at the meeting are as follows:

With respect to the election of directors, shares were voted as follows:

| Nominee             | Number of<br>Votes For | Number of Votes<br>Withheld |
|---------------------|------------------------|-----------------------------|
| Donald R. Brattain  | 35,389,257             | 669,606                     |
| J. Luther King, Jr. | 35,432,394             | 626,469                     |
| John S. Marr, Jr.   | 35,212,793             | 846,070                     |
| G. Stuart Reeves    | 35,401,047             | 657,816                     |
| Michael D. Richards | 35,397,775             | 661,088                     |
| Dustin R. Womble    | 35,198,634             | 860,229                     |
| John M. Yeaman      | 34,588,307             | 1,470,556                   |

With respect to the amendment to our stock option plan to increase the number of shares of our stock that may be issued under the stock option plan from 8,500,000 shares to 11,000,000 shares, votes were as follows:

| For        | Against   | Abstain |
|------------|-----------|---------|
| 28,445,914 | 2,257,351 | 61,111  |

With respect to the ratification of Ernst & Young LLP as our independent auditors for fiscal year 2008, votes were as follows:

| For        | Against | Abstain |
|------------|---------|---------|
| 35,808,235 | 159,265 | 91,364  |

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





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: July 22, 2008