TYLER TECHNOLOGIES INC
Form 10-Q
October 27, 2008

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 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	75-2303920
(State or other jurisdiction of incorporation or organization)	(I.R.S. employer identification no.)

5949 SHERRY LANE, SUITE 1400
DALLAS, TEXAS
75225
(Address of principal executive offices)
(Zip code)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a small reporting company. See definition of “accelerated filer and large accelerated filer” in Rule 12b-2 of the Exchange Act. (Check one):
Large accelerated filer [ ] Accelerated filer [X] 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 [X]

The number of shares of common stock of registrant outstanding on October 23, 2008 was 36,330,337.

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 September 30,		Nine months ended September 30,	
	2008	2007	2008	2007
Revenues:				
Software licenses	$ 11,372	$ 8,145	$ 31,646	$ 24,431
Subscriptions	3,526	2,559	10,503	7,272
Software services	18,600	15,872	54,973	44,213
Maintenance	28,353	22,132	79,102	62,526
Appraisal services	5,289	4,927	14,249	16,514
Hardware and other	1,497	1,297	5,084	4,420
Total revenues	68,637	54,932	195,557	159,376
Cost of revenues:				
Software licenses	2,071	1,886	6,838	5,818
Acquired software	472	427	1,369	1,248
Software services, maintenance and subscriptions	31,988	26,795	93,555	77,677
Appraisal services	3,098	3,248	9,269	11,340
Hardware and other	1,058	946	3,684	3,304
Total cost of revenues	38,687	33,302	114,715	99,387
Gross profit	29,950	21,630	80,842	59,989
Selling, general and administrative expenses	15,985	12,691	46,155	38,448
Research and development expense	1,416	639	5,485	3,266
Amortization of customer and trade name intangibles	612	372	1,770	1,075
Non-cash legal settlement related to warrants	-	-	9,045	-
Operating income	11,937	7,928	18,387	17,200
Other income, net	398	441	1,044	1,252
Income before income taxes	12,335	8,369	19,431	18,452
Income tax provision	5,976	3,209	9,700	7,141
Net income	$ 6,359	$ 5,160	$ 9,731	$ 11,311
Earnings per common share:				
Basic	$ 0.17	$ 0.13	$ 0.26	$ 0.29
Diluted	$ 0.16	$ 0.12	$ 0.25	$ 0.27

Basic weighted average common shares outstanding	38,474	38,688	38,093	38,717
Diluted weighted average common shares outstanding	40,019	41,395	39,626	41,673

See accompanying notes.

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

	September 30, 2008 (Unaudited)	December 31, 2007
ASSETS		
Current assets:		
Cash and cash equivalents	$ 23,779	$ 9,642
Restricted cash equivalents	5,082	4,462
Short-term investments available-for-sale	500	41,590
Accounts receivable (less allowance for losses of $1,841 in 2008 and $1,851 in 2007)	66,430	63,965
Prepaid expenses	7,693	7,726
Other current assets	1,771	1,324
Deferred income taxes	1,839	2,355
Total current assets	107,094	131,064
Accounts receivable, long-term portion	681	398
Property and equipment, net	24,773	9,826
Non-current investments available-for-sale	4,893	-
Other assets:		
Goodwill	88,733	71,677
Customer related intangibles, net	28,071	17,706
Software, net	7,034	9,588
Other intangibles, net	2,577	1,074
Sundry	220	175
	$ 264,076	$ 241,508
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 2,590	$ 3,323
Accrued liabilities	26,265	18,905
Deferred revenue	91,029	73,714
Income taxes payable	-	632
Total current liabilities	119,884	96,574
Deferred income taxes	8,889	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

Additional paid-in capital		150,561		149,568
Accumulated other comprehensive loss, net of tax		(167)		-
Retained earnings		45,363		35,632
Treasury stock, at cost; 10,321,534 and 9,528,467 shares in 2008				
and 2007, respectively		(60,935)		(48,470)
Total shareholders' equity		135,303		137,211
	$	264,076	$	241,508

See accompanying notes.

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

	Nine months ended September 30,	
	2008	2007
Cash flows from operating activities:		
Net income	$ 9,731	$ 11,311
Adjustments to reconcile net income to net cash provided by operations:		
Depreciation and amortization	8,989	7,795
Non-cash legal settlement related to warrants	9,045	-
Share-based compensation expense	2,719	1,705
Changes in operating assets and liabilities, exclusive of effects of acquired companies:		
Accounts receivable	63	6,532
Income tax receivable	(972)	(800)
Prepaid expenses and other current assets	515	504
Accounts payable	(833)	(1,465)
Accrued liabilities	3,555	(1,289)
Deferred revenue	12,587	245
Net cash provided by operating activities	45,399	24,538
Cash flows from investing activities:		
Proceeds from sales of short-term investments	44,565	21,103
Purchases of short-term investments	(8,625)	(29,940)
Cost of acquisitions, net of cash acquired	(23,868)	(9,005)
Investment in software development costs	-	(158)
Additions to property and equipment	(17,375)	(2,575)
Acquired lease	(1,387)	-
(Increase) decrease in restricted investments	(620)	500
(Increase) decrease in other	(38)	40
Net cash used by investing activities	(7,348)	(20,035)
Cash flows from financing activities:		
Purchase of treasury shares	(28,968)	(11,134)
Contributions from employee stock purchase plan	872	833
Proceeds from exercise of stock options	1,617	3,291
Excess tax benefits from share-based compensation expense	560	1,118
Warrant exercise in connection with legal settlement	2,005	-
Net cash used by financing activities	(23,914)	(5,892)
Net increase (decrease) in cash and cash equivalents	14,137	(1,389)
Cash and cash equivalents at beginning of period	9,642	17,212
Cash and cash equivalents at end of period	$ 23,779	$ 15,823

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 September 30, 2008 and December 31, 2007 and operating result amounts are for the three and nine months ended September 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, term license arrangements with renewal periods of twelve months or less and disaster recovery ratably over the period of the applicable agreement as services are provided. Disaster recovery agreements and other hosting services are typically renewable annually. ASP and software subscriptions are typically for periods of three to six years and automatically renew unless either party cancels the agreement. The majority of the ASP and other hosting services and software subscriptions also include professional services as well as maintenance and support. In certain ASP arrangements, the customer also acquires a license to the software.

For ASP and other hosting arrangements, we evaluate whether 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.

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 August 2008, we completed the acquisition of all the capital stock of School Information Systems, Inc. ("SIS") which develops and sells a full suite of student information and financial management systems for K-12 schools. The purchase price, including transaction costs and excluding cash balances acquired, was approximately $9.9 million in cash and approximately 70,000 shares of Tyler common stock valued at $1.2 million.

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 three transactions we acquired total tangible assets of approximately $3.6 million and assumed total liabilities of approximately $8.2 million. We recorded goodwill of $17.0 million, $7.7 million of which is expected to be deductible for tax purposes, and other intangible assets of $14.3 million. The $14.3 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 September 30, 2008 reflects the preliminary allocation of the purchase price to the assets acquired and liabilities assumed based on their estimated fair values at the dates of acquisition.

(4) Financial Instruments

Assets recorded at fair value in the balance sheet as of September 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 September 30, 2008:

	Total	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Cash and cash equivalents (1)	$ 28,861	$ 28,861	$ -	$ -
Short-term investments available-for-sale (1)	500	500	-	-
Non-current investments available-for-sale (2)	4,893	-	-	4,893
Total	$ 34,254	$ 29,361	$ -	$ 4,893

(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. Level 1 financial assets also include auction rate municipal securities which were sold at par during the period October 1, 2008 through October 17, 2008.

(2) Investments available-for-sale consists of auction rate municipal securities ("ARS"). ARS were originally considered Level 2 financial assets and valued using estimated market values as of the balance sheet date obtained from an independent pricing service employed by our broker dealers. These independent pricing services carried 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. However, in the three months ending September 30, 2008, we began using discounted cash flow analysis to more accurately measure possible liquidity discounts. Because the discounted cash flow analysis included unobservable inputs we transferred these securities to Level 3 financial assets.

At September 30, 2008 our ARS 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 and have a current credit rating of A or AAA. The ratings on the ARS take into account credit support through insurance policies guaranteeing each of the bonds' payment of principal and accrued interest, if it becomes necessary. To date we have collected all interest payable on all of our ARS when due and expect to continue to do so in the future. Historically, the carrying value (par value) of the ARS approximated fair market value due to the frequent resetting of variable interest rates. Beginning in February 2008, however, the auctions for ARS began to fail and were largely unsuccessful, requiring us to hold them beyond their typical auction reset dates. As a result, the interest rates on these investments reset to the maximum based on formulas contained in the securities. The rates are generally equal to or higher than the current market for similar securities. The par value of the ARS associated with these failed auctions will not be available to us until a successful auction occurs, a buyer is found outside of the auction process, the securities are called or the underlying securities have matured. Due to these liquidity issues, we performed a discounted cash flow analysis to determine the estimated fair value of these investments. The assumptions used in preparing the models include, but are not limited to, interest rate yield curves for similar securities, market rates of returns, and the expected term of each security. In making assumptions of required rates of return, we considered risk-free interest rates and credit spreads for investments of similar credit quality. As a result of the lack of liquidity in the ARS market, we recorded an after tax temporary unrealized loss on our ARS of $167,000, net of related tax effects of $90,000, in the three months ended September, 30, 2008, which is included in accumulated other comprehensive loss on our balance sheet. We deemed the loss to be temporary because we do not plan to sell any of the ARS prior to maturity at an amount below the original purchase value and, at this time, do not deem it probable that we will receive less than 100% of the principal and accrued interest. Based on our cash and cash equivalents balance of $28.9 million, expected operating cash flows and the liquidation of $500,000 of ARS subsequent to the period ending September 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. 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. The following table reflects the activity for the ARS measured at fair value using Level 3 inputs (in thousands):

	Three months ended

Auction Rate Securities:	September 30, 2008	Nine months ended September 30, 2008
Balance at beginning of period	$ -	$ -
Transfers into level 3	5,150	5,150
Unrealized losses included in accumulated other comprehensive income	(257)	(257)
Balance as of September 30, 2008	$ 4,893	$ 4,893

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(5) Comprehensive Income

The following table provides the composition of other comprehensive income:

	Three months ended September 30,		Nine months ended September 30,	
	2008	2007	2008	2007
Net income, as reported	$ 6,359	$ 5,160	$ 9,731	$ 11,311
Unrealized losses-auction rate securities, net of tax	(167)	-	(167)	-
Comprehensive income	$ 6,192	$ 5,160	$ 9,564	$ 11,311

(6) Shareholders' Equity

The following table details activity in our common stock:

	Nine months ended September 30,			
	2008		2007	
	Shares	Amount	Shares	Amount
Purchases of common stock	(2,194)	$ (31,322)	(889)	$ (11,134)
Stock option exercises	325	1,617	767	3,291
Employee stock plan purchases	78	892	77	853
Shares issued for acquisitions	196	2,863	-	-
Warrant exercises in connection with legal settlement	802	11,050	-	-

As of September 30, 2008 we have authorization from our board of directors to repurchase up to 1.6 million additional shares of Tyler common stock. During the period October 1, 2008 through October 20, 2008 we purchased 1.5 million shares of our common stock for an aggregate purchase price of $20.6 million. On October 23, 2008, our board of directors authorized the repurchase of an additional 2.0 million shares.

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 10 – Commitments and Contingencies for further information.

(7) Income Tax Provision

For the three and nine months ended September 30, 2008, we had an effective income tax rate of 48.4% and 49.9%, respectively, compared to 38.3% and 38.7% for the three months and nine months ended September 30, 2007. Our effective income tax rate increased approximately twelve points 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 $10.1 million in the nine months ended September 30, 2008, compared to $6.9 million in net payments for the same period of the prior year.

(8) Earnings Per Share

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

	Three months ended September 30, 2008	Three months ended September 30, 2007	Nine months ended September 30, 2008	Nine months ended September 30, 2007
Numerator for basic and diluted earnings per share:				
Net income	$ 6,359	$ 5,160	$ 9,731	$ 11,311
Denominator:				
Weighted-average basic common shares outstanding	38,474	38,688	38,093	38,717
Assumed conversion of dilutive securities:				
Stock options	1,545	1,685	1,533	1,753
Warrants	-	1,022	-	1,203
Potentially dilutive common shares	1,545	2,707	1,533	2,956
Denominator for diluted earnings per share - Adjusted weighted-average shares	40,019	41,395	39,626	41,673
Earnings per common share:				
Basic	$ 0.17	$ 0.13	$ 0.26	$ 0.29
Diluted	$ 0.16	$ 0.12	$ 0.25	$ 0.27

(9) 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 September 30, 2008	Three months ended September 30, 2007	Nine months ended September 30, 2008	Nine months ended September 30, 2007
Cost of software services, maintenance and subscriptions	$ 100	$ 59	$ 250	$ 158
Selling, general and administrative expense	998	573	2,469	1,547
Total share-based compensation expense	$ 1,098	$ 632	$ 2,719	$ 1,705

(10) 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 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 three months ending December 31, 2008.

(11) 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.

(12) Subsequent Event

On October 20, 2008, we entered into a new revolving bank credit agreement (the “Credit Facility”) and a related pledge and security agreement. The Credit Facility matures October 19, 2009 and provides for total borrowings of up to $25.0 million and a $6.0 million Letter of Credit facility under which the bank will issue cash collateralized letters of credit. Borrowings under the Credit Facility will bear interest at a rate of either LIBOR plus 1% or prime rate minus 1.5%. As of October 20, 2008, our effective interest rate was 3% under the Credit Facility. As of October 24, 2008 we had no outstanding borrowings under the Credit Facility.

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 August 2008, we completed the acquisition of all the capital stock of School Information Systems, Inc. ("SIS") which develops and sells a full suite of student information and financial management systems for K-12 schools. The total purchase price, including transaction costs and excluding cash balances acquired, was approximately $9.9 million in cash and approximately 70,000 shares of Tyler common stock valued at $1.2 million. 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 September 30, 2008, our total full-time equivalent employee count increased to 1,938 from 1,640 at September 30, 2007. Approximately 49% of these additions or 146 full-time equivalent employees were added as a result of several acquisitions completed since September 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 September 30:

	Third Quarter				%	Nine Months				%
		% of		% of	Increase/		% of		% of	Increase/
($ in thousands)	2008	Total	2007	Total	(Decrease)	2008	Total	2007	Total	(Decrease)
Software licenses	$ 11,372	17%	$ 8,145	15%	40%	$ 31,646	16%	$ 24,431	15%	30%
Subscription	3,526	5	2,559	5	38	10,503	5	7,272	5	44
Software services	18,600	27	15,872	29	17	54,973	28	44,213	28	24
Maintenance	28,353	41	22,132	40	28	79,102	41	62,526	39	27
Appraisal services	5,289	8	4,927	9	7	14,249	7	16,514	10	(14)
Hardware and other	1,497	2	1,297	2	15	5,084	3	4,420	3	15
Total revenues	$ 68,637	100%	$ 54,932	100%	25%	$ 195,557	100%	$ 159,376	100%	23%

Total revenues grew 15% and 14% for the three and nine months ended September 30, 2008, respectively, excluding the impact of acquisitions completed in the prior twelve months.

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

	Third Quarter				%	Nine Months				%
		% of		% of	Increase/		% of		% of	Increase/
	2008	Total	2007	Total	(Decrease)	2008	Total	2007	Total	(Decrease)
Financial management										

and education	$	6,452	57%	$	6,111	75%	6 %	$	21,023	66%	$	16,703	68%	26%
Courts and justice		3,914	34		1,188	15	229		7,754	25		5,039	21	54
Appraisal and tax and other		1,006	9		846	10	19		2,869	9		2,689	11	7
Total software license revenues	$	11,372	100%	$	8,145	100%	40 %	$	31,646	100%	$	24,431	100%	30%

In the three months ended September 30, 2008, we signed 16 new material contracts with average software license fees of approximately $215,000 compared to 26 new material contracts signed in the three months ended September 30, 2007 with average software license fees of approximately $319,000. In the nine months ended September 30, 2008, we signed 50 new material contracts with average software license fees of approximately $310,000 compared to 59 new material contracts signed in the nine months ended September 30, 2007 with average software license fees of approximately $447,000. We consider contracts with a license fee component of $100,000 or more to be material. The mix of our new contracts signed in the three months ended September 30, 2008 included more contacts with a license fee component of less than $100,000 compared to the prior year period. 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 nine months ended September 30, 2008 increased 6% and 26%, respectively, compared to the prior year periods mainly due to contract arrangements that included more software license revenue than in the past. 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 nine months ended September 30, 2008.

- Software license revenue related to our courts and justice software solutions for three and nine months ended September 30, 2008 increased 229% and 54%, respectively, compared to the prior year periods. In the three months ended September 30, 2008 we recorded software license revenue of approximately $1.7 million from a contract which had been deferred in accordance with the terms of the contract. In addition, since late 2007 we expanded our presence in the markets for municipal courts software solutions and public safety software solutions which contributed to 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 and existing customers converting to ASP arrangements 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.

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 nine months ended September 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 $1.1 million and $3.0 million to software service revenues for the three and nine months ended September 30, 2008, respectively.

- Software services revenue related to courts and justice solutions experienced strong increases compared to the three and nine months ended September 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 28% and 27% for the three and nine months ended September 30, 2008, respectively compared to the prior year periods. Maintenance and support services grew 17% and 16% for the three and nine months ended September 30, 2008, respectively, 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 increased 7% for the three months ended September 30, 2008, and declined 14% for the nine months ended September 30, 2008, compared to the prior year periods. The appraisal services business is driven in part by revaluation cycles in various states. In late 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. In mid-2008 we began a complete reappraisal of real property in Orleans Parish, Louisiana. This contract

is valued at approximately $12.0 million and consists of two separate phases expected to be complete by late 2010. We continue to expect appraisal revenue for the full year 2008 will be moderately lower than 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 September 30:

	Third Quarter				Nine Months			
($ in thousands)	2008	% of Related Revenues	2007	% of Related Revenues	2008	% of Related Revenues	2007	% of Related Revenues
Software licenses	$ 2,071	18%	$ 1,886	23%	$ 6,838	22%	$ 5,818	24%
Acquired software	472	4	427	5	1,369	4	1,248	5
Software services, maintenance and subscriptions	31,988	63	26,795	66	93,555	65	77,677	68
Appraisal services	3,098	59	3,248	66	9,269	65	11,340	69
Hardware and other	1,058	71	946	73	3,684	72	3,304	75
Total cost of revenue	$ 38,687	56%	$ 33,302	61%	$ 114,715	59%	$ 99,387	62%

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

	Third Quarter			Nine Months		
Gross Margin percentages	2008	2007	Change	2008	2007	Change
Software licenses and acquired software	77.6%	71.6%	6.0%	74.1%	71.1%	3.0%
Software services, maintenance and subscriptions	36.6	33.9	2.7	35.3	31.9	3.4
Appraisal services	41.4	34.1	7.3	34.9	31.3	3.6
Hardware and other	29.3	27.1	2.2	27.5	25.2	2.3
Overall gross margin	43.6%	39.4%	4.2%	41.3%	37.6%	3.7%

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 nine months ended September 30, 2008, our software license gross margin percentage rose compared to the prior year periods due to strong license fee revenue increases. In addition, the three months ended September 30, 2008 benefitted from slightly lower software development amortization because certain software products became fully amortized during that period. The year-to-date gross margin grew at a 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 nine months ended September 30, 2008, the software services, maintenance and subscriptions gross margin increased 2.7% and 3.4%, 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 225 full-time equivalent employees since September 30, 2007 in order to expand our capacity to implement our contract backlog. This increase includes 102 full-time equivalent employees related to acquisitions completed since September 30, 2007.

In addition, approximately 0.6% of the gross margin increase for the nine months ended September 30, 2008 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 three months ended September 30, 2008 is higher than the prior year period due to higher revenues associated with the Orleans Parish reappraisal project.

Our blended gross margin for the three and nine months ended September 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 September 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 September 30:

	Third Quarter		Change		Nine Months		Change	
($ in thousands)	2008	2007	$	%	2008	2007	$	%
Selling, general and administrative expenses	$ 15,985	$ 12,691	$ 3,294	26%	$ 46,155	$ 38,448	$ 7,707	20%
Percent of revenues	23.3%	23.1%			23.6%	24.1%		

SG&A as a percentage of revenues for the three and nine months ended September 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 declined 2% from September 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 September 30:

	Third Quarter		Change		Nine Months		Change	
($ in thousands)	2008	2007	$	%	2008	2007	$	%
Research and development expense	$ 1,416	$ 639	$ 777	122%	$ 5,485	$ 3,266	$ 2,219	68%
Percent of revenues	2.1%	1.2%			2.8%	2.0%		

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 nine months ended September 30, 2008 and 2007, we offset our research and development expense by $987,000 and $883,000, respectively, which were the amounts earned under the terms of our research and development agreement with Microsoft. We amended this agreement in September 2008 to define the scope of reimbursable development through the balance of the project and now expect to offset research and development expense by approximately $850,000 each quarter through the end of 2010. The actual amount and timing of future research and development costs and related reimbursements 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.

Amortization of Customer and Trade Name Intangibles

Acquisition intangibles are composed of the excess of the purchase price over the fair value of net tangible assets acquired that is allocated to acquired software and customer and trade name intangibles. The remaining excess purchase price is allocated to goodwill that is not subject to amortization. Amortization expense related to acquired software is included with cost of revenues while amortization expense of customer and trade name intangibles is recorded as a non-operating expense. The following table sets forth a comparison of amortization of customer and trade name intangibles for the periods presented as of September 30:

	Third Quarter		Change		Nine Months		Change	
($ in thousands)	2008	2007	$	%	2008	2007	$	%
Amortization of customer and trade name intangibles	$ 612	$ 372	$ 240	65%	$ 1,770	$ 1,075	$ 695	65%

In the nine months ended September 30, 2008, we completed three acquisitions, which increased amortizable customer and trade name intangibles by $12.3 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 September 30:

	Third Quarter		Change		Nine Months		Change	
($ in thousands)	2008	2007	$	%	2008	2007	$	%
Income tax provision	$ 5,976	$ 3,209	$ 2,767	86%	$ 9,700	$ 7,141	$ 2,559	36%
Effective income tax rate	48.4%	38.3%			49.9%	38.7%		

Our effective income tax rate increased approximately twelve points 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 nine months ended September 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.

FINANCIAL CONDITION AND LIQUIDITY

As of September 30, 2008, we had cash and cash equivalents (including restricted cash equivalents) of $28.9 million and current and non-current investments of $5.4 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 September 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 July 2009.

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

Nine months ended September 30,		2008		2007
Cash flows provided by (used by):				
Operating activities	$	45,399	$	24,538
Investing activities		(7,348)		(20,035)
Financing activities		(23,914)		(5,892)
Net increase (decrease) in cash and cash equivalents	$	14,137	$	(1,389)

Operating Activities

Net cash provided by operating activities continues to be our primary source of funds to finance operating needs and capital expenditures. Other capital resources include cash on hand and access to the capital markets. For the nine months ended September 30, 2008, operating activities provided net cash of $45.4 million, primarily generated from net income of $9.7 million, non-cash legal settlement related to warrants charge of $9.0 million, non-cash depreciation and amortization charges of $9.0 million, non-cash share-based compensation expense of $2.7 million, and a decrease in net operating assets of $14.9 million. Net operating assets declined mainly due to several advance payments from customers.

As of September 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 $500,000 for cash at par during the period October 1, 2008 through October 17, 2008. 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. 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. Based on our cash and cash equivalents at September 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 87 days at September 30, 2008 and 95 days at December 31, 2007. DSOs decreased compared to the fourth quarter of 2007 because of annual maintenance billing collections. Our maintenance billings typically peak in December and June of each year and are followed by collections in the subsequent quarter. DSO is calculated based on quarter-end accounts receivable divided by the quotient of annualized quarterly revenues divided by 360 days.

Investing activities used cash of $7.3 million in the nine months ending September 30, 2008 compared to $20.0 million cash used for the same period in 2007. In the nine months ended September 30, 2008, we liquidated $35.9 million of short-term investments in ARS for cash at par, and we completed the acquisitions of School Information Systems, Inc, 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 $23.9 million in cash and approximately 196,000 shares of Tyler

common stock valued at $2.9 million. We also paid $2.5 million primarily for land in Lubbock, Texas in connection with a planned office development and paid $12.7 million for an office building, land, and a related tenant lease in Yarmouth, Maine. Capital expenditures and acquisitions were funded from cash generated from operations.

For the nine months ended September 30, 2007, net cash used by investing activities of $20.0 million included cash payments of $9.0 million for the acquisitions of EDP Enterprises, Inc. and Advanced Data Systems, Inc., along with an office building. Other investing activities in the nine months ended September 30, 2007 were primarily comprised of a net investment of $8.8 million in short term investments and investments of $2.6 million in property and equipment.

Financing activities used cash of $23.9 million, in the nine months ending September 30, 2008 compared to $5.9 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 nine months ended September 30, 2008, we purchased 2.2 million shares of our common stock for an aggregate purchase price of $31.3 million. At September 30, 2008, we had authorization to repurchase up to 1.6 million additional shares of Tyler common stock. A summary of the repurchase activity during the nine months ended September 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
July 1 through July 31	163	-	14.08	2,521
August 1 through August 31	15	-	15.41	2,506
September 1 through September 30	919	-	15.64	1,587
Total nine months ended September 30, 2008	2,194	2,000	$ 14.28	

During the period October 1, 2008 through October 20, 2008 we purchased 1.5 million shares of our common stock for an aggregate purchase price of $20.6 million.

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. On October 23, 2008, our board of directors authorized the repurchase of an additional 2.0 million shares. 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 September 30, 2008, we have paid $2.5 million, primarily for land. We expect to capitalize additional costs of approximately $1.0 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 to 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 three months ended December 31, 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 assets in the future.

On October 20, 2008, we entered into a new revolving bank credit agreement (the “Credit Facility”) and a related pledge and security agreement. The Credit Facility matures October 19, 2009 and provides for total borrowings of up to $25.0 million and a $6.0 million Letter of Credit facility under which the bank will issue cash collateralized letters of credit. Borrowings under the Credit Facility will bear interest at a rate of either LIBOR plus 1% or prime rate minus 1.5%. As of October 20, 2008, our effective interest rate was 3% under the Credit Facility. As of September 30, 2008 we had no debt and outstanding letters of credit totaling $5.1 million under a previous agreement to secure surety bonds required by some of our customer contracts. As of October 24, 2008 we had no outstanding borrowings under the Credit Facility.

We made federal and state income tax payments, net of refunds of $10.1 million in the nine months ended September 30, 2008 compared to $6.9 million in the comparable prior year.

From time to time we engage in discussions with potential acquisition candidates. In order to consummate any such opportunities, which could require significant commitments of capital, we may be required to incur debt or 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 may borrow under our revolving credit facility.

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. 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 September 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

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

ITEM 1A. Risk Factors

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 nine 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

None

ITEM 5. Other Information

None

ITEM 6. Exhibits

Exhibit 4.1	Second Amended and Restated Credit Agreement by and between Tyler Technologies, Inc. and Bank of Texas, N.A. dated October 20, 2008
Exhibit 4.2	Second Amended and Restated Pledge and Security Agreement by and between Tyler Technologies, Inc. and Bank of Texas, N.A. dated October 20, 2008
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: October 23, 2008

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