

TYLER TECHNOLOGIES INC

Form 10-K

February 26, 2009

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549**

**FORM 10-K**

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES AND EXCHANGE ACT OF 1934**  
**For the Fiscal Year Ended December 31, 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.)

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

Securities registered pursuant to Section 12(b) of the Act:

| <b>Title of each class</b>  | <b>Name of each exchange<br/>on which registered</b> |
|---|--|
| COMMON STOCK, \$0.01 PAR VALUE<br>Securities registered pursuant to Section 12(g) of the Act: | NEW YORK STOCK EXCHANGE                              |
| <b>NONE</b>   |  |

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES  NO

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. YES  NO

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 if disclosure of delinquent filer pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of the Form 10-K or any amendment to the Form 10-K. YES  NO

Indicate by check marker whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a capital reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company   
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act.) YES  NO

The aggregate market value of the voting stock held by non-affiliates of the registrant was \$483,676,000 based on the reported last sale price of common stock on June 30, 2008, which is the last business day of the registrant's most recently completed second fiscal quarter.

The number of shares of common stock of the registrant outstanding on February 20, 2009 was 35,430,780.

**DOCUMENTS INCORPORATED BY REFERENCE**

Certain information required by Part III of this annual report is incorporated by reference from the registrant's definitive proxy statement for its annual meeting of stockholders to be held on May 14, 2009.

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PART I

ITEM 1. BUSINESS.

DESCRIPTION OF BUSINESS

Tyler Technologies, Inc. ( Tyler ) is a major provider of integrated information management solutions and services for local governments. We partner with clients to make local government more accessible to the public, more responsive to the needs of citizens and more efficient in its operations. We have a broad line of software solutions and services to address the information technology ( IT ) needs of virtually every major area of operation for cities, counties, schools and other local government entities. Most of our customers have our software installed in-house. For customers who prefer not to physically acquire the software and hardware, we provide outsourced hosting for some of our applications at our data centers through an applications service provider ( ASP ) arrangement through our subscription-based services. We provide professional IT services to our customers, including software and hardware installation, data conversion, training and, at times, product modifications. In addition, we are the nation's largest provider of outsourced property appraisal services for taxing jurisdictions. We also provide continuing customer support services to ensure proper product performance and reliability, which provides us with long-term customer relationships and a significant base of recurring maintenance revenue.

Tyler was founded in 1966. Prior to 1998, we operated as a diversified industrial conglomerate, with operations in various industrial, retail and distribution businesses, all of which have been divested. In 1997, we embarked on a multi-phase growth plan focused on serving the specialized information management needs of local governments nationwide. In 1998 and 1999, we entered the local government IT market through a series of strategic acquisitions of companies in the local government IT market.

MARKET OVERVIEW

The state and local government market is one of the largest and most decentralized IT markets in the country, consisting of all 50 states, approximately 3,000 counties, 36,000 cities and towns and 14,200 school districts. This market is also comprised of approximately 35,000 special districts and other agencies, each with specialized delegated responsibilities and unique information management requirements.

Traditionally, local government bodies and agencies performed state-mandated duties, including property assessment, record keeping, road maintenance, law enforcement, administration of election and judicial functions, and the provision of welfare assistance. Today, a host of emerging and urgent issues are confronting local governments, each of which demands a service response. These areas include criminal justice and corrections, administration and finance, public safety, health and human services, and public works. Transfers of responsibility from the federal and state governments to county and municipal governments and agencies in these and other areas also place additional service and financial requirements on these local government units. In addition, constituents of local governments are increasingly demanding improved service and better access to information from public entities. As a result, local governments recognize the increasing value of information management systems and services to, among other things, improve revenue collection, provide increased access to information, and streamline delivery of services to their constituents. Local government bodies are now recognizing that e-government is an additional responsibility for community development. From integrated tax systems to integrated civil and criminal justice information systems, many counties and cities have benefited significantly from the implementation of jurisdiction-wide systems that allow different agencies or government offices to share data and provide a more comprehensive approach to information management. Many city and county governmental agencies also have unique individual information management requirements, which must be tailored to the specific functions of each particular office.

Many local governments also have difficulties attracting and retaining the staff necessary to support their IT functions. As a result, they seek to establish long-term relationships with reliable providers of high quality IT products and services such as Tyler.

Although local governments generally face budgetary constraints in their operations, their primary revenue sources are usually property taxes, and to a lesser extent, utility billings, which tend to be relatively stable. In addition, the acquisition of new technology typically enables local governments to operate more efficiently, and often provides a measurable return on investment that justifies the purchase of software and related services.



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Gartner estimates that state and local government IT spending will grow from \$51.2 billion in 2009 to \$59.5 billion in 2012, with local government accounting for \$26.1 billion of IT spending in 2009 and \$30.3 billion in 2012. The external services and software segments of the market, where our business is primarily focused, is expected to expand from \$13.8 billion in 2009 to \$16.9 billion in 2012.

### **PRODUCTS AND SERVICES**

We provide a comprehensive and flexible suite of products and services that address the information technology needs of cities, counties, schools and other local government entities. We derive our revenues from five primary sources:

sales of software licenses;

subscription-based arrangements;

software services;

maintenance and support; and

appraisal services.

We design, develop and market a broad range of software solutions to serve mission-critical back-office functions of local governments. Many of our software applications include Internet-accessible solutions that allow for real-time public access to a variety of information or that allow the public to transact business with local governments via the Internet. Our software solutions and services are generally grouped in four major areas:

Financial Management and Education;

Courts and Justice;

Property Appraisal and Tax; and

Public Records and Content Management.

Each of our core software systems consists of several fully integrated application modules. For customers who acquire the software for use in-house, we generally license our systems under standard perpetual license agreements that provide the customer with a fully paid, nonexclusive, nontransferable right to use the software. In some of the product areas, such as financial management and education and property appraisal and tax, we offer multiple solutions designed to meet the needs of different sized governments.

We also offer certain software solutions on a software as a service basis for customers who do not wish to maintain, update and operate these systems or to make large up-front capital expenditures to implement these advanced technologies. For these customers, we host the applications and data at our data centers. Customers typically pay monthly fees under multi-year contracts for these subscription-based services.

Historically, we have had a greater proportion of our annual revenues in the second half of our fiscal year due to governmental budget and spending cycles and the timing of system implementations for customers desiring to go live at the beginning of the calendar year.

A description of our suites of products and services follows:

#### **Software Licenses**

##### *Financial Management and Education*

Our financial management and education solutions are ERP (Enterprise Resource Planning) systems for local governments, which integrate information across all facets of a client organization. Our financial management solutions include modular fund accounting systems that can be tailored to meet the needs of virtually any government agency or not-for-profit entity. Our financial management systems include modules for general ledger, budget preparation, fixed assets, requisitions, purchase orders, bid management, accounts payable, contract management, accounts receivable, investment management, inventory control, project and grant accounting, work orders, job costing, GASB 34 reporting, payroll and human resources. All of our financial management systems are intended to



conform to government auditing and financial reporting requirements and generally accepted accounting principles.

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We sell utility billing systems that support the billing and collection of metered and non-metered services, along with multiple billing cycles. Our Web-enabled utility billing solutions allow customers to access information online such as average consumption and transaction history. In addition, our systems can accept secured Internet payments via credit cards and checks.

We also offer specialized products that automate numerous city functions, including municipal courts, parking tickets, equipment and project costing, animal licenses, business licenses, permits and inspections, code enforcement, citizen complaint tracking, ambulance billing, fleet maintenance, and cemetery records management.

In addition to providing financial management systems to K-12 schools, in 2006 we began offering a student information system for K-12 schools, which manages such applications as scheduling, grades and attendance. We also offer student transportation solutions to manage school bus routing optimization, fleet management, field trips and other related functions. We also added software applications to manage public sector pension funds.

Tyler's financial management and education solutions include Web components that enhance local governments service capabilities by facilitating online access to information for both employees and citizens and enabling online transactions.

### *Courts and Justice*

We offer a complete, fully integrated suite of judicial solutions with our Odyssey family of products. Our solutions help eliminate duplicate data entry, promote more effective business procedures and improve efficiency across the entire justice process. While the Odyssey suite is designed to handle complex, multi-jurisdictional county or statewide implementations, it is equally suited to manage single county systems.

Our unified court case management system is designed to automate the tracking and management of information involved in all case types, including criminal, traffic, civil, family, probate and juvenile courts. It also tracks the status of cases, processes fines and fees and generates the specialized judgment and sentencing documents, notices and forms required in the court process. Documents received by the court can be scanned into the electronic case file and easily retrieved for viewing. Documents generated by the court can be electronically signed and automatically attached to the electronic case file. Additional modules automate the management of court calendars, coordinate judge's schedules and generate court dockets. Our targeted courtroom technologies allow courts to rapidly review calendars, cases and view documents in the courtroom. Courts may also take advantage of our related jury management system.

Our law enforcement systems automate police and sheriff functions from dispatch and records management through booking and jail management. Searching, reporting and tracking features are integrated, allowing reliable, up-to-date access to current arrest and incarceration data, including digital mug shots. Our systems also provide warrant checks for visitors or book-ins, inmate classification and risk assessment, commissary, property and medical processing, and automation of statistics and state and federal reporting. Our computer-aided dispatch/emergency 911 system tracks calls and the availability of emergency response vehicles, interfaces with local and state searches, and assists dispatchers with processing emergency situations. The law enforcement and jail management systems are fully integrated with the suite of Odyssey prosecution and court products that manages the entire judicial process.

Our court and law enforcement systems allow the public to access, via the Internet, a variety of information, including non-confidential criminal and civil court records, jail booking and release information, bond and bondsmen information, and court calendars and dockets. In addition, our systems allow cities and counties to accept payments for traffic and parking tickets over the Internet, with a seamless and automatic interface to back-office justice and financial systems.

Our prosecutor system enables state attorney offices to track and manage criminal cases, including detailed victim information and private case notes. Investigative reports and charging instrument documents can be generated and stored for later viewing. Prosecutors can schedule and record the outcome of grand jury hearings. When integrated with the court system, prosecutors can view the electronic case file and related documents, as well as manage witness lists and subpoenas needed for court hearings.

Our supervision system allows pre-trial and probation offices to manage offender caseloads. Supervision officers can track busy contact schedules, risk/needs assessments and reassessments, detailed drug test results, employment histories, compliance with conditions and payments of fees and restitution. Documents and forms, like pre-sentence

investigations or revocation orders, can be generated and stored for easy viewing. When integrated with the jail and court systems, supervision officers can have easy access and quick notification of offenders that have court hearings scheduled, are arrested locally and have new warrants issued.

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Developed using Microsoft's .NET Framework and tools, Odyssey's server suite includes comprehensive support for service-oriented integrations, scheduled and offline job execution, integrated content management, and role-based security and configuration. Our unique combination of web-based and traditional smart client applications gives Odyssey a market-leading user experience. Our multi-tier architecture is built on the Windows Server® and SQL Server® platforms, and scales to meet the needs of any enterprise environment. Odyssey employs replicated OLTP/DSS databases and a variety of IP load balancing systems for optimal performance, clustered installations for maximum fault tolerance, and Terminal Server/Citrix deployment options to simplify management.

### *Property Appraisal and Tax*

We provide systems and software that automate the appraisal and assessment of real and personal property, including record keeping, mass appraisal, inquiry and protest tracking, appraisal and tax roll generation, tax statement processing, and electronic state-level reporting. These systems are image- and video-enabled to facilitate the storage of and access to the many property-related documents and for the online storage of digital photographs of properties for use in defending values in protest situations. Other related tax applications are available for agencies that bill and collect taxes, including cities, counties, school tax offices, and special taxing and collection agencies. These systems support billing, collections, lock box operations, mortgage company electronic payments, and various reporting requirements.

### *Public Records and Content Management*

We offer a number of specialized software applications designed to help county governments enhance and automate courthouse operations. These systems record, scan and index information for the many documents maintained at the courthouse, such as deeds, mortgages, liens, UCC financing statements and vital records (birth, death and marriage certificates). These applications include fully integrated imaging systems with batch and scan processing capabilities and fully integrated receipting and cashiering systems as well as Web-enabled public access.

### Subscription-Based Services

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. Our ASP arrangements and other hosted service offerings, provide certain software solutions on a software as a service basis for customers who do not wish to maintain, update and operate these systems or to make large up-front capital expenditures to implement these advanced technologies.

ASP arrangements and other hosting services are typically for a period of three to six years and automatically renew unless either party cancels the agreement. Other software subscriptions and disaster recovery service arrangements are typically under annual contracts. The majority of the ASP and other hosting services and software subscriptions also include professional services and maintenance and support services. In certain ASP arrangements, the customer also acquires a license to the software.

### Software Services

We provide a variety of professional IT services to customers who utilize our software products. Virtually all of our customers contract with us for installation, training, and data conversion services in connection with their purchase of Tyler's software solutions. The complete implementation process for a typical system includes planning, design, data conversion, set-up and testing. At the culmination of the implementation process, an installation team travels to the customer's facility to ensure the smooth transfer of data to the new system. Installation fees are charged separately to customers on either a fixed-fee or hourly charge basis, depending on the contract, with full pass-through to customers of travel and other out-of-pocket expenses.

Both in connection with the installation of new systems and on an ongoing basis, we provide extensive training services and programs related to our products and services. Training can be provided in our training centers, onsite at customers' locations, or at meetings and conferences, and can be customized to meet customers' requirements. The vast majority of our customers contract with us for training services, both to improve their employees' proficiency and productivity and to fully utilize the functionality of our systems. Training services are generally billed on an hourly basis, along with travel and other expenses.

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### Maintenance and Support

Following the implementation of our software systems, we provide ongoing software support services to assist our customers in operating the systems and to periodically update the software. Support is provided over the phone to customers through help desks staffed by our customer support representatives. For more complicated issues, our staff, with the customers' permission, can log on to customers' systems remotely. We maintain our customers' software largely through releases that contain improvements and incremental additions, along with updates necessary because of legislative or regulatory changes.

Virtually all of our software customers contract with us for maintenance and support, which provides us with a significant source of recurring revenue. We generally provide maintenance and support under annual contracts, with a typical fee based on a percentage of the software product's license fee. These fees can be increased annually and may also increase as new license fees increase. Maintenance and support fees are generally paid in advance for the entire maintenance contract period. Most maintenance contracts automatically renew unless the customer or Tyler gives notice of termination prior to expiration. Similar support is provided to our ASP customers, and is included in their overall monthly fees which are classified as subscription-based revenues.

### Appraisal Services

We are the nation's largest provider of property appraisal outsourcing services for local government taxing authorities. These services include:

the physical inspection of commercial and residential properties;

data collection and processing;

sophisticated computer analyses for property valuation;

preparation of tax rolls;

community education regarding the assessment process; and

arbitration between taxpayers and the assessing jurisdiction.

Local government taxing authorities normally reappraise properties from time to time to update values for tax assessment purposes and to maintain equity in the taxing process. In some jurisdictions, reassessment cycles are mandated by law; in others, they are discretionary. While some taxing jurisdictions perform reappraisals in-house, many local governments outsource this function because of its cyclical nature and because of the specialized knowledge and expertise requirements associated with it. Our appraisal services business unit has been in this business since 1938.

In some instances, we also sell property tax and/or appraisal software products in connection with appraisal outsourcing projects, while other customers may only engage us to provide appraisal services. Appraisal outsourcing services are somewhat seasonal in nature to the extent that winter weather conditions reduce the productivity of data collection activities in connection with those projects.

### STRATEGY

Our objective is to grow our revenue and earnings internally, supplemented by focused strategic acquisitions. The key components of our business strategy are to:

Provide high quality, value-added products and services to our clients. We compete on the basis of, among other things, delivering to customers our deep domain expertise in local government operations through the highest value products and services in the market. We believe we have achieved a reputation as a premium product and service provider to the local government market.

Continue to expand our product and service offerings. While we already have what we believe to be the broadest line of software products for local governments, we continually upgrade our core software applications and expand our complementary product and service offerings to respond to technological

advancements and the changing needs of our clients. For example, we offer solutions that allow the public to access data and conduct transactions with local governments, such as paying traffic tickets, property taxes and utility bills, via the Internet. We believe that the addition of such features enhance the market appeal of our core products. Since 2001, we have also offered certain of our software products under an ASP or

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other software as a subscription-based service model which we believe will, over time, have increasing appeal to local governments and will be expanded to include more applications. We have also increased our offerings of consulting and business process reengineering services.

Expand our customer base. We seek to establish long-term relationships with new customers primarily through our sales and marketing efforts. While we currently have customers in all 50 states, Canada, Puerto Rico, and the United Kingdom, not all of our solutions have achieved nationwide geographic penetration. We intend to continue to expand into new geographic markets by adding sales staff and targeting marketing efforts by solutions in those areas. We also intend to continue to expand our customer base to include more large governments. While our traditional market focus has primarily been on small and mid-sized governments, our increased size and market presence, together with the technological advances and improved scalability of certain of our solutions, are allowing us to achieve success in selling to larger customers.

Expand our existing customer relationships. Our existing customer base offers significant opportunities for additional sales of IT solutions and services that we currently offer, but that existing customers do not fully utilize. Add-on sales to existing customers typically involve lower sales and marketing expenses than sales to new customers.

Grow recurring revenues. We have a large recurring revenue base from maintenance and support and subscription-based services, which had revenues of \$121.8 million in 2008. We have historically experienced very low customer turnover (approximately 2% annually) and recurring revenues continue to grow as the installed customer base increases.

Maximize economies of scale and take advantage of financial leverage in our business. We seek to build and maintain a large client base to create economies of scale, enabling us to provide value-added products and services to our customers while expanding our operating margins. Because we sell primarily off-the-shelf software, increased sales of the same solutions result in incrementally higher gross margins. In addition, we believe that we have a marketing and administrative infrastructure in place that we can leverage to accommodate significant long-term growth without proportionately increasing selling, general and administrative expenses.

Attract and retain highly qualified employees. We believe that the depth and quality of our operating management and staff is one of our significant strengths, and that the ability to retain such employees is crucial to our continued growth and success. We believe that our stable management team, financial strength and growth opportunities, as well as our leadership position in the local government market, enhance our attractiveness as an employer for highly skilled employees.

Pursue selected strategic acquisitions. While we expect to primarily grow internally, from time to time we selectively pursue strategic acquisitions that provide us with one or more of the following:

- o products and services to complement our existing offerings;
- o entry into new markets related to local governments; and
- o new customers and/or geographic expansion.

Establish strategic alliances. In January 2007 we announced a strategic alliance with Microsoft Corporation to jointly develop core public sector functionality for Microsoft Dynamics AX to address the unique accounting needs of public sector organizations worldwide. As part of this alliance we are enhancing Microsoft Dynamics AX with public sector-specific functionality. The co-development will broaden the functionality of Microsoft Dynamics AX, providing both Tyler and Microsoft with a public sector accounting platform to support their

existing and prospective clients well into the future. Microsoft Dynamics AX with public sector functionality will be sold in the United States and internationally through Microsoft's distribution channels and is expected to be released in late 2010. Tyler will also become an authorized Microsoft reseller for the Microsoft Dynamics solutions developed under this arrangement, and will sell the solutions directly into the government market. Tyler will receive license and maintenance royalties on direct and indirect sales of the solutions co-developed under this multi-year term relationship.

**SALES, MARKETING, AND CUSTOMERS**

We market our products and services through direct sales and marketing personnel located throughout the United States. Other in-house sales staff focuses on add-on sales, professional services and support.



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Sales of new systems are typically generated from referrals from other government offices or departments within a county or municipality, referrals from other local governments, relationships established between sales representatives and county or local officials, contacts at trade shows, direct mailings, and direct contact from prospects already familiar with us. We are active in numerous national, state, county, and local government associations, and participate in annual meetings, trade shows, and educational events.

Customers consist primarily of county and municipal agencies, school districts and other local government offices. In counties, customers include the auditor, treasurer, tax assessor/collector, county clerk, district clerk, county and district court judges, probation officers, sheriff, and county appraiser. At municipal government sites, customers include directors from various departments, including administration, finance, utilities, public works, code enforcement, personnel, purchasing, taxation, municipal court, and police. Contracts for software products and services are generally implemented over periods of three months to one year, with annually renewing maintenance and support update agreements thereafter. Although either the customer or we can terminate these agreements, historically almost all support and maintenance agreements are automatically renewed annually. Contracts for appraisal outsourcing services are generally one to three years in duration. During 2008, approximately 41% of our revenue was attributable to ongoing support and maintenance agreements.

### **COMPETITION**

We compete with numerous local, regional, and national firms that provide or offer some or many of the same solutions and services that we provide. Most of these competitors are smaller companies that may be able to offer less expensive solutions than ours. Many of these firms operate within a specific geographic area and/or in a narrow product or service niche. We also compete with national firms, some of which have greater financial and technical resources than we do, including Oracle Corporation, Lawson Software, Inc., SAP AG, Affiliated Computer Services, Inc., SunGard Data Systems, Inc., New World Systems, Constellation Software, Inc. and Manatron, Inc. In addition, we sometimes compete with consulting and systems integration firms, such as BearingPoint, Inc., which develop custom systems, primarily for larger governments. We also occasionally compete with central internal information service departments of local governments, which require us to persuade the end-user department to discontinue service by its own personnel and outsource the service to us. We compete on a variety of factors, including price, service, name recognition, reputation, technological capabilities, and the ability to modify existing products and services to accommodate the individual requirements of the customer. Our ability to offer an integrated system of applications for several offices or departments is often a competitive strength. Local governmental units often are required to seek competitive proposals through a request for proposal process.

### **SUPPLIERS**

Substantially all of the computers, peripherals, printers, scanners, operating system software, office automation software, and other equipment necessary for the implementation and provision of our software systems and services are presently available from several third-party sources. Hardware is purchased on original equipment manufacturer or distributor terms at discounts from retail. We have not experienced any significant supply problems.

### **BACKLOG**

At December 31, 2008, our estimated revenue backlog was approximately \$243.4 million, compared to \$250.1 million at December 31, 2007. The backlog represents signed contracts under which the products have not been delivered or the services have not been performed as of year-end. Approximately \$181.3 million of the backlog is expected to be recognized during 2009.

### **INTELLECTUAL PROPERTY, PROPRIETARY RIGHTS, AND LICENSES**

We regard certain features of our internal operations, software, and documentation as confidential and proprietary and rely on a combination of contractual restrictions, trade secret laws and other measures to protect our proprietary intellectual property. We generally do not rely on patents. We believe that, due to the rapid rate of technological change in the computer software industry, trade secrets and copyright protection are less significant than factors such as knowledge, ability and experience of our employees, frequent product enhancements, and timeliness and quality of support services. We typically license our software products under non-exclusive license agreements which are generally non-transferable and have a perpetual term.



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### **EMPLOYEES**

At December 31, 2008, we had 1,940 employees. Appraisal outsourcing projects are cyclical in nature and can be widely dispersed geographically. We often hire temporary employees to assist in these projects whose term of employment generally ends with the project's completion. None of our employees are represented by a labor union or are subject to collective bargaining agreements. We consider our relations with our employees to be positive.

### **INTERNET WEBSITE AND AVAILABILITY OF PUBLIC FILINGS**

We file annual, quarterly, current and other reports, proxy statements and other information with the Securities and Exchange Commission, or SEC, pursuant to the Securities Exchange Act. You may read and copy any materials we file with the SEC at the SEC's Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an Internet site that contains reports, proxy and other information statements, and other information regarding issuers, including us, that file electronically with the SEC. The address of this site is <http://www.sec.gov>.

We also maintain an Internet site at [www.tylertech.com](http://www.tylertech.com). We make available free of charge through this site our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Forms 4 and 5, Current Reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC. In addition, copies of our annual report will be made available, free of charge upon written request.

Our Code of Business Conduct and Ethics is also available on our Web site. We intend to satisfy the disclosure requirements regarding amendments to, or waivers from, a provision of our Code of Business Conduct and Ethics by posting such information on our Web site.

### **ITEM 1A. RISK FACTORS**

An investment in our common stock involves a high degree of risk. Investors evaluating our company should carefully consider the factors described below and all other information contained in this Annual Report. Any of the following factors could materially harm our business, operating results, and financial condition. Additional factors and uncertainties not currently known to us or that we currently consider immaterial could also harm our business, operating results, and financial condition. This section should be read in conjunction with the Financial Statements and related Notes and Management's Discussion and Analysis of Financial Condition and Results of Operations included in this Annual Report. We may make forward-looking statements from time to time, both written and oral. We undertake no obligation to revise or publicly release the results of any revisions to these forward-looking statements. Our actual results may differ materially from those projected in any such forward-looking statements due to a number of factors, including those set forth below and elsewhere in this Annual Report.

*Declining general economic conditions and uncertainties in the global credit crisis and equity markets may adversely affect our operating results and financial condition.*

The financial market crisis has continued to disrupt credit and equity markets worldwide and has led to continued weakening in the global economic environment during the first quarter of 2009. Local and state governments may face financial pressures that could in turn affect our growth rate in 2009. We cannot assure you local and state spending levels will be unaffected by the global credit crisis and if budget shortfalls occur they may negatively impact local and state information technology spending and could have a material adverse effect upon our business, operating results, and financial condition.

*A decline in information technology spending may result in a decrease in our revenues or lower our growth rate.*

A decline in the demand for information technology among our current and prospective customers may result in decreased revenues or a lower growth rate for us because our sales depend, in part, on our customers' level of funding for new or additional information technology systems and services. Moreover, demand for our solutions may be reduced by a decline in overall demand for computer software and services. Accordingly, we cannot assure you that we will be able to increase or maintain our revenues.

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*Our products are complex and we run the risk of errors or defects with new product introductions or enhancements.* Software products as complex as those developed by us may contain errors or defects, especially when first introduced or when new versions or enhancements are released. Although we have not experienced material adverse effects resulting from any such defects or errors to date, we cannot assure you that material defects and errors will not be found after commencement of product shipments. Any such defects could result in loss of revenues or delay market acceptance.

Our license agreements with our customers typically contain provisions designed to limit our exposure to potential liability claims. It is possible, however, that we may not always be able to negotiate such provisions in our contracts with customers or that the limitation of liability provisions contained in our license agreements may not be effective as a result of existing or future federal, state or local laws, ordinances, or judicial decisions. Although we maintain errors and omissions and general liability insurance, and we try to structure our contracts to include limitations on liability, we cannot assure you that a successful claim could not be made or would not have a material adverse effect on our business, financial condition, and results of operations.

*We may experience fluctuations in quarterly revenue that could adversely impact our stock price and our operating results.*

Our actual revenues in a quarter could fall below expectations, which could lead to a decline in our stock price. Our revenues and operating results are difficult to predict and may fluctuate substantially from quarter to quarter. Revenues from license fees in any quarter depend substantially upon our contracting activity and our ability to recognize revenues in that quarter in accordance with our revenue recognition policies. Our quarterly revenue may fluctuate and may be difficult to forecast for a variety of reasons, including the following:

- a significant number of our prospective customers' decisions regarding whether to enter into license agreements with us may be made within the last few weeks of each quarter;

- the size of license transactions can vary significantly;

- customers may unexpectedly postpone or cancel orders due to changes in their strategic priorities, project objectives, budget or personnel;

- customer purchasing processes vary significantly and a customer's internal approval, expenditure authorization and contract negotiation processes can be difficult and time consuming to complete, even after selection of a vendor;

- the number, timing, and significance of software product enhancements and new software product announcements by us and our competitors may affect purchase decisions; and

- we may have to defer revenues under our revenue recognition policies.

Fluctuation in our quarterly revenues may adversely affect our operating results. In each fiscal quarter our expense levels, operating costs, and hiring plans are based to some extent on projections of future revenues and are relatively fixed. If our actual revenues fall below expectations, we could experience a reduction in operating results.

*As with other software vendors, we may be required to delay revenue recognition into future periods, which could adversely impact our operating results.*

We have in the past had to, and in the future may have to, defer revenue recognition for license fees due to several factors, including whether:

- license agreements include applications that are under development or other undelivered elements;

- we must deliver services that are considered essential to the functionality of the software, including significant modifications, customization, or complex interfaces, which could delay product delivery or acceptance;

- the transaction involves acceptance criteria;

the transaction involves contingent payment terms or fees;

we are required to accept a fixed-fee services contract; or

we are required to accept extended payment terms.

Because of the factors listed above and other specific requirements under generally accepted accounting principles in the United States for software revenue recognition, we must have very precise terms in our license agreements in order to recognize revenue when we initially deliver and install software or perform services. Negotiation of mutually acceptable terms and conditions can extend the sales cycle, and sometimes we do not obtain terms and conditions that permit revenue recognition at the time of delivery or even as work on the project is completed.

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*Compliance with changing regulation of corporate governance and public disclosure may result in additional expenses.*

Changing laws, regulations, and standards relating to corporate governance and public disclosure, including the Sarbanes-Oxley Act of 2002, new Securities and Exchange Commission regulations and New York Stock Exchange rules, are creating uncertainty for companies such as ours. The costs required to comply with such evolving laws are difficult to predict. To maintain high standards of corporate governance and public disclosure, we intend to invest all reasonably necessary resources to comply with evolving standards. This investment may result in an unforeseen increase in general and administrative expenses and a diversion of management time and attention from revenue-generating activities, which may harm our business, financial condition, or results of operations.

*Increases in service revenue as a percentage of total revenues could decrease overall margins and adversely affect our operating results.*

We realize lower margins on software and appraisal service revenues than on license revenue. The majority of our contracts include both software licenses and professional services. Therefore, an increase in the percentage of software service and appraisal service revenue compared to license revenue could have a detrimental impact on our overall gross margins and could adversely affect operating results.

*Selling products and services into the public sector poses unique challenges.*

We derive substantially all of our revenues from sales of software and services to state, county and city governments, other municipal agencies, and other public entities. We expect that sales to public sector customers will continue to account for substantially all of our revenues in the future. We face many risks and challenges associated with contracting with governmental entities, including:

the sales cycle of governmental agencies may be complex and lengthy;

payments under some public sector contracts are subject to achieving implementation milestones, and we have had, and may in the future have, differences with customers as to whether milestones have been achieved;

political resistance to the concept of government agencies contracting with third parties to provide information technology solutions;

changes in legislation authorizing government s contracting with third parties;

the internal review process by governmental agencies for bid acceptance;

changes to the bidding procedures by governmental agencies;

changes in governmental administrations and personnel;

limitations on governmental resources placed by budgetary restraints, which in some circumstances, may provide for a termination of executed contracts because of a lack of future funding; and

the general effect of economic downturns and other changes on local governments ability to spend public funds on outsourcing arrangements.

Each of these risks is outside our control. If we fail to adequately adapt to these risks and uncertainties, our financial performance could be adversely affected.

*The open bidding process for governmental contracts creates uncertainty in predicting future contract awards.*

Many governmental agencies purchase products and services through an open bidding process. Generally, a governmental entity will publish an established list of requirements requesting potential vendors to propose solutions for the established requirements. To respond successfully to these requests for proposals, we must accurately estimate our cost structure for servicing a proposed contract, the time required to establish operations for the proposed client, and the likely terms of any other third party proposals submitted. We cannot guarantee that we will win any bids in the

future through the request for proposal process, or that any winning bids will ultimately result in contracts on favorable terms. Our failure to secure contracts through the open bidding process, or to secure such contracts on favorable terms, may adversely affect our business, financial condition, and results of operations.

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*Fixed-price contracts may affect our profits.*

Some of our present contracts are on a fixed-priced basis, which can lead to various risks, including:  
the failure to accurately estimate the resources and time required for an engagement;

the failure to effectively manage governmental agencies and other customers' expectations regarding the scope of services to be delivered for an estimated price; and

the failure to timely complete fixed-price engagements within budget to the customers' satisfaction.

If we do not adequately assess these and other risks, we may be subject to cost overruns and penalties, which may harm our business, financial condition, or results of operations.

*We face significant competition from other vendors and potential new entrants into our markets.*

We believe we are a leading provider of integrated solutions for the public sector. However, we face competition from a variety of software vendors that offer products and services similar to those offered by us, as well as from companies offering to develop custom software. We compete on the basis of a number of factors, including:

the attractiveness of the business strategy and services we offer;

the breadth of products and services we offer;

features and functionality of our software;

price;

quality of products and service;

technological innovation;

name recognition;

our ability to modify existing products and services to accommodate the particular needs of our customers; and

our financial strength and stability.

We believe the market is highly fragmented with a large number of competitors that vary in size, primary computer platforms, and overall product scope. Our competitors include consulting firms, publicly held companies that focus on selected segments of the public sector market, and a significant number of smaller, privately held companies. Certain competitors have greater technical, marketing, and financial resources than we do. We cannot assure you that such competitors will not develop products or offer services that are superior to our products or services or that achieve greater market acceptance.

We also compete with internal, centralized information service departments of governmental entities, which require us to persuade the end-user to stop the internal service and outsource to us. In addition, our customers may elect in the future to provide information management services internally through new or existing departments, which could reduce the market for our services.

We could face additional competition as other established and emerging companies enter the public sector software application market and new products and technologies are introduced. Increased competition could result in pricing pressure, fewer customer orders, reduced gross margins, and loss of market share. In addition, current and potential competitors may make strategic acquisitions or establish cooperative relationships among themselves or with third-parties, thereby increasing the ability of their products to address the needs of our prospective customers. It is possible that new competitors or alliances among current and new competitors may emerge and rapidly gain significant market share. Further, competitive pressures could require us to reduce the price of our software licenses and related services. We cannot assure you that we will be able to compete successfully against current and future



competitors, and the failure to do so would have material adverse effect upon our business, operating results, and financial condition.

*We must respond to rapid technological changes to be competitive.*

The market for our products is characterized by rapid technological change, evolving industry standards in computer hardware and software technology, changes in customer requirements, and frequent new product introductions and enhancements. The introduction of products embodying new technologies and the emergence of new industry standards can render existing products obsolete and unmarketable. As a result, our future success will depend, in part, upon our ability to continue to enhance existing products and develop and introduce in a timely manner or acquire new products that keep pace with technological developments, satisfy increasingly sophisticated customer requirements, and achieve market acceptance. We cannot assure you that we will successfully

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identify new product opportunities and develop and bring new products to market in a timely and cost-effective manner. Further, we cannot assure you that the products, capabilities, or technologies developed by others will not render our products or technologies obsolete or noncompetitive. If we are unable to develop or acquire on a timely and cost-effective basis new software products or enhancements to existing products, or if such new products or enhancements do not achieve market acceptance, our business, operating results, and financial condition may be materially adversely affected.

*Our failure to properly manage growth could adversely affect our business.*

We have expanded our operations since February 1998, when we entered the business of providing software solutions and services to the public sector. We intend to continue expansion in the foreseeable future to pursue existing and potential market opportunities. This growth places a significant demand on management and operational resources. In order to manage growth effectively, we must implement and improve our operational systems, procedures, and controls on a timely basis. We must also identify, hire, train, and manage key managerial and technical personnel. If we fail to implement these systems or employ and retain such qualified personnel, our business, financial condition, and results of operations may be materially adversely affected.

*We may be unable to hire, integrate, and retain qualified personnel.*

Our continued success will depend upon the availability and performance of our key management, sales, marketing, customer support, and product development personnel. The loss of key management or technical personnel could adversely affect us. We believe that our continued success will depend in large part upon our ability to attract, integrate, and retain such personnel. We have at times experienced and continue to experience difficulty in recruiting qualified personnel. Competition for qualified software development, sales, and other personnel is intense, and we cannot assure you that we will be successful in attracting and retaining such personnel.

*We may experience difficulties in executing our acquisition strategy.*

In addition, a significant portion of our growth has resulted from strategic acquisitions in new product and geographic markets. Although our future focus will be on internal growth, we will continue to identify and pursue strategic acquisitions and alliances with suitable candidates. Our future success will depend, in part, on our ability to successfully integrate future acquisitions and other strategic alliances into our operations. Acquisitions may involve a number of special risks, including diversion of management's attention, failure to retain key acquired personnel, unanticipated events or circumstances, legal liabilities, and amortization of certain acquired intangible assets. Some or all of these risks could have a material adverse effect on our business, financial condition, and results of operations. Although we conduct due diligence reviews of potential acquisition candidates, we may not identify all material liabilities or risks related to acquisition candidates. There can be no assurance that any such strategic acquisitions or alliances will be accomplished on favorable terms or will result in profitable operations.

*We may be unable to protect our proprietary rights.*

Many of our product and service offerings incorporate proprietary information, trade secrets, know-how, and other intellectual property rights. We rely on a combination of contracts, copyrights, and trade secret laws to establish and protect our proprietary rights in our technology. We cannot be certain that we have taken all appropriate steps to deter misappropriation of our intellectual property. In addition, there has been significant litigation in the United States in recent years involving intellectual property rights. We are not currently involved in any material intellectual property litigation. We may, however, be a party to intellectual property litigation in the future to protect our proprietary information, trade secrets, know-how, and other intellectual property rights. Further, we cannot assure you that third parties will not assert infringement or misappropriation claims against us in the future with respect to current or future products. Any claims or litigation, with or without merit, could be time-consuming and result in costly litigation and diversion of management's attention. Further, any claims and litigation could cause product shipment delays or require us to enter into royalty or licensing arrangements. Such royalty or licensing arrangements, if required, may not be available on terms acceptable to us, if at all. Thus, litigation to defend and enforce our intellectual property rights could have a material adverse effect on our business, financial condition, and results of operations, regardless of the final outcome of such litigation.

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*Changes in the insurance markets may affect our ability to win some contract awards and may lead to increased expenses.*

Some of our customers, primarily those for our property appraisal services, require that we secure performance bonds before they will select us as their vendor. The number of qualified, high-rated insurance companies that offer performance bonds has decreased in recent years, while the costs associated with securing these bonds has increased dramatically. In addition, we are generally required to issue a letter of credit as security for the issuance of a performance bond. We periodically enter into long-term borrowing agreements and each letter of credit we issue without corresponding cash collateral may reduce our borrowing capacity under the borrowing agreement. We cannot guarantee that we will be able to secure such performance bonds in the future on terms that are favorable to us, if at all. Our inability to obtain performance bonds on favorable terms or at all could impact our future ability to win some contract awards, particularly large property appraisal services contracts, which could have a material adverse effect on our business, financial condition, and results of operations.

Recent volatility in the stock markets, increasing shareholder litigation, the adoption of expansive legislation that redefines corporate controls (in particular, legislation adopted to prevent future corporate and accounting scandals), as well as other factors have recently led to significant increases in premiums for directors and officers liability insurance. The number of insurers offering directors and officers insurance at competitive rates has also decreased in recent years. Volatility of the insurance market may result in future increases in our general and administrative expenses, which may adversely affect future operating results.

*Our stock price may be volatile.*

The market price of our common stock may be volatile and may be significantly affected by many different factors. Some examples of factors that can have a significant impact on our stock price include:

actual or anticipated fluctuations in our operating results;

announcements of technological innovations, new products, or new contracts by us or our competitors;

developments with respect to patents, copyrights, or other proprietary rights;

conditions and trends in the software and other technology industries;

adoption of new accounting standards affecting the software industry;

changes in financial estimates by securities analysts; and

general market conditions and other factors.

In addition, the stock market has from time to time experienced significant price and volume fluctuations that have particularly affected the market prices for the common stock of technology companies. These broad market fluctuations may adversely affect the market price of our common stock. In the past, following periods of volatility in the market price of a particular company's securities, securities class action litigation has often been brought against that company. We cannot assure you that similar litigation will not occur in the future with respect to us. Such litigation could result in substantial costs and a diversion of management's attention and resources, which could have a material adverse effect upon our business, operating results, and financial condition.

*Historically, we have not paid dividends on our common stock.*

We have not declared or paid a cash dividend since we entered the business of providing software solutions and services to the public sector in February 1998. Additionally, our bank credit agreement contains restrictions on the payment of cash dividends. We intend to retain earnings for use in the operation and expansion of our business. We do not anticipate paying any cash dividends on our common stock in the foreseeable future.

*Provisions in our certificate of incorporation, bylaws, and Delaware law could deter takeover attempts.*

Our board of directors may issue up to 1,000,000 shares of preferred stock and may determine the price, rights, preferences, privileges, and restrictions, including voting and conversion rights, of these shares of preferred stock.

These determinations may be made without any further vote or action by our stockholders. The rights of the holders of our common stock will be subject to, and may be adversely affected by, the rights of the holders of any preferred stock that may be issued in the future. The issuance of preferred stock may make it more difficult for a third party to acquire a majority of our outstanding voting stock. In addition, some provisions of our Certificate of Incorporation, Bylaws, and of the Delaware General Corporation Law could also delay, prevent, or make more difficult a merger, tender offer, or proxy contest involving us.

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*Financial Outlook.*

From time to time in press releases and otherwise, we may publish forecasts or other forward-looking statements regarding our results, including estimated revenues or net earnings. Any forecast of our future performance reflects various assumptions. These assumptions are subject to significant uncertainties, and as a matter of course, any number of them may prove to be incorrect. Further, the achievement of any forecast depends on numerous risks and other factors (including those described in this discussion), many of which are beyond our control. As a result, we cannot be certain that our performance will be consistent with any management forecasts or that the variation from such forecasts will not be material and adverse. Current and potential stockholders are cautioned not to base their entire analysis of our business and prospects upon isolated predictions, but instead are encouraged to utilize our entire publicly available mix of historical and forward-looking information, as well as other available information regarding us, our products and services, and the software industry when evaluating our prospective results of operations.

**ITEM 1B. UNRESOLVED STAFF COMMENTS.**

Not applicable.

**ITEM 2. PROPERTIES.**

We occupy a total of approximately 441,000 square feet of office space, 127,000 square feet of which we own. One of the office buildings we own (approximately 84,000 square feet) has been leased to third-party tenants. The lease agreements with respect to approximately 70% of this leased space expire in July 2011 and the remaining agreement expires in June 2013. Upon expiration of these agreements we expect to begin occupying the facility. We lease our principal executive office located in Dallas, Texas, as well as other offices for our operations in Colorado, Iowa, Maine, Ohio, Texas and Washington.

**ITEM 3. LEGAL PROCEEDINGS.**

On November 3, 2008, a putative collective action complaint was filed against us in the United States District Court for the Eastern District of Texas on behalf of current and former customer support analysts, client liaisons, engineers, trainers, and education services specialists. The petition alleges that we misclassified these groups of employees as exempt rather than non-exempt under the Fair Labor Standards Act; therefore, the petition alleges that we failed to properly pay overtime wages. The suit was initiated by six former employees working out of our Longview, Texas, office and seeks to recover damages in the form of lost overtime pay since October 31, 2005, liquidated damages equal to the amount of lost overtime pay, interest, costs, and attorneys' fees. We intend to vigorously defend the action. Given the preliminary nature of the alleged claims and the inherent unpredictability of litigation, we cannot at this time estimate the possible outcome of any such action.

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 in 2008.

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

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.**

Not applicable.

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## PART II

## ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.

Our common stock is traded on the New York Stock Exchange under the symbol TYL. At December 31, 2008, we had approximately 2,140 stockholders of record. A number of our stockholders hold their shares in street name; therefore, there are substantially more than 2,140 beneficial owners of our common stock.

The following table shows, for the calendar periods indicated, the high and low sales price per share of our common stock as reported on the New York Stock Exchange.

|       |   | High    | Low     |
|-------|---|---------|---------|
| 2007: | First Quarter                             | \$14.93 | \$12.03 |
|       | Second Quarter                            | 13.28   | 11.70   |
|       | Third Quarter                             | 15.74   | 11.39   |
|       | Fourth Quarter                            | 16.20   | 12.81   |
| 2008: | First Quarter                             | \$14.70 | \$12.29 |
|       | Second Quarter                            | 15.97   | 13.33   |
|       | Third Quarter                             | 18.47   | 13.29   |
|       | Fourth Quarter                            | 15.17   | 9.79    |
| 2009: | First Quarter (through February 20, 2009) | \$13.50 | \$11.35 |

We did not pay any cash dividends in 2008 or 2007. Our bank credit agreement contains restrictions on the payment of cash dividends. We intend to retain earnings for use in the operation and expansion of our business, and, therefore, we do not anticipate declaring a cash dividend in the foreseeable future.

The following table summarizes certain information related to our stock option plan and our Employee Stock Purchase Plan ( ESPP ). There are no warrants or rights related to our equity compensation plans as of December 31, 2008.

| Plan Category   | Number of securities to be issued upon exercise of               | Weighted average exercise price of       | Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in initial column as of December 31, 2008) |
|---|--|--|---|
| Equity compensation plans approved by security shareholders:    | outstanding options, warrants and rights as of December 31, 2008 | outstanding options, warrants and rights |   |
| Stock options   | 5,308,618  | \$ 9.69                                  | 996,271   |
| ESPP  | 35,460   | 10.18                                    | 446,096   |
| Equity compensation plans not approved by security shareholders |  |  |   |
|   | 5,344,078  | \$ 9.69                                  | 1,442,367   |



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During 2008, we purchased approximately 4.3 million shares of our common stock for an aggregate purchase price of \$59.0 million. A summary of the repurchase activity during 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 |
|--|------------------------------------|--|------------------------------|--|
| Three months ended March 31                        | 814,000                            |  | \$12.92                      | 967,000  |
| Additional authorization by the board of directors |                                    | 2,000,000  |                              | 2,967,000  |
| Three months ended June 30                         | 283,000                            |  | 13.80                        | 2,684,000  |
| Three months ended September 30                    | 1,097,000                          |  | 15.40                        | 1,587,000  |
| Additional authorization by the board of directors |                                    | 2,000,000  |                              | 3,587,000  |
| October 1 through October 31                       | 1,667,000                          |  | 13.44                        | 1,920,000  |
| November 1 through November 30                     | 274,000                            |  | 13.00                        | 1,646,000  |
| December 1 through December 31                     | 148,000                            |  | 11.48                        | 1,498,000  |
| Total year ended December 31, 2008                 | 4,283,000                          | 4,000,000  | \$13.77                      |  |

The repurchase program, which was approved by our board of directors, was announced in October 2002, and was amended in April and July 2003, October 2004, October 2005, May 2007, May 2008 and October 2008. Our board of directors authorized the repurchase of an additional 2.0 million shares on both May 15, 2008 and October 23, 2008. As of December 31, 2008, we had remaining authorization to repurchase up to 1.5 million additional shares of our common stock. There is no expiration date specified for the authorization and we intend to repurchase stock under the plan from time to time. Our bank credit agreement contains restrictions on the amount of common stock we may purchase.



**Table of Contents****Performance Graph**

*The following Performance Graph and related information shall not be deemed soliciting material or to be filed with the Securities and Exchange Commission, nor shall such information be incorporated by reference into any future filing under the Securities Act of 1933 or Securities Exchange Act of 1934, each as amended, except to the extent that we specifically incorporate it by reference into such filing.*

The following table compares total Shareholder returns for Tyler over the last five years to the Standard and Poor's 500 Stock Index and the Standard and Poor's 600 Information Technology Index assuming a \$100 investment made on December 31, 2003. Each of the three measures of cumulative total return assumes reinvestment of dividends. The stock performance shown on the graph below is not necessarily indicative of future price performance.

| Company / Index                         | 12/31/03 | 12/31/04 | 12/31/05 | 12/31/06 | 12/31/07 | 12/31/08 |
|---|----------|----------|----------|----------|----------|----------|
| Tyler Technologies, Inc.                | 100      | 86.81    | 91.17    | 146.00   | 133.85   | 124.40   |
| S&P 500 Index                           | 100      | 110.88   | 116.33   | 134.70   | 142.10   | 89.53    |
| S&P 600 Information<br>Technology Index | 100      | 106.65   | 106.39   | 116.42   | 127.25   | 75.88    |

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**Table of Contents****ITEM 6. SELECTED FINANCIAL DATA.**

(In thousands, except per share data)

|  | FOR THE YEARS ENDED DECEMBER 31, |            |            |            |            |
|--|----------------------------------|------------|------------|------------|------------|
|  | 2008                             | 2007       | 2006       | 2005       | 2004       |
| <b>STATEMENT OF OPERATIONS DATA:</b>                         |                                  |            |            |            |            |
| Revenues   | \$ 265,101                       | \$ 219,796 | \$ 195,303 | \$ 170,457 | \$ 172,270 |
| Costs and expenses:  |                                  |            |            |            |            |
| Cost of revenues <sup>(1)</sup>                              | 155,314                          | 135,371    | 120,499    | 108,970    | 108,432    |
| Selling, general and administrative expenses <sup>(1)</sup>  | 62,923                           | 51,724     | 48,389     | 43,821     | 42,931     |
| Research and development expense                             | 7,286                            | 4,443      | 3,322      | 2,421      | 2,520      |
| Restructuring charge   |                                  |            |            | 1,260      |            |
| Amortization of customer and trade name intangibles          | 2,438                            | 1,478      | 1,318      | 1,266      | 1,267      |
| Non-cash legal settlement related to warrants <sup>(2)</sup> | 9,045                            |            |            |            |            |
| Operating income   | 28,095                           | 26,780     | 21,775     | 12,719     | 17,120     |
| Other income, net  | 1,181                            | 1,800      | 1,080      | 906        | 317        |
| Income from operations before income taxes                   | 29,276                           | 28,580     | 22,855     | 13,625     | 17,437     |
| Income tax provision   | 14,414                           | 11,079     | 8,493      | 5,432      | 7,309      |
| Net Income   | \$ 14,862                        | \$ 17,501  | \$ 14,362  | \$ 8,193   | \$ 10,128  |
| Net income per diluted share                                 | \$ 0.38                          | \$ 0.42    | \$ 0.34    | \$ 0.19    | \$ 0.23    |
| Weighted average diluted shares                              | 39,184                           | 41,352     | 41,868     | 42,075     | 44,566     |
| <b>STATEMENT OF CASH FLOWS DATA:</b>                         |                                  |            |            |            |            |
| Cash flows provided by operating activities                  | \$ 47,802                        | \$ 34,111  | \$ 26,804  | \$ 21,187  | \$ 22,159  |
| Cash flows (used by) provided by investing activities        | (9,554)                          | (34,275)   | (24,326)   | 1,820      | (9,914)    |
| Cash flows used by financing activities                      | (46,128)                         | (7,406)    | (5,999)    | (14,847)   | (9,940)    |
| <b>BALANCE SHEET DATA:</b>                                   |                                  |            |            |            |            |
| Total assets   | \$ 251,761                       | \$ 241,508 | \$ 220,276 | \$ 194,437 | \$ 190,487 |
| Shareholders' equity   | 114,262                          | 137,211    | 125,875    | 112,197    | 118,400    |

<sup>(1)</sup> Effective January 1, 2006, we adopted the fair value recognition

provisions of Statement of Financial Accounting Standards No. 123R, Share-Based Payment using the modified-prospective method. In 2008, 2007 and 2006, respectively, cost of revenues included \$364,000, \$227,000 and \$147,000 share-based compensation expense. Selling, general and administrative expenses in 2008, 2007 and 2006, respectively, included \$3.5 million, \$2.1 million and \$1.8 million share-based compensation expense. In accordance with the standard, results of operations for the years prior to 2006 are reported under the previous accounting standard and no expense was recorded.

- (2) 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 was  
not tax deductible.

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**ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.**

**FORWARD-LOOKING STATEMENTS**

In addition to historical information, this Annual Report on Form 10-K contains forward-looking statements. The forward-looking statements are made in reliance upon safe harbor provisions of the Private Securities Litigation Reform Act of 1995. The forward-looking statements are subject to certain risks and uncertainties that could cause actual results to differ materially from those reflected in the forward-looking statements. Factors that might cause such a difference include, but are not limited to, those discussed in Item 1A, Risk Factors. Readers are cautioned not to place undue reliance on these forward-looking statements, which reflect management's opinions only as of the date hereof. We undertake no obligation to revise or publicly release the results of any revision to these forward-looking statements. Readers should carefully review the risk factors described in this Annual Report and other documents we file from time to time with the SEC.

When used in this Annual Report, the words believes, plans, estimates, expects, anticipates, intends, continues, will, should, projects, forecasts, might, could or the negative of such terms and similar expressions are intended to identify forward-looking statements.

**OVERVIEW**

**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.

Our products are generally grouped into four major areas:

Financial Management and Education;

Courts and Justice;

Property Appraisal and Tax; and

Public Records and Content Management.

We monitor and analyze several key performance indicators in order to manage our business and evaluate our financial and operating performance. These indicators include the following:

**Revenues** We derive our revenues from five primary sources: sale of software licenses; subscription-based services; software services; appraisal services; and maintenance and support. Because the majority of the software we sell is off-the-shelf, increased sales of software products generally result in incrementally higher gross margins. Thus, the most significant driver to our business is the number and size of software license sales. In addition, new software license sales generally generate implementation services revenues as well as future maintenance and support revenues, which we view as a recurring revenue source. We also monitor our customer base and churn since our maintenance and support revenue should increase due to our historically low customer turnover.

**Cost of Revenues and Gross Margins** Our primary cost component is personnel expenses in connection with providing software implementation, subscription-based services, maintenance and support, and appraisal services to our customers. We can improve gross margins by controlling headcount and related costs and by expanding our revenue base, especially from those products and services that produce incremental revenue with minimal incremental cost, such as software licenses, subscription-based services, and maintenance and support. Our appraisal projects are seasonal in nature, and we often employ appraisal personnel on a short-term

basis to coincide with the life of a project. As of December 31, 2008, our total full-time equivalent employee count increased to 1,940 from 1,627 at December 31, 2007. The majority of these additions were to our implementation and support staff, including additions to our capacity to deliver our backlog. Our implementation

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and support staff at December 31, 2008 includes 102 full-time equivalent employees added as a result of three acquisitions completed in 2008.

**Selling, General and Administrative ( SG&A ) Expenses** The primary components of SG&A expense are administrative and sales personnel salaries and commissions, marketing expense, rent and professional fees. Sales commissions generally fluctuate with revenues but other administrative expenses tend to grow at a slower rate than revenues.

**Liquidity and Cash Flows** The primary driver of our cash flows is net income. Uses of cash include acquisitions, capital investments in property and equipment and software development and the discretionary purchases of treasury stock. In 2008, we purchased 4.3 million shares of our common stock at an aggregate purchase price of \$59.0 million. Almost half of our treasury stock purchases occurred in the fourth quarter of 2008. During 2008 we also used cash of \$23.9 million to acquire three companies and invested \$20.1 million in property and equipment. Our investment in property and equipment included \$16.0 million for land, office buildings and a related tenant lease. Our working capital needs are fairly stable throughout the year with the significant components of cash outflows being payment of personnel expenses offset by cash inflows representing collection of accounts receivable and cash receipts from customers in advance of revenue being earned.

**Balance Sheet** Cash, accounts receivable and days sales outstanding and deferred revenue balances are important indicators of our business.

### Acquisitions

We completed the acquisitions of School Information Systems, Inc., VersaTrans Solutions Inc. and certain assets of Olympia Computing Company, Inc. d/b/a Schoolmaster to expand 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. In connection with these transactions we acquired total tangible assets of approximately \$3.5 million and assumed total liabilities of approximately \$8.2 million.

### Outlook

The financial market crisis has continued to disrupt credit and equity markets worldwide and has led to continued weakening in the global economic environment during the first quarter of 2009. Local and state governments may face financial pressures that could in turn affect our growth rate in the first quarter of 2009 and for the calendar year. Consistent with our historical trends, we expect that first quarter 2009 earnings will not reach the level achieved in the fourth quarter of 2008; however, we currently do not anticipate a material negative impact for the 2009 first quarter due to the current economic downturn.

### **CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

Our discussion and analysis of financial condition and results of operations is based upon our financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States ( GAAP ). The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets and liabilities at the date of the financial statements, the reported amounts of revenues, cost of revenues and expenses during the reporting period, and related disclosure of contingent assets and liabilities. The Notes to the Financial Statements included as part of this Annual Report describe our significant accounting policies used in the preparation of the financial statements. Significant items subject to such estimates and assumptions include the application of the percentage-of-completion and proportionate performance methods of revenue recognition, the carrying amount and estimated useful lives of intangible assets, determination of share-based compensation expense and valuation allowance for receivables. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

We believe the following critical accounting policies affect significant judgments and estimates used in the preparation of our financial statements.

*Revenue Recognition.* We recognize revenues in accordance with the provisions of Statement of Position ( SOP ) 97-2, Software Revenue Recognition, as amended by SOP 98-4 and SOP 98-9, as well as Technical Practice Aids issued from time to time by the American Institute of Certified Public Accountants, and in accordance with the Securities and Exchange Commission Staff Accounting Bulletin No. 104 Revenue Recognition. We recognize revenue on our appraisal services contracts using the proportionate performance method of accounting, with considerations for the provisions of Emerging Issue Task Force ( EITF ) No. 00-21, Revenue Arrangements with Multiple Deliverables. Our revenues are derived from sales of software licenses, subscription-



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based services, appraisal services, maintenance and support, and services that typically range from installation, training and basic consulting to software modification and customization to meet specific customer needs. For multiple element software arrangements, which do not entail the performance of services that are considered essential to the functionality of the software, we generally record revenue when the delivered products or performed services result in a legally enforceable and non-refundable claim. We maintain allowances for doubtful accounts and sales adjustments, which are provided at the time the revenue is recognized. Because most of our customers are governmental entities, we rarely incur a loss resulting from the inability of a customer to make required payments. In a limited number of cases, we encounter a customer who is dissatisfied with some aspect of the software product or our service, and we may offer a concession to such customer. In those limited situations where we grant a concession, we rarely reduce the contract arrangement fee, but alternatively may perform additional services, such as additional training or programming a minor feature the customer had in their prior software solution. These amounts have historically been considered nominal. In connection with our customer contracts and the adequacy of related allowances and measures of progress towards contract completion, our project managers are charged with the responsibility to continually review the status of each customer on a specific contract basis. Also, we review, on at least a quarterly basis, significant past due accounts receivable and the adequacy of related reserves. Events or changes in circumstances that indicate that the carrying amount for the allowances for doubtful accounts and sales adjustments may require revision, include, but are not limited to, deterioration of a customer's financial condition, failure to manage our customer's expectations regarding the scope of the services to be delivered, and defects or errors in new versions or enhancements of our software products.

For those software arrangements that involve significant production, modification or customization of the software, which is considered essential to its functionality, and for substantially all property appraisal outsourcing projects, we recognize revenue and profit as the work progresses using the percentage-of-completion method and the proportionate performance method of revenue recognition. These methods rely on estimates of total expected contract revenue, billings and collections and expected contract costs, as well as measures of progress toward completion. We believe reasonably dependable estimates of revenue and costs and progress applicable to various stages of a contract can be made. At times, we perform additional and/or non-contractual services for little to no incremental fee to satisfy customer expectations. If changes occur in delivery, productivity or other factors used in developing our estimates of expected costs or revenues, we revise our cost and revenue estimates, and any revisions are charged to income in the period in which the facts that give rise to that revision first become known.

We use contract accounting, primarily the percentage-of-completion method, and apply the provisions of SOP No. 81-1 Accounting for Performance of Construction Type and Certain Production Type Contracts for those software arrangements that involve significant production, modification or customization of the software, or where our software services are otherwise considered essential to the functionality of the software. In addition, we recognize revenue using the proportionate performance method of revenue recognition for our property appraisal projects, some of which can range up to three years. In connection with these and certain other contracts, we may perform the work prior to when the services are billable and/or payable pursuant to the contract. 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.

For subscription-based services such as application service provider arrangements and other hosting arrangements, we evaluate whether each of the elements in these arrangements represents a separate unit of accounting, as defined by 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. In connection with certain of our contracts, we have recorded retentions receivable or unbilled receivables consisting of costs and estimated profit in excess of billings as of the balance sheet date. Many of the contracts which give rise to unbilled receivables at a given balance sheet date are subject to billings in the subsequent accounting period. Management reviews unbilled receivables and related contract provisions to ensure we are justified in recognizing revenue prior to billing the customer and that we have objective evidence which allows us to recognize such revenue. In addition, we have a sizable amount of deferred revenue which represents billings in excess of revenue earned. The majority of this liability consists of maintenance billings for which payments are made in

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advance and the revenue is ratably earned over the maintenance period, generally one year. We also have deferred revenue for those contracts in which we receive a deposit and the conditions in which to record revenue for the service or product has not been met. On a periodic basis, we review by customer the detail components of our deferred revenue to ensure our accounting remains appropriate.

*Intangible Assets and Goodwill.* Our business acquisitions typically result in the creation of goodwill and other intangible asset balances, and these balances affect the amount and timing of future period amortization expense, as well as expense we could possibly incur as a result of an impairment charge. The cost of acquired companies is allocated to identifiable tangible and intangible assets based on estimated fair value, with the excess allocated to goodwill. Accordingly, we have a significant balance of acquisition date intangible assets, including software, customer related intangibles, trade name and goodwill. In addition, we capitalize software development costs incurred subsequent to the establishment of technological feasibility. These intangible assets are amortized over their estimated useful lives. All intangible assets with definite and indefinite lives are reviewed for impairment annually or whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable.

Recoverability of goodwill is generally measured by a comparison of the carrying amount of an asset to its fair value, generally determined by estimated future net cash flows expected to be generated by the asset. We evaluate goodwill for impairment annually as of April, or more frequently if impairment indicators arise. An impairment loss is recognized to the extent that the carrying amount exceeds the asset's fair value. The fair values calculated in our impairment tests are determined using discounted cash flow models involving several assumptions. These assumptions include, but are not limited to, anticipated operating income growth rates, our long-term anticipated operating income growth rate and the discount rate. The assumptions that are used are based upon what we believe a hypothetical marketplace participant would use in estimating fair value. We have identified two reporting units for impairment testing. The appraisal services and appraisal software stand-alone business unit qualified as a reporting unit since it is one level below an operating segment, discrete financial information exists for the business unit and the executive management group directly reviews this business unit. The other software business units were aggregated into the other single reporting unit. The appraisal services and appraisal software stand-alone business unit is organized in such a manner that both of its revenue sources are tightly integrated with each other and discrete financial information at the operating profit level does not exist for this business unit's respective revenue sources.

Recoverability of other intangible assets is generally measured by comparison of the carrying amount to estimated undiscounted future cash flows.

The assessment of recoverability or of the estimated useful life for amortization purposes will be affected if the timing or the amount of estimated future operating cash flows is not achieved. Events or changes in circumstances that indicate the carrying amount may not be recoverable include, but are not limited to, a significant decrease in the market value of the business or asset acquired, a significant adverse change in the extent or manner in which the business or asset acquired is used, or a significant adverse change in the business climate. In addition, products, capabilities, or technologies developed by others may render our software products obsolete or non-competitive.

*Share-Based Compensation.* We have a stock option plan that provides for the grant of stock options to key employees, directors and non-employee consultants. We estimate the fair value of share-based awards on the date of grant using the Black-Scholes option valuation model. Share-based compensation expense includes the estimated effects of forfeitures, which will be adjusted over the requisite service period to the extent actual forfeitures differ, or are expected to differ from such estimates. Changes in estimated forfeitures are recognized in the period of change and will also impact the amount of expense to be recognized in future periods. Forfeiture rate assumptions are derived from historical data. We estimate stock price volatility at the date of grant based on the historical volatility of our common stock. Estimated option life is determined using the simplified method in accordance with Staff Accounting Bulletin No. 110. Determining the appropriate fair-value model and calculating the fair value of share-based awards at the grant date requires considerable judgment, including estimating stock price volatility, expected option life and forfeiture rates.

**Table of Contents****ANALYSIS OF RESULTS OF OPERATIONS AND OTHER**

The following discussion compares the historical results of operations on a basis consistent with GAAP for the years ended December 31, 2008, 2007 and 2006.

**2008 Compared to 2007*****Revenues***

The following table sets forth a comparison of the key components of our revenues for the following years ended December 31:

| (\$ in thousands)     | 2008              | % of<br>Total | 2007              | % of<br>Total | Change           |            |
|-----------------------|-------------------|---------------|-------------------|---------------|------------------|------------|
|                       |                   |               |                   |               | \$               | %          |
| Software licenses     | \$ 41,490         | 16%           | \$ 35,063         | 16%           | \$ 6,427         | 18%        |
| Subscriptions         | 14,374            | 5             | 10,406            | 5             | 3,968            | 38         |
| Software services     | 74,997            | 28            | 60,283            | 27            | 14,714           | 24         |
| Maintenance           | 107,458           | 41            | 85,411            | 39            | 22,047           | 26         |
| Appraisal services    | 19,098            | 7             | 21,318            | 10            | (2,220)          | (10)       |
| Hardware and other    | 7,684             | 3             | 7,315             | 3             | 369              | 5          |
| <b>Total revenues</b> | <b>\$ 265,101</b> | <b>100%</b>   | <b>\$ 219,796</b> | <b>100%</b>   | <b>\$ 45,305</b> | <b>21%</b> |

*Software licenses.* Software license revenues consist of the following components for the following years ended December 31:

| (\$ in thousands)                      | 2008             | % of<br>Total | 2007             | % of<br>Total | Change          |            |
|--|------------------|---------------|------------------|---------------|-----------------|------------|
|  |                  |               |                  |               | \$              | %          |
| Financial management and education     | \$ 27,323        | 66%           | \$ 24,988        | 71%           | \$ 2,335        | 9%         |
| Courts and justice                     | 10,128           | 24            | 5,987            | 17            | 4,141           | 69         |
| Appraisal and tax and other            | 4,039            | 10            | 4,088            | 12            | (49)            | (1)        |
| <b>Total software license revenues</b> | <b>\$ 41,490</b> | <b>100%</b>   | <b>\$ 35,063</b> | <b>100%</b>   | <b>\$ 6,427</b> | <b>18%</b> |

In 2008 we signed 72 material new contracts with average software license fees of approximately \$311,000, compared to 86 material new contracts signed in 2007 with average software license fees of approximately \$434,000. We consider contracts with a license fee component of \$100,000 or more to be material. Average software license fees in 2007 included the impact of one courts and justice statewide contract that contained an unusually large amount of software license fees. Although a contract is signed in a particular year, the year in which the revenue is recognized may be different because we recognize revenue according to our revenue recognition policy as described in Note 1 in the Notes to Financial Statements.

Changes in software license revenues consist of the following components:

Software license revenue related to our financial management and education solutions for 2008 increased 9% compared to the prior year. Revenue from student information management solutions as well as student transportation management solutions acquired in the last twelve months contributed substantially to the increase. The remaining increase was mainly due to contract arrangements that included more software license revenue than in the past.

Software license revenue related to our courts and justice software solutions increased 69% for 2008 compared to the prior year. New statewide contracts in Indiana and New Mexico contributed approximately two-thirds of the increase. The remaining increase was primarily due to an expanded presence in the markets for municipal courts

software solutions and public safety software solutions.

*Subscriptions.* Subscription-based services revenue primarily consists of revenues derived from 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

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and miscellaneous other hosted service agreements are typically renewable annually. New ASP customers and existing customers converting to ASP arrangements provided the majority of the subscription revenue increase with the remaining increase due to new disaster recovery customers and slightly higher rates for disaster recovery services.

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

Software services revenue related to financial management and education solutions, which comprises approximately half of our software services revenue in the years presented, increased substantially compared to 2007. This increase was driven in part by increased capacity to deliver backlog following additions to our implementation and support staff since 2007 and due to 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 \$3.9 million to software service revenues in 2008. Excluding the impact of acquisitions, we have added approximately 95 full-time equivalent employees to our financial management and education implementation and training staff since 2007.

Software services revenue related to our courts and justice solutions experienced strong increases compared to 2007, reflecting increased capacity to deliver backlog following additions to our implementation and support staff since mid-2007. In addition, increased contract volume for municipal courts software solutions and public safety software solutions also generated higher related services revenue. We have added approximately 12 full-time equivalent employees to our courts and justice implementation and training staff since 2007.

*Maintenance.* We provide maintenance and support services for our software products and third party software. Maintenance revenues increased 26% in 2008 compared to 2007. Maintenance and support services grew 16% in 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 10% in 2008 compared to 2007. 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. Appraisal revenues for the first six months of 2008 were down 23% compared to the first six months of 2007. 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. As a result of this contract and an overall increase in contract volume, appraisal revenues for the last six months of 2008 increased 4% over the last six months of 2007. In 2009, we expect appraisal revenue to increase over 2008 by a modest amount.

**Table of Contents**Cost of Revenues and Gross Margins

The following table sets forth a comparison of the key components of our cost of revenues and those components stated as a percentage of related revenues for the following years ended December 31:

| (\$ in thousands)                                      | 2008       | % of<br>related<br>revenues | 2007       | % of<br>related<br>revenues | Change    |      |
|--|------------|-----------------------------|------------|-----------------------------|-----------|------|
|  |            |                             |            |                             | \$        | %    |
| Software licenses                                      | \$ 9,224   | 22%                         | \$ 7,953   | 23%                         | \$ 1,271  | 16%  |
| Acquired software                                      | 1,799      | 4                           | 2,279      | 7                           | (480)     | (21) |
| Software services,<br>maintenance and<br>subscriptions | 126,247    | 64                          | 104,993    | 67                          | 21,254    | 20   |
| Appraisal services                                     | 12,251     | 64                          | 14,467     | 68                          | (2,216)   | (15) |
| Hardware and other                                     | 5,793      | 75                          | 5,679      | 78                          | 114       | 2    |
| Total cost of revenues                                 | \$ 155,314 | 59%                         | \$ 135,371 | 62%                         | \$ 19,943 | 15%  |

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

|  | 2008  | 2007  | Change |
|--|-------|-------|--------|
| Gross margin percentages                         |       |       |        |
| Software licenses and acquired software          | 73.4% | 70.8% | 2.6%   |
| Software services, maintenance and subscriptions | 35.9  | 32.7  | 3.2    |
| Appraisal services                               | 35.9  | 32.1  | 3.8    |
| Hardware and other                               | 24.6  | 22.4  | 2.2    |
| Overall gross margin                             | 41.4% | 38.4% | 3.0%   |

*Software license.* Approximately one-half 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, over the estimated useful life of the product, any capitalized costs associated with its development. 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. In 2008, our software license gross margin percentage rose compared to the prior year mainly due to strong license fee revenue increases. Because approximately one-half of our cost of software license revenues is comprised of amortization of capitalized development costs, increased license fee revenues inherently result in higher gross margins.

*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. In 2008, the software services, maintenance and subscriptions gross margin increased compared to the prior year 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 215 full-time equivalent employees since 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 2007.

*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 2008 is higher than the prior year due to cost savings associated with a

significant complex reappraisal project.



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Our blended gross margin in 2008 was higher than the prior year in large part due to leverage in the utilization of our support and maintenance staff and economies of scale, with resulting increases in gross margin for each revenue category.

*Selling, General and Administrative Expenses*

The following table sets forth a comparison of our selling, general and administrative ( SG&A ) expenses for the following years ended December 31:

| (\$ in thousands)                            | 2008     | % of<br>revenues | 2007     | % of<br>revenues | Change<br>\$ | %   |
|--|----------|------------------|----------|------------------|--------------|-----|
| Selling, general and administrative expenses | \$62,923 | 24%              | \$51,724 | 24%              | \$11,199     | 22% |

Excluding the impact of acquisitions, our full-time equivalent SG&A employee count increased 9% from 2007.

*Research and Development Expense*

The following table sets forth a comparison of our research and development expense for the following years ended December 31:

| (\$ in thousands)                | 2008    | % of<br>revenues | 2007    | % of<br>revenues | Change<br>\$ | %   |
|----------------------------------|---------|------------------|---------|------------------|--------------|-----|
| Research and development expense | \$7,286 | 3%               | \$4,443 | 2%               | \$2,843      | 64% |

Research and development expense mainly consist 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 because the Microsoft Dynamics AX development effort was not fully staffed until mid-2007. In 2008 and 2007, we offset our research and development expense by \$1.8 million and \$1.6 million, 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 the Warrants owned by 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.

**Table of Contents**Amortization of Customer and Trade Name Intangibles

Acquisition intangibles are comprised 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 estimated useful lives of both customer and trade name intangibles are 5 to 25 years. The following table sets forth a comparison of amortization of customer and trade name intangibles for the following years ended December 31:

| (\$ in thousands)                                   | 2008    | 2007    | Change |     |
|---|---------|---------|--------|-----|
|   |         |         | \$     | %   |
| Amortization of customer and trade name intangibles | \$2,438 | \$1,478 | \$960  | 65% |

In 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.

Estimated annual amortization expense relating to customer and trade name acquisition intangibles, excluding acquired software for which the amortization expense is recorded as cost of revenues, for the next five years is as follows (in thousands):

|      |         |
|------|---------|
| 2009 | \$2,591 |
| 2010 | 2,591   |
| 2011 | 2,575   |
| 2012 | 2,508   |
| 2013 | 2,365   |

Other

Interest income was the main component of other income in both 2008 and 2007. Other income in 2008 also includes non-usage and other fees associated with a credit agreement entered into in October 2008. Interest income in 2008 was \$1.1 million compared to \$1.8 million in 2007. Interest income declined due to lower invested cash balances and slightly lower interest rates. Our invested cash balances declined due to increased purchases of treasury stock and investments in office buildings and land in 2008.

Income Tax Provision

The following table sets forth a comparison of our income tax provision for the following years ended December 31:

| (\$ in thousands)    | 2008     | 2007     | Change  |     |
|----------------------|----------|----------|---------|-----|
|                      |          |          | \$      | %   |
| Income tax provision | \$14,414 | \$11,079 | \$3,335 | 30% |

|                           |       |       |
|---------------------------|-------|-------|
| Effective income tax rate | 49.2% | 38.8% |
|---------------------------|-------|-------|

Our effective income tax rate increased approximately twelve points compared to the prior year due to a non-cash legal settlement related to warrants charge of \$9.0 million, which was not deductible. The effective income tax rates were different from the statutory United States federal income tax rate of 35% primarily due to 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.

Slightly less than half of our stock option awards qualify as an incentive stock option ( ISO ) for income tax purposes. As such, a tax benefit is not recorded at the time the compensation cost related to the options is recorded for book purposes due to the fact that an ISO does not ordinarily result in a tax benefit unless there is a disqualifying disposition. Non-qualified stock options result in the creation of a deferred tax asset, which is a temporary difference, until the time that the option is exercised. Due to the treatment of ISOs for tax purposes, our effective tax rate from year to year is subject to variability.



**Table of Contents****2007 Compared to 2006**Revenues

The following table sets forth a comparison of the key components of our revenues for the following years ended December 31:

| (\$ in thousands)  | 2007       | % of<br>Total | 2006       | % of<br>Total | Change     |      |
|--------------------|------------|---------------|------------|---------------|------------|------|
|                    |            |               |            |               | \$         | %    |
| Software licenses  | \$ 35,063  | 16%           | \$ 37,247  | 19%           | \$ (2,184) | (6)% |
| Subscriptions      | 10,406     | 5             | 7,298      | 4             | 3,108      | 43   |
| Software services  | 60,283     | 27            | 50,861     | 26            | 9,422      | 19   |
| Maintenance        | 85,411     | 39            | 73,413     | 38            | 11,998     | 16   |
| Appraisal services | 21,318     | 10            | 19,755     | 10            | 1,563      | 8    |
| Hardware and other | 7,315      | 3             | 6,729      | 3             | 586        | 9    |
| Total revenues     | \$ 219,796 | 100%          | \$ 195,303 | 100%          | \$ 24,493  | 13%  |

*Software licenses.* Software license revenues consist of the following components for the following years ended December 31:

| (\$ in thousands)                  | 2007      | % of<br>Total | 2006      | % of<br>Total | Change     |      |
|------------------------------------|-----------|---------------|-----------|---------------|------------|------|
|                                    |           |               |           |               | \$         | %    |
| Financial management and education | \$ 24,988 | 71%           | \$ 27,292 | 73%           | \$ (2,304) | (8)% |
| Courts and justice                 | 5,987     | 17            | 4,756     | 13            | 1,231      | 26   |
| Appraisal and tax and other        | 4,088     | 12            | 5,199     | 14            | (1,111)    | (21) |
| Total software license revenues    | \$ 35,063 | 100%          | \$ 37,247 | 100%          | \$ (2,184) | (6)% |

Changes in software license revenues consist of the following components:

Software license revenue related to our financial management and education solutions for 2007 decreased 8% compared to the prior year. Over half the decline was due to product mix in 2007 that required less third party software. A portion of the remaining decline was mainly due to a number of customers in 2007 choosing our subscription-based options, rather than purchasing the software under a traditional perpetual software license arrangement. Although these customers represented a relatively small percentage of new customers, the size of those contracts was larger than in the prior year. Subscription-based arrangements result in lower software license revenues in the initial year as compared to traditional perpetual software license arrangement but generate higher overall subscription-based services revenue over the term of the contract.

Software license revenue related to our courts and justice software solutions increased 26% for 2007 compared to the prior year. In the fourth quarter of 2007 we recorded software license revenue of approximately \$1.3 million from a contract which had been deferred in accordance with the terms of the contract.

Appraisal and tax and other software license declined 21% in 2007 compared to the prior year primarily due to the deferral of software license revenue on a customer arrangement pending establishment of a revised timeline for the completion of certain development and implementation services.

*Subscriptions.* In 2007, new ASP customers provided approximately two-thirds of the subscription revenue increase due to further expansion into existing markets and new markets such as Pennsylvania and Texas.



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

Software services revenue related to financial management and education solutions, which comprises approximately half of our software services revenue in the years presented, experienced modest increases in 2007 compared to the prior year due to increased contract volume and additions to implementation and training staff which enabled us to deliver our backlog at a faster rate. Excluding the impact of acquisitions we added approximately 40 people to our financial management and education implementation and training staff during 2007.

Software services revenue related to our courts and justice solutions experienced substantial increases in 2007 compared to the prior year, reflecting increased contract volume. We had approximately 34 active Odyssey contracts in 2007 compared to approximately 25 active Odyssey contracts in 2006, primarily due to continued expansion in Texas and Florida and a new contract with Indiana. We added approximately 50 people to our courts and justice implementation and training staff during 2007.

Software services revenue related to appraisal and tax and other solutions, which comprise approximately 25% of our software services revenue in the periods presented, had moderate increases for 2007 compared to 2006. The majority of the increase is related to one large appraisal and tax software implementation, which was substantially completed by December 31, 2007.

*Maintenance.* Maintenance revenues increased over the prior year due to growth in our installed customer base and slightly higher maintenance rates on most of our solutions.

*Appraisal services.* Appraisal services revenue for 2007 was 8% higher than 2006. The increase was due to activity related to Ohio's revaluation cycle, which occurs every six years, and a \$4.0 million contract with Fulton County, Georgia, which began late in 2006. The Ohio revaluation projects began with smaller counties late in the first quarter of 2006 and expanded to larger counties by the third quarter of 2006. A substantial portion of the Ohio revaluation projects was complete by December 31, 2007.

**Table of Contents**Cost of Revenues and Gross Margins

The following table sets forth a comparison of the key components of our cost of revenues and those components stated as a percentage of related revenues for the following years ended December 31:

| (\$ in thousands)                                      | 2007       | % of<br>related<br>revenues | 2006       | % of<br>related<br>revenues | Change     |       |
|--|------------|-----------------------------|------------|-----------------------------|------------|-------|
|  |            |                             |            |                             | \$         | %     |
| Software licenses                                      | \$ 7,953   | 23%                         | \$ 9,968   | 27%                         | \$ (2,015) | (20)% |
| Acquired software                                      | 2,279      | 7                           | 1,360      | 4                           | 919        | 68    |
| Software services,<br>maintenance and<br>subscriptions | 104,993    | 67                          | 90,601     | 69                          | 14,392     | 16    |
| Appraisal services                                     | 14,467     | 68                          | 13,563     | 69                          | 904        | 7     |
| Hardware and other                                     | 5,679      | 78                          | 5,007      | 74                          | 672        | 13    |
| Total cost of revenues                                 | \$ 135,371 | 62%                         | \$ 120,499 | 62%                         | \$ 14,872  | 12%   |

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

| Gross margin percentages                         | 2007  | 2006  | Change |
|--|-------|-------|--------|
| Software licenses and acquired software          | 70.8% | 69.6% | 1.2%   |
| Software services, maintenance and subscriptions | 32.7  | 31.1  | 1.6    |
| Appraisal services                               | 32.1  | 31.3  | 0.8    |
| Hardware and other                               | 22.4  | 25.6  | (3.2)  |
| Overall gross margin                             | 38.4% | 38.3% | 0.1%   |

*Software license.* In 2007, our software license gross margin percentage increased slightly compared to the prior year because our product mix in 2007 included less third party software, which has higher associated costs than proprietary software. The gross margin also benefited from lower amortization expense of software development costs because some products became fully amortized during the first quarter of 2006.

*Software services, maintenance and subscription-based services.* In 2007, the software services, maintenance and subscription gross margin percentage increased 1.6% over the prior year 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 increased our implementation and support staff by 162 full-time equivalent employees since December 31, 2006. This increase includes 73 additional employees related to acquisitions completed in 2007. The remaining additions were to increase our capacity to train and deliver our contract backlog, particularly for our courts and justice solutions.

*Appraisal services.* In 2007, higher revenues associated with increased activity on the Ohio revaluation projects contributed to the slight appraisal services gross margin percentage increase.

Our blended gross margin for 2007 was flat compared to the prior year due to a revenue mix that included less software license and significant additions to our development and implementation staff to deliver our growing backlog. Software license revenue inherently has higher gross margins than other revenues such as professional services and hardware. Although the revenue mix for 2007 also included less software license than the prior year, the negative impact on the gross margin was offset by lower third party software costs as well as lower amortization expense of software development costs described above.

**Table of Contents**Selling, General and Administrative Expenses

The following table sets forth a comparison of our selling, general and administrative ( SG&A ) expenses for the following years ended December 31:

| (\$ in thousands)                            | 2007     | % of<br>revenues | 2006     | % of<br>revenues | Change<br>\$ | %  |
|--|----------|------------------|----------|------------------|--------------|----|
| Selling, general and administrative expenses | \$51,724 | 24%              | \$48,389 | 25%              | \$3,335      | 7% |

SG&A costs grew at a slower rate than revenues in 2007 due to leverage in the utilization of our administrative and sales staff.

Research and Development Expense

The following table sets forth a comparison of our research and development expense for the following years ended December 31:

| (\$ in thousands)                | 2007    | % of<br>revenues | 2006    | % of<br>revenues | Change<br>\$ | %   |
|----------------------------------|---------|------------------|---------|------------------|--------------|-----|
| Research and development expense | \$4,443 | 2%               | \$3,322 | 2%               | \$1,121      | 34% |

For 2007, research and development expense included costs associated with the Microsoft Dynamics AX project, in addition to costs associated with other new product development efforts. In 2007, we reduced our research and development expense by \$1.6 million, which was the amount earned under the terms of our strategic alliance with Microsoft.

Other

In 2007 interest income was the main component of other income. Other income in 2006 also includes non-usage and other fees associated with a credit agreement we terminated in January 2007 and gains and losses on risk management liabilities and assets associated with a foreign exchange contract. Interest income in 2007 was \$1.8 million compared to \$1.4 million in 2006. The increase in interest income was due to higher invested cash balances as the result of positive cash flow in 2007.

Income Tax Provision

The following table sets forth a comparison of our income tax provision for the following years ended December 31:

| (\$ in thousands)    | 2007     | 2006    | Change<br>\$ | %   |
|----------------------|----------|---------|--------------|-----|
| Income tax provision | \$11,079 | \$8,493 | \$2,586      | 30% |

Effective income tax rate 38.8% 37.2%

The effective income tax rates were different from the statutory United States federal income tax rate of 35% primarily due to state income taxes, non-deductible share-based compensation expense, the qualified manufacturing activities deduction, and non-deductible meals and entertainment costs.

The effective rate for 2006 was lower than the 2007 effective tax rate mainly due to changes in the Texas franchise tax law and rates enacted in the second quarter of 2006 and favorable state income tax audit results.

**FINANCIAL CONDITION AND LIQUIDITY**

As of December 31, 2008, we had cash and cash equivalents (including restricted cash equivalents) of \$6.8 million and current and non-current investments of \$4.6 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 December 31, 2008, we had outstanding borrowings of \$8.0 million and outstanding letters of credit totaling \$5.1 million to secure surety bonds required by some of our customer contracts.



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The following table sets forth a summary of cash flows for the years ended December 31:

| (\$ in thousands)                         | 2008       | 2007       | 2006       |
|---|------------|------------|------------|
| Cash flows provided by (used by):         |            |            |            |
| Operating activities                      | \$ 47,802  | \$ 34,111  | \$ 26,804  |
| Investing activities                      | (9,554)    | (34,275)   | (24,326)   |
| Financing activities                      | (46,128)   | (7,406)    | (5,999)    |
| Net decrease in cash and cash equivalents | \$ (7,880) | \$ (7,570) | \$ (3,521) |

Net cash provided by operating activities continues to be our primary source of funds to finance operating needs and capital expenditures. Other capital resources include cash on hand, public and private issuances of debt and equity securities, and bank borrowings. The capital and credit markets have become more volatile and tight as a result of adverse conditions that have caused the failure and near failure of a number of large financial services companies. It is possible that our ability to access the capital and credit markets may be limited by these or other factors.

Notwithstanding the foregoing, at this time, we believe that cash provided by operating activities, cash on hand and our revolving credit agreement are sufficient to fund our working capital requirements, capital expenditures, income tax obligations, and share repurchases for the foreseeable future.

In 2008, operating activities provided net cash of \$47.8 million, primarily generated from net income of \$14.9 million, non-cash legal settlement related to warrants charge of \$9.0 million, non-cash depreciation and amortization charges of \$12.6 million, non-cash share-based compensation expense of \$3.8 million, and a decrease in net operating assets of \$8.5 million. Net operating assets declined mainly due to several advance payments from customers offset somewhat by an increase in annual maintenance billings processed in December.

Our short-term and non-current investments available-for-sale consist of auction rate municipal securities ( ARS ) which are collateralized debt obligations supported by municipal and state agencies and do not include mortgage-backed securities. Short-term investments available-for-sale consist of ARS which were sold at par during the period January 1, 2009 through February 20, 2009.

All of our non-current ARS are reflected at estimated fair value in the balance sheet at December 31, 2008. In prior periods, due to the auction process which took place every 28 to 35 days for most ARS, quoted market prices were readily available, which would have qualified as Level 1 under Statement of Financial Accounting Standards No. 157,

Fair Value Measurements. However, due to recent events in credit markets beginning during the first quarter of 2008, the auction events for most of these securities failed. Therefore, quoted prices in active markets are no longer available and we determined the estimated fair values of these securities as of December 31, 2008, utilizing a discounted trinomial model.

In association with this estimate of fair value, we have recorded an after tax temporary unrealized loss on our non-current ARS of \$387,000, net of related tax effects of \$209,000 in 2008, which is included in accumulated other comprehensive loss on our balance sheet. As of December 31, 2008, we have continued to earn and collect interest on all of our ARS. We believe that this temporary decline in fair value is due entirely to liquidity issues, because the underlying assets of these securities are supported by municipal 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. In addition, 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 \$6.8 million, expected operating cash flows and the liquidation of \$775,000 of ARS subsequent to the period ending December 31, 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 have classified these securities as non-current because we believe the market for these securities may take in excess of twelve months to fully recover. We will continue to evaluate any

changes in the market value of our non-current ARS and in the future, depending upon existing market conditions, we may be required to record an other-than-temporary decline in market value.

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At December 31, 2008, our days sales outstanding ( DSOs ) were 99 days compared to DSOs of 95 days at December 31, 2007. DSOs are calculated based on accounts receivable (excluding long-term receivables) divided by the quotient of annualized quarterly revenues divided by 360 days. The increase in DSOs is primarily due to an increase in maintenance billings processed in December.

Investing activities used cash of \$9.6 million in 2008 compared to \$34.3 million in 2007. In 2008, we liquidated \$36.4 million of ARS investments 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 to expand 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. In connection with plans to consolidate workforces and support planned long-term growth, we paid \$3.3 million, which included \$2.1 million for land, for an office development in Lubbock, Texas. We also 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.

Investing activities in 2007 included cash payments of \$9.0 million for the acquisitions of EDP Enterprises, Inc., Advanced Data Systems, Inc. and certain other software assets. Other investing activities during 2007 were \$22.1 million, net of sales, to purchase ARS investments and \$3.7 million in property and equipment. The property and equipment expenditures were related to computer hardware and software and other asset additions to support internal growth. Investing activities in 2006 include cash payments of \$12.2 million and 325,000 shares of Tyler common stock for the acquisitions of MazikUSA, Inc. and TACS, Inc. and certain maintenance and support agreements associated with one of our financial solutions. Other investing activities during 2006 were capital expenditures of \$4.3 million, including \$4.1 million for computer hardware and purchased software for internal use, including a new enterprise-wide customer relationship management system, and other asset additions to support internal growth.

Cash used in financing activities was primarily comprised of purchases of treasury shares, net of proceeds from stock option exercises and contributions from our employee stock purchase plan. During 2008, we purchased 4.3 million shares of our common stock for an aggregate purchase price of \$59.0 million. Common stock purchases were funded primarily from cash from operations as well as borrowings of \$8.0 million under a revolving bank credit agreement entered into in late October. At December 31, 2008, we had authorization to repurchase up to 1.5 million additional shares of Tyler common stock.

During 2007, we purchased approximately 1.3 million shares of our common stock for an aggregate purchase price of \$16.2 million (\$14.1 million in cash and \$2.1 million in accrued liabilities at December 31, 2007.) In 2006 we purchased approximately 1.0 million shares of our common stock for an aggregate cash purchase price of \$10.5 million.

In 2008 we received \$1.8 million from the exercise of options to purchase approximately 379,000 shares of our common stock under our employee stock option plan. During 2007, we received \$3.6 million from the exercise of options to purchase approximately 878,000 shares of our common stock under our employee stock option plan and during 2006 we issued 623,000 shares of common stock and received \$2.9 million in aggregate proceeds upon exercise of stock options. In 2008 we received \$1.2 million from contributions to the Tyler Technologies, Inc. Employee Stock Purchase Plan ( ESPP ). In 2007 and 2006, we received \$1.2 million and \$1.0 million, respectively, from contributions to the ESPP.

Subsequent to December 31, 2008 and through February 20, 2009 we purchased approximately 419,000 shares of our common stock for an aggregate cash purchase price of \$5.1 million.

On October 20, 2008, we entered into a 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 bear interest at a rate of either LIBOR plus 1% or prime rate minus 1.5%. As of December 31, 2008, our effective interest rate was 1.47% under the Credit Facility. The effective average interest rate for borrowings during the period October 20 through December 31, 2008 was 2.1%. The Credit Facility is secured by substantially all of our personal property. The Credit Facility requires us to maintain certain financial ratios

and other financial conditions and prohibits us from making certain investments, advances, cash dividends or loans, restricts the amount of our common stock we may purchase and the limits incurrence of additional indebtedness and liens. We expect borrowings to fund discretionary purchases of our common stock or fund acquisitions and these covenants are not expected to impact our financial condition or operating performance. As of December 31, 2008, we were in compliance with those covenants.

As of December 31, 2008, we had outstanding borrowings of \$8.0 million and unused available borrowing capacity of \$17.0 million under the Credit Facility. In addition, as of December 31, 2008, our bank had issued outstanding letters of credit totaling \$5.1 million

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to secure surety bonds required by some of our customer contracts. These letters of credit have been collateralized by restricted cash balances invested in a certificate of deposit. These letters of credit expire through mid-2009. Excluding acquisitions, we anticipate that 2009 capital spending will be between \$14.0 million and \$16.0 million. Approximately \$11.0 million of these expenditures will be incurred to complete the construction of an office development in Lubbock, Texas. The remainder of our 2009 expenditures are primarily related to computer equipment and software for infrastructure expansions. We currently do not expect to capitalize significant amounts related to software development in 2009, but the actual amount and timing of those costs, and whether they are capitalized or expensed may result in additional capitalized software development. Capital spending in 2009 is expected to be funded from existing cash balances and cash flows from operations.

From time to time we engage in discussions with potential acquisition candidates. In order to pursue 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 acquisition opportunities and how such opportunities will be financed.

We lease office facilities, as well as transportation, computer and other equipment used in our operations under non-cancelable operating lease agreements expiring at various dates through 2013. Most leases contain renewal options and some contain purchase options. Following are the future obligations under non-cancelable leases at December 31, 2008 (in thousands):

|   | 2009    | 2010    | 2011    | 2012    | 2013  | Thereafter | Total    |
|---|---------|---------|---------|---------|-------|------------|----------|
| Future rental payments under operating leases | \$5,931 | \$4,489 | \$3,271 | \$2,153 | \$567 | \$         | \$16,411 |

As of December 31, 2008, we do not have any off-balance sheet arrangements, guarantees to third parties or material purchase commitments, except for the operating lease commitments listed above.

**CAPITALIZATION**

At December 31, 2008, our capitalization consisted of \$8.0 million of short-term debt and \$114.3 of shareholders equity.

**NEW ACCOUNTING PRONOUNCEMENTS**

In December 2007, the Financial Accounting Standards Board issued SFAS No. 141R Business Combinations. SFAS No. 141R 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. 141R is effective for fiscal years beginning after December 15, 2008, with early adoption prohibited. The adoption of SFAS No. 141 R is not expected to have a material impact on our consolidated financial statements or related disclosures.

In April 2008, the FASB issued FASB Staff Position ( FSP ) No. 142-3, Determination of the Useful Life of Intangible Assets. FSP No. 142-3 amends the factors an entity should consider in developing renewal or extension assumptions used in determining the useful life of recognized intangible assets under FASB Statement No. 142, Goodwill and Other Intangible Assets. This new guidance applies prospectively to intangible assets that are acquired individually or with a group of other assets in business combinations and asset acquisitions. FSP No. 142-3 is effective for financial statements issued for fiscal years and interim periods beginning after December 15, 2008. Early adoption is prohibited. The adoption of FSP No. 142-3 is not expected to have a material impact on our financial statements or related disclosures.

**ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.**

Market risk represents the risk of loss that may affect us due to adverse changes in financial market prices and interest rates. Our short-term and non-current investments available-for-sale consist of auction rate municipal securities ( ARS ) which are collateralized debt obligations supported by municipal and state agencies and do not include mortgage-backed securities. Short-term investments available-for-sale consist of ARS which were sold at par during

the period January 1, 2009 through February 20, 2009.

All of our non-current ARS are reflected at estimated fair value in the balance sheet at December 31, 2008. In prior periods, due to the auction process which took place every 28 to 35 days for most ARS, quoted market prices were readily available, which would have qualified as Level 1 under Statement of Financial Accounting Standards No. 157, Fair Value Measurements. However, due to

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recent events in credit markets beginning during the first quarter of 2008, the auction events for most of these securities failed. Therefore, quoted prices in active markets are no longer available and we determined the estimated fair values of these securities as of December 31, 2008, utilizing a discounted trinomial model.

In association with this estimate of fair value, we have recorded an after tax temporary unrealized loss on our non-current ARS of \$387,000, net of related tax effects of \$209,000 in 2008, which is included in accumulated other comprehensive loss on our balance sheet. As of December 31, 2008, we have continued to earn and collect interest on all of our ARS. We believe that this temporary decline in fair value is due entirely to liquidity issues, because the underlying assets of these securities are supported by municipal 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. In addition, 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 \$6.8 million, expected operating cash flows and the liquidation of \$775,000 of ARS subsequent to the period ending December 31, 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 have classified these securities as non-current because we believe the market for these securities may take in excess of twelve months to fully recover. We will continue to evaluate any changes in the market value of our non-current ARS and in the future, depending upon existing market conditions, we may be required to record an other-than-temporary decline in market value.

**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.**

The reports of our independent registered public accounting firm and our financial statements, related notes, and supplementary data are included as part of this Annual Report beginning on page F-1.

**ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.**

None.

**ITEM 9A. CONTROLS AND PROCEDURES**

*Evaluation of Disclosure Controls and Procedures* We maintain disclosure controls and procedures (as defined in Rule 13a-15(e) of the Securities Exchange Act) designed to provide reasonable assurance that the information required to be disclosed by us in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. These include controls and procedures designed to ensure that this information is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate to allow timely decisions regarding required disclosures. Management, with the participation of the chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures as of December 31, 2008. Based on this evaluation the chief executive officer and chief financial officer have concluded that our disclosure controls and procedures were effective as of December 31, 2008.

*Management's Report on Internal Control Over Financial Reporting* Tyler's management is responsible for establishing and maintaining effective internal control over financial reporting as defined in Securities Exchange Act Rule 13a-15(f). Tyler's internal control over financial reporting is designed to provide reasonable assurance to Tyler's management and board of directors regarding the preparation and fair presentation of published financial statements. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

Management assessed the effectiveness of Tyler's internal control over financial reporting as of December 31, 2008. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control - Integrated Framework*. Based on our assessment, we believe that, as of December 31, 2008, Tyler's internal control over financial reporting is effective based on those criteria.





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Management's assessment of the effectiveness of internal control over financial reporting as of December 31, 2008 has been audited by Ernst & Young, LLP, the independent registered public accounting firm who also audited Tyler's financial statements. Ernst & Young's attestation report on management's assessment of Tyler's internal control over financial reporting appears on page F-2 hereof.

*Changes in Internal Control Over Financial Reporting* During the quarter ended December 31, 2008, there were no changes in our internal controls over financial reporting, as defined in Securities Exchange Act Rule 13a-15(f), that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**ITEM 9B. OTHER INFORMATION**

None.

**PART III**

See the information under the following captions in Tyler's definitive Proxy Statement, which is incorporated herein by reference. Only those sections of the Proxy Statement that specifically address the items set forth herein are incorporated by reference. Such incorporation by reference does not include the Compensation Discussion and Analysis, the Compensation Committee Report or the Audit Committee Report which are included in the Proxy Statement.

|          |  | Headings in Proxy Statement  |
|----------|--|--|
| ITEM 10. | DIRECTORS, EXECUTIVE OFFICERS,<br>AND CORPORATE GOVERNANCE.  | Tyler Management and Corporate Governance<br>Principles and Board Matters    |
| ITEM 11. | EXECUTIVE COMPENSATION.  | Executive Compensation   |
| ITEM 12. | SECURITY OWNERSHIP OF CERTAIN<br>BENEFICIAL OWNERS AND<br>MANAGEMENT AND RELATED<br>STOCKHOLDER MATTERS. | Security Ownership of Certain Beneficial Owners<br>and Management            |
| ITEM 13. | CERTAIN RELATIONSHIPS AND<br>RELATED TRANSACTIONS, AND<br>DIRECTOR INDEPENDENCE.                         | Executive Compensation and Certain Relationships<br>and Related Transactions |
| ITEM 14. | PRINCIPAL ACCOUNTING FEES AND<br>SERVICES.   |  |

The information required under this item may be found under the section captioned "Proposals For Consideration Proposal Two Ratification of Ernst & Young LLP as Our Independent Auditors for Fiscal Year 2009" in our Proxy Statement and is incorporated herein by reference.

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PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES.

The following documents are filed as part of this Annual Report:

(a)(1) The financial statements are filed as part of this Annual Report.

|  | Page |
|--|------|
| <u>Reports of Independent Registered Public Accounting Firm</u>                                | F-1  |
| <u>Statements of Operations for the years ended December 31, 2008, 2007, and 2006</u>          | F-3  |
| <u>Balance Sheets as of December 31, 2008 and 2007</u>   | F-4  |
| <u>Statements of Shareholders' Equity for the years ended December 31, 2008, 2007 and 2006</u> | F-5  |
| <u>Statements of Cash Flows for the years ended December 31, 2008, 2007 and 2006</u>           | F-6  |
| <u>Notes to Financial Statements</u>   | F-7  |

(2) Financial statement schedules:

There are no financial statement schedules filed as part of this Annual Report, since the required information is included in the financial statements, including the notes thereto, or the circumstances requiring inclusion of such schedules are not present.

(3) Exhibits

Certain of the exhibits to this Annual Report are hereby incorporated by reference, as specified:

| Exhibit<br>Number | Description   |
|-------------------|---|
| 3.1               | Restated Certificate of Incorporation of Tyler Three, as amended through May 14, 1990, and Certificate of Designation of Series A Junior Participating Preferred Stock (filed as Exhibit 3.1 to our Form 10-Q for the quarter ended June 30, 1990, and incorporated by reference herein). |
| 3.2               | Certificate of Amendment to the Restated Certificate of Incorporation (filed as Exhibit 3.1 to our Form 8-K, dated February 19, 1998, and incorporated by reference herein).  |
| 3.3               | Amended and Restated By-Laws of Tyler Corporation, dated November 4, 1997 (filed as Exhibit 3.3 to our Form 10-K for the year ended December 31, 1997, and incorporated by reference herein).   |

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| Exhibit<br>Number | Description  |
|-------------------|--|
| 3.4               | Certificate of Amendment dated May 19, 1999 to the Restated Certificate of Incorporation (filed as Exhibit 3.4 to our Form 10-K for the year ended December 31, 2000, and incorporated by reference herein).   |
| 4.1               | Specimen of Common Stock Certificate (filed as Exhibit 4.1 to our registration statement no. 33-33505 and incorporated by reference herein).   |
| 4.2               | Second Amended and Restated Credit Agreement by and between Tyler Technologies, Inc. and Bank of Texas, N.A. dated October 20, 2008 (filed as Exhibit 4.1 to our Form 10-Q for the three months ended September 30, 2008 and incorporated by reference herein).              |
| 4.3               | Second Amended and Restated Pledge and Security Agreement by and between Tyler Technologies, Inc. and Bank of Texas, N.A. dated October 20, 2008 (filed as Exhibit 4.2 to our Form 10-Q for the three months ended September 30, 2008 and incorporated by reference herein). |
| *4.4              | First Amendment to Second Amended and Restated Credit Agreement by and between Tyler Technologies, Inc. and Bank of Texas, N.A. dated January 30, 2009.  |
| 10.1              | Form of Indemnification Agreement for directors and officers (filed as Exhibit 10.1 to our Form 10-K for the year ended December 31, 2002 and incorporated by reference herein).   |
| 10.2              | Stock Option Plan amended and restated as of May 12, 2000 (filed as Exhibit 4.1 to our registration statement no. 333-98929 and incorporated by reference herein).   |
| 10.3              | Employment and Non-Competition Agreement between Tyler Technologies, Inc. and John S. Marr Jr. dated February 26, 2008 (filed as Exhibit 10.5 to our Form 10-K for the year ended December 31, 2007 and incorporated by reference herein).                                   |
| 10.4              | Employment and Non-Competition Agreement between Tyler Technologies, Inc. and Dustin R. Womble dated February 26, 2008 (filed as Exhibit 10.6 to our Form 10-K for the year ended December 31, 2007 and incorporated by reference herein).                                   |
| 10.5              | Employment and Non-Competition Agreement between Tyler Technologies, Inc. and Brian K. Miller, dated February 26, 2008 (filed as Exhibit 10.7 to our Form 10-K for the year ended December 31, 2007 and incorporated by reference herein).                                   |
| 10.6              | Employment and Non-Competition Agreement between Tyler Technologies, Inc. and H. Lynn Moore dated February 26, 2008 (filed as Exhibit 10.8 to our Form 10-K for the year ended December 31, 2007 and incorporated by reference herein).                                      |
| 10.7              | Employee Stock Purchase Plan (filed as Exhibit 4.1 to our registration statement 333-116406 dated June 10, 2004 and incorporated by reference herein).   |
| *23               | Consent of Independent Registered Public Accounting Firm   |
| *31.1             | Rule 13a-14(a) Certification by Principal Executive Officer.   |

\*31.2 Rule 13a-14(a) Certification by Principal Financial Officer.

\*32 Section 1350 Certification of Principal Executive Officer and Principal Financial Officer.

\* Filed herewith.

A copy of each exhibit may be obtained at a price of 15 cents per page, with a \$10.00 minimum order, by writing Investor Relations, 5949 Sherry Lane, Suite 1400, Dallas, Texas, 75225.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

Date: February 25, 2009

By: /s/ John S. Marr  
John S. Marr  
Chief Executive Officer and President  
(principal executive officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Date: February 25, 2009

By: /s/ John S. Marr  
John S. Marr  
Chief Executive Officer and President  
Director  
(principal executive officer)

Date: February 25, 2009

By: /s/ John M. Yeaman  
John M. Yeaman  
Chairman of the Board

Date: February 25, 2009

By: /s/ Brian K. Miller  
Brian K. Miller  
Executive Vice President and Chief  
Financial Officer  
(principal financial officer)

Date: February 25, 2009

By: /s/ W. Michael Smith  
W. Michael Smith  
Vice President and Chief Accounting  
Officer  
(principal accounting officer)

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Date: February 25, 2009

By: /s/ Donald R. Brattain  
Donald R. Brattain  
Director

Date: February 25, 2009

By: /s/ J. Luther King  
J. Luther King  
Director

Date: February 25, 2009

By: /s/ G. Stuart Reeves  
G. Stuart Reeves  
Director

Date: February 25, 2009

By: /s/ Michael D. Richards  
Michael D. Richards  
Director

Date: February 25, 2009

By: /s/ Dustin R. Womble  
Dustin R. Womble  
Director

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors and Shareholders

Tyler Technologies, Inc.

We have audited the accompanying balance sheets of Tyler Technologies, Inc. as of December 31, 2008 and 2007, and the related statements of operations, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2008. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Tyler Technologies, Inc. at December 31, 2008 and 2007, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2008, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Tyler Technologies, Inc.'s internal control over financial reporting as of December 31, 2008, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 25, 2009 expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP

Dallas, Texas

February 25, 2009

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors and Shareholders

Tyler Technologies, Inc.

We have audited Tyler Technologies, Inc.'s internal control over financial reporting as of December 31, 2008, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Tyler Technologies, Inc.'s management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Tyler Technologies, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2008, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the balance sheets of Tyler Technologies, Inc. as of December 31, 2008 and 2007, and the related statements of operations, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2008 and our report dated February 25, 2009 expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP

Dallas, Texas

February 25, 2009

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Tyler Technologies, Inc.  
 Statements of Operations  
 For the years ended December 31  
 In thousands, except per share amounts

|   | 2008      | 2007      | 2006      |
|---|-----------|-----------|-----------|
| Revenues:   |           |           |           |
| Software licenses                                   | \$ 41,490 | \$ 35,063 | \$ 37,247 |
| Subscriptions                                       | 14,374    | 10,406    | 7,298     |
| Software services                                   | 74,997    | 60,283    | 50,861    |
| Maintenance   | 107,458   | 85,411    | 73,413    |
| Appraisal services                                  | 19,098    | 21,318    | 19,755    |
| Hardware and other                                  | 7,684     | 7,315     | 6,729     |
| Total revenues                                      | 265,101   | 219,796   | 195,303   |
| Cost of revenues:                                   |           |           |           |
| Software licenses                                   | 9,224     | 7,953     | 9,968     |
| Acquired software                                   | 1,799     | 2,279     | 1,360     |
| Software services, maintenance and subscriptions    | 126,247   | 104,993   | 90,601    |
| Appraisal services                                  | 12,251    | 14,467    | 13,563    |
| Hardware and other                                  | 5,793     | 5,679     | 5,007     |
| Total cost of revenues                              | 155,314   | 135,371   | 120,499   |
| Gross profit  | 109,787   | 84,425    | 74,804    |
| Selling, general and administrative expenses        | 62,923    | 51,724    | 48,389    |
| Research and development expense                    | 7,286     | 4,443     | 3,322     |
| Amortization of customer and trade name intangibles | 2,438     | 1,478     | 1,318     |
| Non-cash legal settlement related to warrants       | 9,045     |           |           |
| Operating income                                    | 28,095    | 26,780    | 21,775    |
| Other income, net                                   | 1,181     | 1,800     | 1,080     |
| Income before income taxes                          | 29,276    | 28,580    | 22,855    |
| Income tax provision                                | 14,414    | 11,079    | 8,493     |
| Net income  | \$ 14,862 | \$ 17,501 | \$ 14,362 |
| Earnings per common share:                          |           |           |           |
| Basic   | \$ 0.39   | \$ 0.45   | \$ 0.37   |
| Diluted   | \$ 0.38   | \$ 0.42   | \$ 0.34   |

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|  |        |        |        |
|--|--------|--------|--------|
| Basic weighted average common shares outstanding   | 37,714 | 38,735 | 38,817 |
| Diluted weighted average common shares outstanding | 39,184 | 41,352 | 41,868 |
| See accompanying notes.                            |        |        |        |

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Tyler Technologies, Inc.

Balance Sheets

December 31

In thousands, except share and per share amounts

|  | 2008              | 2007              |
|--|-------------------|-------------------|
| <b>ASSETS</b>  |                   |                   |
| Current assets:  |                   |                   |
| Cash and cash equivalents  | \$ 1,762          | \$ 9,642          |
| Restricted cash equivalents  | 5,082             | 4,462             |
| Short-term investments available-for-sale  | 775               | 41,590            |
| Accounts receivable (less allowance for losses of \$2,115 in 2008 and \$1,851 in 2007) | 76,989            | 63,965            |
| Prepaid expenses   | 8,602             | 7,726             |
| Other current assets   | 1,444             | 1,324             |
| Deferred income taxes  | 2,570             | 2,355             |
| <b>Total current assets</b>  | <b>97,224</b>     | <b>131,064</b>    |
| Accounts receivable, long-term portion   | 197               | 398               |
| Property and equipment, net  | 26,522            | 9,826             |
| Non-current investments available-for-sale   | 3,779             |                   |
| Other assets:  |                   |                   |
| Goodwill   | 88,791            | 71,677            |
| Customer related intangibles, net  | 27,438            | 17,706            |
| Software, net  | 5,112             | 9,588             |
| Other intangibles, net   | 2,471             | 1,074             |
| Sundry   | 227               | 175               |
|  | <b>\$ 251,761</b> | <b>\$ 241,508</b> |
| <b>LIABILITIES AND SHAREHOLDERS EQUITY</b>   |                   |                   |
| Current liabilities:   |                   |                   |
| Accounts payable   | \$ 2,617          | \$ 3,323          |
| Accrued liabilities  | 22,913            | 18,905            |
| Short-term obligation  | 8,000             |                   |
| Deferred revenue   | 95,773            | 73,714            |
| Income taxes payable   | 166               | 632               |
| <b>Total current liabilities</b>   | <b>129,469</b>    | <b>96,574</b>     |
| Deferred income taxes  | 8,030             | 7,723             |
| Commitments and contingencies  |                   |                   |
| Shareholders equity:   |                   |                   |
| Preferred stock, \$10.00 par value; 1,000,000 shares authorized, none issued           | 481               | 481               |

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|  |            |            |
|--|------------|------------|
| Common stock, \$0.01 par value; 100,000,000 shares authorized; 48,147,969 shares issued in 2008 and 2007 |            |            |
| Additional paid-in capital   | 151,245    | 149,568    |
| Accumulated other comprehensive loss, net of tax   | (387)      |            |
| Retained earnings  | 50,494     | 35,632     |
| Treasury stock, at cost; 12,333,549 and 9,528,467 shares in 2008 and 2007, respectively                  | (87,571)   | (48,470)   |
| Total shareholders' equity   | 114,262    | 137,211    |
|  | \$ 251,761 | \$ 241,508 |

See accompanying notes.

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Tyler Technologies, Inc.  
 Statements of Shareholders' Equity  
 For the years ended December 31, 2008, 2007 and 2006  
 In thousands

|  | Common |        | Additional<br>Paid-in<br>Capital | Accumulated<br>Other<br>Comprehensive<br>Income<br>(Loss) | Retained<br>Earnings | Treasury Stock |             | Total<br>Shareholders'<br>Equity |
|--|--------|--------|----------------------------------|---|----------------------|----------------|-------------|----------------------------------|
|  | Shares | Amount |                                  |   |                      | Shares         | Amount      |                                  |
| Balance at<br>December 31,<br>2005                                       | 48,148 | \$ 481 | \$ 151,515                       | \$  | \$ 3,769             | (9,273)        | \$ (43,568) | \$ 112,197                       |
| Comprehensive<br>income:   |        |        |                                  |   |                      |                |             |                                  |
| Net income   |        |        |                                  |   | 14,362               |                |             | 14,362                           |
| Unrealized loss on<br>investment<br>securities, net of<br>tax            |        |        |                                  | (10)  |                      |                |             | (10)                             |
| Total<br>comprehensive<br>income   |        |        |                                  |   |                      |                |             | 14,352                           |
| Issuance of shares<br>pursuant to stock<br>compensation plan             |        |        | (3,158)                          |   |                      | 623            | 6,074       | 2,916                            |
| Stock<br>compensation  |        |        | 1,960                            |   |                      |                |             | 1,960                            |
| Treasury stock<br>purchases  |        |        |                                  |   |                      | (1,033)        | (10,531)    | (10,531)                         |
| Issuance of shares<br>pursuant to<br>Employee Stock<br>Purchase Plan     |        |        | 22                               |   |                      | 102            | 918         | 940                              |
| Federal income tax<br>benefit related to<br>exercise of stock<br>options |        |        | 1,150                            |   |                      |                |             | 1,150                            |
| Issuance of shares<br>for acquisitions                                   |        |        | 138                              |   |                      | 325            | 2,753       | 2,891                            |
| Balance at<br>December 31,<br>2006                                       | 48,148 | 481    | 151,627                          | (10)  | 18,131               | (9,256)        | (44,354)    | 125,875                          |
| Comprehensive<br>income:   |        |        |                                  |   |                      |                |             |                                  |
| Net income   |        |        |                                  |   | 17,501               |                |             | 17,501                           |

|   |        |     |         |       |         |          |          |          |
|---|--------|-----|---------|-------|---------|----------|----------|----------|
| Unrealized gain on investment securities, net of tax            |        |     |         | 10    |         |          |          | 10       |
| Total comprehensive income                                      |        |     |         |       |         |          |          | 17,511   |
| Issuance of shares pursuant to stock compensation plan          |        |     | (7,339) |       | 878     | 10,928   |          | 3,589    |
| Stock compensation  |        |     | 2,365   |       |         |          |          | 2,365    |
| Treasury stock purchases  |        |     |         |       | (1,250) | (16,163) |          | (16,163) |
| Issuance of shares pursuant to Employee Stock Purchase Plan     |        |     | (2)     |       | 100     | 1,119    |          | 1,117    |
| Federal income tax benefit related to exercise of stock options |        |     | 2,917   |       |         |          |          | 2,917    |
| Balance at December 31, 2007                                    | 48,148 | 481 | 149,568 |       | 35,632  | (9,528)  | (48,470) | 137,211  |
| Comprehensive income:   |        |     |         |       |         |          |          |          |
| Net income  |        |     |         |       | 14,862  |          |          | 14,862   |
| Unrealized loss on investment securities, net of tax            |        |     |         | (387) |         |          |          | (387)    |
| Total comprehensive income                                      |        |     |         |       |         |          |          | 14,475   |
| Issuance of shares pursuant to stock compensation plan          |        |     | (3,495) |       | 379     | 5,310    |          | 1,815    |
| Stock compensation  |        |     | 3,820   |       |         |          |          | 3,820    |
| Treasury stock purchases  |        |     |         |       | (4,283) | (58,984) |          | (58,984) |
| Issuance of shares pursuant to Employee Stock Purchase Plan     |        |     | (186)   |       | 101     | 1,376    |          | 1,190    |

|   |        |        |            |          |           |          |             |    |         |
|---|--------|--------|------------|----------|-----------|----------|-------------|----|---------|
| Federal income tax benefit related to exercise of stock options |        |        |            | 822      |           |          |             |    | 822     |
| Issuance of shares in connection with legal settlement          |        |        |            | 455      |           | 802      | 10,595      |    | 11,050  |
| Issuance of shares for acquisitions                             |        |        |            | 261      |           | 196      | 2,602       |    | 2,863   |
| Balance at December 31, 2008                                    | 48,148 | \$ 481 | \$ 151,245 | \$ (387) | \$ 50,494 | (12,333) | \$ (87,571) | \$ | 114,262 |

See accompanying notes.

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Tyler Technologies, Inc.  
 Statements of Cash Flows  
 For the years ended December 31  
 In thousands

|  | 2008      | 2007      | 2006      |
|--|-----------|-----------|-----------|
| Cash flows from operating activities:  |           |           |           |
| Net income   | \$ 14,862 | \$ 17,501 | \$ 14,362 |
| Adjustments to reconcile net income to net cash provided by operating activities:        |           |           |           |
| Depreciation and amortization  | 12,611    | 11,211    | 10,102    |
| Non-cash legal settlement related to warrants  | 9,045     |           |           |
| Share-based compensation expense   | 3,820     | 2,365     | 1,960     |
| Purchased in-process research and development charge                                     |           |           | 140       |
| Non-cash interest and other charges  |           |           | 220       |
| Provision for losses accounts receivable   | 1,764     | 753       | 2,077     |
| Excess tax benefit from exercises of share-based arrangements                            | (666)     | (1,891)   | (614)     |
| Deferred income tax benefit  | (2,151)   | (1,598)   | (2,520)   |
| Changes in operating assets and liabilities, exclusive of effects of acquired companies: |           |           |           |
| Accounts receivable  | (11,853)  | (1,575)   | (10,400)  |
| Income tax payable   | 827       | 3,919     | 536       |
| Prepaid expenses and other current assets  | (338)     | (304)     | (1,496)   |
| Accounts payable   | (870)     | (1,955)   | 1,626     |
| Accrued liabilities  | 3,420     | (1,619)   | 972       |
| Deferred revenue   | 17,331    | 7,304     | 9,839     |
| Net cash provided by operating activities  | 47,802    | 34,111    | 26,804    |
| Cash flows from investing activities:  |           |           |           |
| Proceeds from sales of investments   | 45,065    | 45,480    | 19,016    |
| Purchases of investments   | (8,625)   | (67,545)  | (26,825)  |
| Cost of acquisitions, net of cash acquired   | (23,868)  | (9,005)   | (12,237)  |
| Additions to property and equipment  | (20,143)  | (3,678)   | (4,088)   |
| Investment in software development costs   |           | (167)     | (236)     |
| Acquired lease   | (1,387)   |           |           |
| (Increase) decrease in restricted investments  | (620)     | 500       | 38        |
| Decrease in other  | 24        | 140       | 6         |
| Net cash used by investing activities  | (9,554)   | (34,275)  | (24,326)  |
| Cash flows from financing activities:  |           |           |           |
| Purchase of treasury shares  | (59,847)  | (14,037)  | (10,531)  |
| Net borrowings on revolving credit facility  | 8,000     |           |           |
| Contributions from employee stock purchase plan  | 1,233     | 1,151     | 1,002     |
| Proceeds from exercise of stock options  | 1,815     | 3,589     | 2,916     |
| Excess tax benefits from exercise of share-based arrangements                            | 666       | 1,891     | 614       |



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|  |          |          |           |
|--|----------|----------|-----------|
| Warrant exercise in connection with legal settlement | 2,005    |          |           |
| Net cash used by financing activities                | (46,128) | (7,406)  | (5,999)   |
| Net decrease in cash and cash equivalents            | (7,880)  | (7,570)  | (3,521)   |
| Cash and cash equivalents at beginning of year       | 9,642    | 17,212   | 20,733    |
| Cash and cash equivalents at end of year             | \$ 1,762 | \$ 9,642 | \$ 17,212 |

See accompanying notes

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

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

DESCRIPTION OF BUSINESS

We provide integrated software systems and related services for local governments. We develop and market a broad line of software solutions 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, 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.

Tyler s business is subject to risks and uncertainties including dependence on IT spending by customers, general economic conditions, fluctuations of quarterly results, a lengthy and variable sales cycle, dependence on key personnel, dependence on principal products and third-party technology and rapid technological change. In addition, our products are complex and we run the risk of errors or defects with new product introductions or enhancements.

CASH AND CASH EQUIVALENTS

Cash in excess of that necessary for operating requirements is invested in short-term, highly liquid, income-producing investments. Investments with original maturities of three months or less are classified as cash and cash equivalents, which primarily consist of money market funds. Cash and cash equivalents are stated at cost, which approximates market value.

We maintain a \$6.0 million Letter of Credit facility under which the bank issues cash collateralized letters of credit. As of December 31, 2008, approximately \$5.1 million of our cash equivalents are restricted and designated as collateral for our letters of credit issued in connection with our surety bond program. These letters of credit expire through mid 2009.

INVESTMENTS

Investments consist of auction rate municipal securities. These investments are classified as available-for-sale securities and are stated at fair value in accordance with Statement of Financial Accounting Standards ( SFAS ) No. 157, Fair Value Measurements. Unrealized holding gains and losses, net of the related tax effect, if any, are not reflected in earnings but are reported as a separate component of other comprehensive income until realized. The cost basis of securities sold is determined using the average cost method. We account for the transactions as Proceeds from sales of investments for the security relinquished, and a Purchase of investments for the security purchased, in the accompanying Statement of Cash Flows.

REVENUE RECOGNITION

Software Arrangements:

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

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

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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.

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### **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 ) No. 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.

### **Allocation of Revenue in Statement of Operations**

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



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determine the license fee. Management's best estimate of fair value of undelivered elements for which VSOE of fair value has not been established is based upon the VSOE of similar offerings and other objective criteria.

### **Appraisal Services:**

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

### **Other:**

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

### **USE OF ESTIMATES**

The preparation of our financial statements in conformity with accounting principles generally accepted in the United States ( GAAP ) requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant items subject to such estimates and assumptions include the application of the percentage-of-completion and proportionate performance methods of revenue recognition, the carrying amount and estimated useful lives of intangible assets, determination of share-based compensation expense and valuation allowance for receivables. Actual results could differ from estimates.

### **PROPERTY AND EQUIPMENT, NET**

Property, equipment and purchased software are recorded at original cost and increased by the cost of any significant improvements after purchase. We expense maintenance and repairs when incurred. Depreciation and amortization is calculated using the straight-line method over the shorter of the asset's estimated useful life or the term of the lease in the case of leasehold improvements. For income tax purposes, we use accelerated depreciation methods as allowed by tax laws.

### **RESEARCH AND DEVELOPMENT COSTS**

We expensed research and development costs of \$7.3 million during 2008, \$4.4 million during 2007 and \$3.3 million during 2006. In 2008 and 2007, we reduced our research and development expense by approximately \$1.8 million and \$1.6 million, respectively, which was the amount earned under the terms of our strategic alliance with a development partner.





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### **INCOME TAXES**

Income taxes are accounted for under the asset and liability method. Deferred taxes arise because of different treatment between financial statement accounting and tax accounting, known as temporary differences. We record the tax effect of these temporary differences as deferred tax assets (generally items that can be used as a tax deduction or credit in the future periods) and deferred tax liabilities (generally items that we received a tax deduction for, which have not yet been recorded in the income statement). The deferred tax assets and liabilities are measured using enacted tax rules and laws that are expected to be in effect when the temporary differences are expected to be recovered or settled. A valuation allowance would be established to reduce deferred tax assets if it is likely that a deferred tax asset will not be realized.

### **SHARE-BASED COMPENSATION**

We have a stock option plan that provides for the grant of stock options to key employees, directors and non-employee consultants. Stock options vest after three to five years of continuous service from the date of grant and have a contractual term of ten years. We account for share-based compensation utilizing the fair value recognition provisions of SFAS No. 123R, Share-Based Payment. See Note 10 Share-Based Compensation for further information.

### **SEGMENT AND RELATED INFORMATION**

Although we have a number of operating divisions, separate segment data has not been presented as they meet the criteria for aggregation as permitted by SFAS No. 131, Disclosures About Segments of an Enterprise and Related Information.

### **GOODWILL AND OTHER INTANGIBLE ASSETS**

We have used the purchase method of accounting for all of our business combinations. Our business acquisitions result in the allocation of the purchase price to goodwill and other intangible assets. We first allocate the cost of acquired companies to identifiable assets based on estimated fair values. The excess of the purchase price over the fair value of identifiable assets acquired, net of liabilities assumed, is recorded as goodwill.

Under SFAS No. 142, Goodwill and Other Intangible Assets, we evaluate goodwill for impairment annually as of April, or more frequently if impairment indicators arise. An impairment loss is recognized to the extent that the carrying amount exceeds the asset's fair value. The fair values calculated in our impairment tests are determined using discounted cash flow models involving several assumptions. These assumptions include, but are not limited to, anticipated operating income growth rates, our long-term anticipated operating income growth rate and the discount rate. The assumptions that are used are based upon what we believe a hypothetical marketplace participant would use in estimating fair value. In the implementation of SFAS No. 142, we identified two reporting units for impairment testing. The appraisal services and appraisal software stand-alone business unit qualified as a reporting unit since it is one level below an operating segment, discrete financial information exists for the business unit and the executive management group directly reviews this business unit. The other software business units were aggregated into the other single reporting unit. The appraisal services and appraisal software stand-alone business unit is organized in such a manner that both of its revenue sources are tightly integrated with each other and discrete financial information at the operating profit level does not exist for this business unit's respective revenue sources. There have been no significant impairments of goodwill or other intangibles.

### **IMPAIRMENT OF LONG-LIVED ASSETS**

We periodically evaluate whether current facts or circumstances indicate that the carrying value of our property and equipment or other long-lived assets to be held and used may not be recoverable. If such circumstances are determined to exist, we measure the recoverability of assets to be held and used by a comparison of the carrying amount of the asset or appropriate grouping of assets and the estimated undiscounted future cash flows expected to be generated by the assets. If the carrying amount of the assets exceeds their estimated future cash flows, an impairment charge is recognized for the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of would be separately presented in the balance sheet and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated. The assets and liabilities of a disposed group classified as held for sale would be presented separately in the appropriate asset and liability sections of the balance sheet. There have been no significant impairments of long-lived assets.



**Table of Contents****COSTS OF COMPUTER SOFTWARE**

Software development costs have been accounted for in accordance with SFAS No. 86, Accounting for the Costs of Computer Software to be Sold, Leased, or Otherwise Marketed. Under SFAS No. 86, capitalization of software development costs begins upon the establishment of technological feasibility and prior to the availability of the product for general release to customers. We did not capitalize any software development costs in 2008. We capitalized software development costs of approximately \$167,000 during 2007, and \$236,000 during 2006. Software development costs primarily consist of personnel costs and rent for related office space. We begin to amortize capitalized costs when a product is available for general release to customers. Amortization expense is determined on a product-by-product basis at a rate not less than straight-line basis over the product's remaining estimated economic life, but not to exceed five years. Amortization of software development costs was approximately \$4.7 million in 2008, \$4.6 million in 2007, and \$5.1 million in 2006 and is included in cost of software license revenue in the accompanying statements of operations.

**FAIR VALUE OF FINANCIAL INSTRUMENTS**

Cash and cash equivalents, accounts receivables, accounts payables, short-term obligations, deferred revenues and certain other assets at cost approximate fair value because of the short maturity of these instruments. In accordance with SFAS No. 157 Fair Value Measurements, our investments available-for-sale are recorded at fair value as of December 31, 2008 based upon the level of judgment associated with the inputs used to measure their fair value. See Note 3 Fair Value of Financial Instruments for further information.

**CONCENTRATIONS OF CREDIT RISK AND UNBILLED RECEIVABLES**

Concentrations of credit risk with respect to receivables are limited due to the size and geographical diversity of our customer base. Historically, our credit losses have not been significant. As a result, we do not believe we have any significant concentrations of credit risk as of December 31, 2008.

We maintain allowances for doubtful accounts and sales adjustments, which are provided at the time the revenue is recognized. Since most of our customers are domestic governmental entities, we rarely incur a loss resulting from the inability of a customer to make required payments. Events or changes in circumstances that indicate that the carrying amount for the allowances for doubtful accounts and sales adjustments may require revision, include, but are not limited to, deterioration of a customer's financial condition, failure to manage our customer's expectations regarding the scope of the services to be delivered, and defects or errors in new versions or enhancements of our software products. The following table summarizes the changes in the allowances for doubtful accounts and sales adjustments:

|   | Years ended December 31, |          |          |
|---|--------------------------|----------|----------|
|   | 2008                     | 2007     | 2006     |
| Balance at beginning of year                          | \$ 1,851                 | \$ 2,971 | \$ 1,991 |
| Provisions for losses - accounts receivable           | 1,764                    | 753      | 2,077    |
| Collection of accounts previously written off         | 10                       |          | 11       |
| Deductions for accounts charged off or credits issued | (1,510)                  | (1,873)  | (1,108)  |
| Balance at end of year                                | \$ 2,115                 | \$ 1,851 | \$ 2,971 |

The termination clauses in most of our contracts provide for the payment for the fair value of products delivered or services performed in the event of early termination. Our property appraisal outsourcing service contracts can range up to three years and, in a few cases, as long as five years in duration. In connection with these contracts, as well as certain software service contracts, we may perform work prior to when the software and services are billable and/or payable pursuant to the contract. We have historically recorded such unbilled receivables (costs and estimated profit in excess of billings) in connection with (1) property appraisal services contracts accounted for using proportionate performance accounting in which the revenue is earned based upon activities performed in one accounting period but the billing normally occurs shortly thereafter and may span another accounting period; (2) software services contracts accounted for using the percentage-of-completion method of revenue recognition using labor hours as a measure of progress towards completion in which the services are performed in one accounting period but the billing for the

software element of the arrangement may be based upon the specific phase of the implementation; (3) software revenue for which we have objective evidence that the customer-specified objective criteria has been met but the billing has not yet been submitted to the customer; and (4) in a limited number of cases, we may grant extended payment terms generally to existing customers with whom we have a long-term

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relationship and favorable collection history. In addition, certain of our property appraisal outsourcing contracts are required by law to have an amount withheld from a progress billing (generally a 10% retention) until final and satisfactory project completion is achieved, typically upon the completion of fieldwork or formal hearings. In connection with this activity, we have recorded unbilled receivables of \$13.7 million and \$11.2 million at December 31, 2008 and 2007, respectively. We also have recorded retention receivable of \$1.5 million and \$3.9 million at December 31, 2008 and 2007, respectively, and these retentions become payable upon the completion of the contract or completion of our field work and formal hearings. Unbilled receivables and retention receivables expected to be collected in excess of one year have been classified as accounts receivable, long-term portion in the accompanying balance sheets.

**INDEMNIFICATION**

Most of our software license agreements indemnify our customers in the event that the software sold infringes upon the intellectual property rights of a third party. These agreements typically provide that in such event we will either modify or replace the software so that it becomes non-infringing or procure for the customer the right to use the software. We have recorded no liability associated with these indemnifications, as we are not aware of any pending or threatened infringement actions that are possible losses. We believe the estimated fair value of these intellectual property indemnification clauses is minimal.

We have also agreed to indemnify our officers and board members if they are named or threatened to be named as a party to any proceeding by reason of the fact that they acted in such capacity. A form of the indemnification agreement was filed as Exhibit 10.1 to our Form 10-K for the year ended December 31, 2002. We maintain directors and officers insurance coverage to protect against any such losses. We have recorded no liability associated with these indemnifications. Because of our insurance coverage, we believe the estimated fair value of these indemnification agreements is minimal.

**NEW ACCOUNTING PRONOUNCEMENTS**

In December 2007, the Financial Accounting Standards Board ( FASB ) issued SFAS No. 141R Business Combinations. SFAS No. 141R 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. 141R is effective for fiscal years beginning after December 15, 2008, with early adoption prohibited. The adoption of SFAS No. 141 R is not expected to have a material impact on our financial statements or related disclosures.

In April 2008, the FASB issued FASB Staff Position ( FSP ) No. 142-3, Determination of the Useful Life of Intangible Assets. FSP No. 142-3 amends the factors an entity should consider in developing renewal or extension assumptions used in determining the useful life of recognized intangible assets under FASB Statement No. 142, Goodwill and Other Intangible Assets. This new guidance applies prospectively to intangible assets that are acquired individually or with a group of other assets in business combinations and asset acquisitions. FSP No. 142-3 is effective for financial statements issued for fiscal years and interim periods beginning after December 15, 2008. Early adoption is prohibited. The adoption of FSP No. 142-3 is not expected to have a material impact on our financial statements or related disclosures.

**(2) 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

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including transaction costs, was approximately \$13.9 million in cash and approximately 126,000 shares of Tyler common stock valued at \$1.7 million.

Our balance sheet as of December 31, 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. In connection with these three transactions we acquired total tangible assets of approximately \$3.5 million and assumed total liabilities of approximately \$8.2 million. We recorded goodwill of \$17.1 million, \$7.8 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.

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 September 2007, we completed the acquisition of all the capital stock of EDP Enterprises, Inc. ( EDP ), which develops and sells financial and student information and management systems for public school districts in Texas. In February 2007, we completed the acquisition of all of the capital stock of Advanced Data Systems, Inc. ( ADS ), which develops and sells fund accounting solutions, primarily in New England. The combined purchase price, including transaction costs along with an office building used in ADS 's business and excluding cash balances acquired, for these acquisitions as well as miscellaneous other software asset purchases was \$9.0 million.

**(3) FAIR VALUE OF FINANCIAL INSTRUMENTS**

In 2006 the FASB issued SFAS No. 157, Fair Value Measurements. SFAS No. 157 does not establish requirements for any new fair value measurements, but it does apply to existing accounting pronouncements in which fair value measurements are already required. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in accordance with accounting principles generally accepted in the United States, and expands disclosures about fair value measurements. We adopted the principles of SFAS No. 157 as of January 1, 2008, for financial instruments. SFAS No. 157 establishes a three-tier fair value hierarchy, which prioritize the inputs used in measuring fair value. These tiers include the following:

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

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

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

As of December 31, 2008 we held certain items that are required to be measured at fair value on a recurring basis. The fair value of these financial assets was determined using the following inputs at December 31, 2008:

|  | Total     | Quoted prices<br>in<br>active markets<br>for<br>identical<br>assets<br>(Level 1) | Significant<br>other<br>observable<br>inputs<br>(Level 2) | Significant<br>unobservable<br>inputs<br>(Level 3) |
|--|-----------|--|---|--|
| Cash and cash equivalents                  | \$ 6,844  | \$ 6,844   | \$  | \$   |
| Short-term investments available-for-sale  | 775       | 775  |   |  |
| Non-current investments available-for-sale | 3,779     |  |   | 3,779  |
|  | \$ 11,398 | \$ 7,619   | \$  | \$ 3,779   |

Cash and cash equivalents consist primarily of money market funds with original maturity dates of three months or less, for which we determine fair value through quoted market prices.

Investments available-for-sale consist of auction rate municipal securities ( ARS ) which are collateralized debt obligations supported by municipal and state agencies and do not include mortgage-backed securities. Short-term investments available-for-sale consists of ARS which were sold at par during the period January 1, 2009 through February 20, 2009.

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All of our non-current ARS are reflected at estimated fair value in the balance sheet at December 31, 2008. In prior periods, due to the auction process which took place every 28 to 35 days for most ARS, quoted market prices were readily available, which would have qualified as Level 1 under SFAS No. 157. However, due to recent events in credit markets beginning during the first quarter of 2008, the auction events for most of these securities failed. Therefore, quoted prices in active markets are no longer available and we determined the estimated fair values of these securities utilizing a discounted trinomial model. The model considers the probability of three potential occurrences for each auction event through the maturity date of each ARS. The three potential outcomes for each auction are (i) successful auction/early redemption, (ii) failed auction and (iii) issuer default. Inputs in determining the probabilities of the potential outcomes include but are not limited to, the securities collateral, credit rating, insurance, issuer's financial standing, contractual restrictions on disposition and the liquidity in the market. The fair value of each ARS is determined by summing the present value of the probability-weighted future principal and interest payments determined by the model.

In association with this estimate of fair value, we have recorded an after tax temporary unrealized loss on our non-current ARS of \$387,000, net of related tax effects of \$209,000 in 2008, which is included in accumulated other comprehensive loss on our balance sheet. As of December 31, 2008 we have continued to earn and collect interest on all of our ARS. We believe that this temporary decline in fair value is due entirely to liquidity issues, because the underlying assets of these securities are supported by municipal 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. In addition, 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 \$6.8 million, expected operating cash flows and the liquidation of \$775,000 of ARS subsequent to the period ending December 31, 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 have classified these securities as non-current because we believe the market for these securities may take in excess of twelve months to fully recover. We will continue to evaluate any changes in the market value of our non-current ARS and in the future, depending upon existing market conditions, we may be required to record an other-than-temporary decline in market value.

The following table reflects the activity for assets measured at fair value using Level 3 inputs for the year ended December 31, 2008:

|  |          |
|--|----------|
| Balance as of December 31, 2007                                    | \$       |
| Transfers into level 3   | 5,150    |
| Transfers out of level 3   | (775)    |
| Unrealized losses included in accumulated other comprehensive loss | (596)    |
| Balance as of December 31, 2008                                    | \$ 3,779 |

**(4) PROPERTY AND EQUIPMENT, NET**

Property and equipment, net consists of the following at December 31:

|   | Useful<br>Lives<br>(years) | 2008     | 2007   |
|---|----------------------------|----------|--------|
| Land                                      |                            | \$ 3,349 | \$ 179 |
| Computer equipment and purchased software | 3-5                        | 19,553   | 18,502 |
| Furniture and fixtures                    | 5                          | 5,103    | 4,625  |
| Building and leasehold improvements       | 5-35                       | 16,248   | 4,099  |

|   |   |           |          |
|---|---|-----------|----------|
| Transportation equipment                  | 5 | 266       | 279      |
|   |   | 44,519    | 27,684   |
| Accumulated depreciation and amortization |   | (17,997)  | (17,858) |
| Property and equipment, net               |   | \$ 26,522 | \$ 9,826 |

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Depreciation expense was \$3.5 million during 2008, \$2.8 million during 2007, and \$2.4 million during 2006. We purchased an office building in Yarmouth, Maine in mid-2008 which is leased to third-party tenants. These leases expire between 2011 and 2013 and are expected to provide rental income of approximately \$1.3 million during both 2009 and 2010, \$877,000 during 2011, \$406,000 during 2012 and \$169,000 during 2013. Upon expiration of these agreements we expect to begin occupying the facility. Rental income associated with these leases in 2008 was \$662,000 and was included as a reduction of selling, general and administrative expenses.

**(5) GOODWILL AND OTHER INTANGIBLE ASSETS**

Intangible assets and related accumulated amortization consists of the following at December 31:

|   | 2008       | 2007      |
|---|------------|-----------|
| Gross carrying amount of acquisition intangibles: |            |           |
| Goodwill  | \$ 88,791  | \$ 71,677 |
| Customer related intangibles                      | 38,887     | 26,858    |
| Software acquired                                 | 22,143     | 20,093    |
| Trade name  | 1,971      | 1,681     |
| Lease acquired                                    | 1,387      |           |
|   | 153,179    | 120,309   |
| Accumulated amortization                          | (30,825)   | (26,450)  |
| Acquisition intangibles, net                      | \$ 122,354 | \$ 93,859 |
| Post acquisition software development costs       | \$ 36,701  | \$ 36,701 |
| Accumulated amortization                          | (35,243)   | (30,515)  |
| Post acquisition software costs, net              | \$ 1,458   | \$ 6,186  |

Total amortization expense for acquisition related intangibles and post acquisition software development costs was \$9.1 million during 2008, \$8.4 million during 2007, and \$7.7 million during 2006.

The allocation of acquisition intangible assets is summarized in the following table:

|                                 | December 31, 2008           |   |                             | December 31, 2007           |   |                             |
|---------------------------------|-----------------------------|---|-----------------------------|-----------------------------|---|-----------------------------|
|                                 | Gross<br>Carrying<br>Amount | Weighted<br>Average<br>Amortization<br>Period | Accumulated<br>Amortization | Gross<br>Carrying<br>Amount | Weighted<br>Average<br>Amortization<br>Period | Accumulated<br>Amortization |
| Non-amortizable<br>intangibles: |                             |   |                             |                             |   |                             |
| Goodwill                        | \$88,791                    |   | \$                          | \$71,677                    |   | \$                          |
| Amortizable intangibles:        |                             |   |                             |                             |   |                             |
| Customer related<br>intangibles | 38,887                      | 18 years                                      | 11,449                      | 26,858                      | 21 years                                      | 9,152                       |
| Software acquired               | 22,143                      | 5 years                                       | 18,489                      | 20,093                      | 5 years                                       | 16,691                      |
| Trade name                      | 1,971                       | 19 years                                      | 749                         | 1,681                       | 21 years                                      | 607                         |
| Lease acquired                  | 1,387                       | 5 years                                       | 138                         |                             |   |                             |

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The changes in the carrying amount of goodwill for the two years ended December 31, 2008 are as follows:

|   |           |
|---|-----------|
| Balance as of December 31, 2006   | \$ 66,127 |
| Goodwill acquired during the year related to the purchase of ADS          | 2,240     |
| Goodwill acquired during the year related to the purchase of EDP          | 3,187     |
| Other   | 123       |
| Balance as of December 31, 2007   | 71,677    |
| Goodwill acquired during the year related to the purchase of VersaTrans   | 9,278     |
| Goodwill acquired during the year related to the purchase of SIS          | 6,351     |
| Goodwill acquired during the year related to the purchase of Schoolmaster | 1,475     |
| Other   | 10        |
| Balance as of December 31, 2008   | \$ 88,791 |

Estimated annual amortization expense relating to acquisition intangibles, including acquired software for which the amortization expense is recorded as cost of revenues and acquired leases for which amortization expense is recorded as selling, general and administrative expenses, is as follows:

|                           |         |
|---------------------------|---------|
| Years ending December 31, |         |
| 2009                      | \$4,093 |
| 2010                      | 4,093   |
| 2011                      | 3,510   |
| 2012                      | 3,228   |
| 2013                      | 2,679   |

**(6) ACCRUED LIABILITIES**

Accrued liabilities consist of the following at December 31:

|  |           |           |
|--|-----------|-----------|
|  | 2008      | 2007      |
| Accrued wages, bonuses and commissions | \$ 13,908 | \$ 10,029 |
| Other accrued liabilities              | 4,474     | 3,744     |
| Accrued treasury stock purchases       | 1,263     | 2,126     |
| Accrued health claims                  | 1,921     | 1,806     |
| Accrued third party contract costs     | 1,347     | 1,200     |
|  | \$ 22,913 | \$ 18,905 |

**(7) SHORT-TERM OBLIGATION**

On October 20, 2008, we entered into a 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 bear interest at a rate of either LIBOR plus 1% or prime rate minus 1.5%. As of December 31, 2008, our effective interest rate was 1.47% under the Credit Facility. The effective average interest rate for borrowings during the period October 20 through December 31, 2008 was 2.1%. The Credit Facility is secured by substantially all of our personal property. The Credit Facility requires us to maintain certain financial ratios and other financial conditions and prohibits us from making certain investments, advances, cash dividends or loans, restricts the amount of our common stock we may purchase and limits incurrence of additional indebtedness and liens.

As of December 31, 2008, we were in compliance with those covenants.

As of December 31, 2008, we had outstanding borrowings of \$8.0 million and unused available borrowing capacity of \$17.0 million under the Credit Facility. In addition, as of December 31, 2008, our bank had issued outstanding letters of credit totaling \$5.1 million to secure surety bonds required by some of our customer contracts. These letters of credit have been collateralized by restricted cash

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balances invested in a certificate of deposit and expire through mid-2009. The carrying amount of the Credit Facility approximates fair value due to the short-term nature of the instrument.

**(8) INCOME TAX**

The income tax provision (benefit) on income from operations consists of the following:

|          | Years ended December 31, |           |          |
|----------|--------------------------|-----------|----------|
|          | 2008                     | 2007      | 2006     |
| Current: |                          |           |          |
| Federal  | \$ 14,320                | \$ 10,593 | \$ 9,701 |
| State    | 2,245                    | 2,084     | 1,312    |
|          | 16,565                   | 12,677    | 11,013   |
| Deferred | (2,151)                  | (1,598)   | (2,520)  |
|          | \$ 14,414                | \$ 11,079 | \$ 8,493 |

Reconciliation of the U.S. statutory income tax rate to our effective income tax expense rate for operations follows:

|   | Years ended December 31, |           |          |
|---|--------------------------|-----------|----------|
|   | 2008                     | 2007      | 2006     |
| Income tax expense at statutory rate                | \$ 10,247                | \$ 10,003 | \$ 7,999 |
| State income tax, net of federal income tax benefit | 1,089                    | 1,321     | 430      |
| Non-deductible business expenses                    | 3,988                    | 608       | 518      |
| Qualified manufacturing activities                  | (700)                    | (490)     | (263)    |
| Other, net  | (210)                    | (363)     | (191)    |
|   | \$ 14,414                | \$ 11,079 | \$ 8,493 |

In 2008, non-deductible business expenses include the impact of a non-cash legal settlement related to warrants charge of \$9.0 million, which was not tax deductible. See Note 14 Commitments and Contingencies for more information. Slightly less than half of our unvested stock option awards qualify as an incentive stock option ( ISO ) for income tax purposes. As such, a tax benefit is not recorded at the time the compensation cost related to the options is recorded for book purposes due to the fact that an ISO does not ordinarily result in a tax benefit unless there is a disqualifying disposition. Stock option grants of non-qualified options result in the creation of a deferred tax asset, which is a temporary difference, until the time that the option is exercised. Due to the treatment of ISOs for tax purposes, our effective tax rate from year to year is subject to variability.

The tax effects of the major items recorded as deferred tax assets and liabilities as of December 31 are:

|   | 2008     | 2007     |
|---|----------|----------|
| Deferred income tax assets:                 |          |          |
| Operating expenses not currently deductible | \$ 1,466 | \$ 1,502 |
| Employee benefit plans                      | 2,528    | 1,687    |
| Capital loss carryforward                   | 221      |          |
| Property and equipment                      | 203      | 114      |
| Total deferred income tax assets            | 4,418    | 3,303    |
| Deferred income tax liabilities:            |          |          |
| Intangible assets                           | (9,697)  | (8,504)  |

|                                       |            |            |
|---------------------------------------|------------|------------|
| Other                                 | (181)      | (167)      |
| Total deferred income tax liabilities | (9,878)    | (8,671)    |
| Net deferred income tax liabilities   | \$ (5,460) | \$ (5,368) |

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Although realization is not assured, we believe it is more likely than not that all the deferred tax assets at December 31, 2008 and 2007 will be realized. Accordingly, we believe no valuation allowance is required for the deferred tax assets. However, the amount of the deferred tax asset considered realizable could be adjusted in the future if estimates of reversing taxable temporary differences are revised.

No reserves for uncertain income tax positions have been recorded pursuant to Financial Standards Accounting Board Interpretation ( FIN ) No. 48, Accounting for Uncertainty in Income Taxes.

We are subject to U.S. federal tax as well as income tax of multiple state and local jurisdictions. We are no longer subject to United States federal income tax examinations for years before 2006 and are no longer subject to state and local income tax examinations by tax authorities for the years before 2004.

We paid income taxes, net of refunds received, of \$15.7 million in 2008, \$8.7 million in 2007, and \$10.4 million in 2006.

**(9) SHAREHOLDERS EQUITY**

The following table details activity in our common stock:

|   | Years ended December 31, |             |         |             |         |             |
|---|--------------------------|-------------|---------|-------------|---------|-------------|
|   | 2008                     |             | 2007    |             | 2006    |             |
|   | Shares                   | Amount      | Shares  | Amount      | Shares  | Amount      |
| Purchases of common stock                         | (4,283)                  | \$ (58,984) | (1,250) | \$ (16,163) | (1,033) | \$ (10,531) |
| Stock option exercises                            | 379                      | 1,815       | 878     | 3,589       | 623     | 2,916       |
| Employee stock plan purchases                     | 101                      | 1,190       | 100     | 1,117       | 102     | 940         |
| Shares issued for acquisitions                    | 196                      | 2,863       |         |             | 325     | 2,891       |
| Shares issued in connection with legal settlement | 802                      | 11,050      |         |             |         |             |

Subsequent to December 31, 2008 and through February 20, 2009, we repurchased 419,000 shares for an aggregate purchase price of \$5.1 million. As of February 20, 2009 we had authorization from our board of directors to repurchase up to 1.1 million additional shares of our 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 14 Commitments and Contingencies for further information.

**(10) SHARE-BASED COMPENSATION****Share-Based Compensation Plan**

We have a stock option plan that provides for the grant of stock options to key employees, directors and non-employee consultants. Stock options vest after three to five years of continuous service from the date of grant and have a contractual term of ten years. Once options become exercisable, the employee can purchase shares of our common stock at the market price on the date we granted the option. We account for share-based compensation utilizing the fair value recognition provisions of SFAS No. 123R, Share-Based Payment.

As of December 31, 2008, there were 996,000 shares available for future grants under the plan from the 11.0 million shares previously approved by the stockholders.

**Determining Fair Value Under SFAS No. 123R**

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

Expected Life. The expected life of awards granted represents the period of time that they are expected to be outstanding. In





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December 2007, Staff Accounting Bulletin ( SAB ) No. 110 was issued which extends the use of the simplified method for those companies that conclude that it is not reasonable to base its estimate of expected life of options on its historical share option exercise experience. We have used the simplified method to estimate expected life since adopting SFAS No. 123R due to insufficient historical exercise data. In the late 1990s we made significant changes to our business and growth strategy and as a result our current optionee group has not been in place long enough to generate sufficient historical data to estimate the expected period of time an option award would be expected to be outstanding.

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

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

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

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

The following weighted average assumptions were used for options granted:

|                          | Years ended December 31, |       |       |
|--------------------------|--------------------------|-------|-------|
|                          | 2008                     | 2007  | 2006  |
| Expected life (in years) | 6.5                      | 6.5   | 6     |
| Expected volatility      | 40.9%                    | 42.6% | 45.0% |
| Risk-free interest rate  | 3.5%                     | 4.5%  | 4.9%  |
| Expected forfeiture rate | 3%                       | 3%    | 3%    |

**Share-Based Compensation Under SFAS No. 123R**

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

|  | Years ended December 31, |          |          |
|--|--------------------------|----------|----------|
|  | 2008                     | 2007     | 2006     |
| Cost of software services, maintenance and subscriptions | \$ 364                   | \$ 227   | \$ 147   |
| Selling, general and administrative expense              | 3,456                    | 2,138    | 1,813    |
| Total share-based compensation expense                   | 3,820                    | 2,365    | 1,960    |
| Tax benefit  | (846)                    | (451)    | (336)    |
| Net decrease in net income                               | \$ 2,974                 | \$ 1,914 | \$ 1,624 |

**Table of Contents****Stock Option Activity**

Options granted, exercised, forfeited and expired are summarized as follows:

|                                  | Number of<br>Shares | Weighted<br>Average<br>Price<br>Exercise | Weighted<br>Average<br>Remaining<br>Contractual<br>Life<br>(Years) | Aggregate<br>Intrinsic<br>Value |
|----------------------------------|---------------------|--|--|---------------------------------|
| Outstanding at December 31, 2005 | 4,608               | \$ 4.99                                  |  |                                 |
| Granted                          | 237                 | 10.76                                    |  |                                 |
| Exercised                        | (623)               | 4.68                                     |  |                                 |
| Forfeited                        | (127)               | 6.42                                     |  |                                 |
| Expired                          | (8)                 | 5.21                                     |  |                                 |
| Outstanding at December 31, 2006 | 4,087               | 5.32                                     |  |                                 |
| Granted                          | 773                 | 13.42                                    |  |                                 |
| Exercised                        | (878)               | 4.09                                     |  |                                 |
| Forfeited                        | (10)                | 8.29                                     |  |                                 |
| Outstanding at December 31, 2007 | 3,972               | 7.16                                     |  |                                 |
| Granted                          | 1,750               | 14.38                                    |  |                                 |
| Exercised                        | (379)               | 4.79                                     |  |                                 |
| Forfeited                        | (34)                | 10.82                                    |  |                                 |
| Outstanding at December 31, 2008 | 5,309               | 9.69                                     | 7  | \$17,474                        |
| Exercisable at December 31, 2008 | 2,463               | \$ 5.71                                  | 5  | \$15,656                        |

As of December 31, 2008, we had unvested options to purchase 2.8 million shares with a weighted average grant date fair value of \$6.28. As of December 31, 2008, we had \$14.3 million of total unrecognized compensation cost related to unvested options, net of expected forfeitures, which is expected to be amortized over a weighted average amortization period of 3.9 years.

Other information pertaining to option activity was as follows during the twelve months ended December 31:

|   | 2008    | 2007    | 2006    |
|---|---------|---------|---------|
| Weighted average grant-date fair value of stock options granted | \$ 6.73 | \$ 6.69 | \$ 6.13 |
| Total fair value of stock options vested                        | 2,600   | 1,710   | 1,757   |
| Total intrinsic value of stock options exercised                | 3,929   | 8,793   | 4,227   |

**Employee Stock Purchase Plan**

Under our Employee Stock Purchase Plan ( ESPP ) participants may contribute up to 15% of their annual compensation to purchase common shares of Tyler. The purchase price of the shares is equal to 85% of the closing price of Tyler shares on the last day of each quarterly offering period. As of December 31, 2008, there were 446,000 shares available for future grants under the ESPP from the 1.0 million shares originally reserved for issuance.

**Table of Contents****(11) EARNINGS PER SHARE**

Basic earnings and diluted earnings per share data were computed as follows:

|   | Years Ended December 31, |           |           |
|---|--------------------------|-----------|-----------|
|   | 2008                     | 2007      | 2006      |
| Numerator for basic and diluted earnings per share                          |                          |           |           |
| Net income  | \$ 14,862                | \$ 17,501 | \$ 14,362 |
| Denominator:  |                          |           |           |
| Weighted-average basic common shares outstanding                            | 37,714                   | 38,735    | 38,817    |
| Assumed conversion of dilutive securities:                                  |                          |           |           |
| Stock options   | 1,470                    | 1,715     | 1,799     |
| Warrants  |                          | 902       | 1,252     |
| Potentially dilutive common shares  | 1,470                    | 2,617     | 3,051     |
| Denominator for diluted earnings per share Adjusted weighted-average shares | 39,184                   | 41,352    | 41,868    |
| Earnings per common share:  |                          |           |           |
| Basic   | \$ 0.39                  | \$ 0.45   | \$ 0.37   |
| Diluted   | \$ 0.38                  | \$ 0.42   | \$ 0.34   |

Stock options representing the right to purchase common stock of 1.6 million shares in 2008, 128,000 shares in 2007, and 13,000 shares in 2006, were not included in the computation of diluted earnings per share because their inclusion would have had an antidilutive effect.

**(12) LEASES**

We lease office facilities for use in our operations, as well as transportation, computer and other equipment. We also have an office facility lease agreement with a shareholder. Most of our leases are noncancelable operating lease agreements and they expire at various dates through 2013. In addition to rent, the leases generally require us to pay taxes, maintenance, insurance and certain other operating expenses.

Rent expense was approximately \$5.9 million in 2008, and \$4.9 million in both 2007 and 2006, which included rent expense associated with related party lease agreements of \$1.8 million in both 2008 and in 2007, and \$1.7 million in 2006.

Future minimum lease payments under all noncancelable leases at December 31, 2008 are as follows:

|                           |           |
|---------------------------|-----------|
| Years ending December 31, |           |
| 2009                      | \$ 5,931  |
| 2010                      | 4,489     |
| 2011                      | 3,271     |
| 2012                      | 2,153     |
| 2013                      | 567       |
| Thereafter                |           |
|                           | \$ 16,411 |

Included in future minimum lease payments are noncancelable payments due to related parties of \$1.7 million in 2009, \$579,000 in 2010 and none thereafter.

**(13) EMPLOYEE BENEFIT PLANS**

We provide a defined contribution plan for the majority of our employees meeting minimum service requirements. The employees can contribute up to 30% of their current compensation to the plan subject to certain statutory limitations. We contribute up to a maximum of 2.5% of an employee's compensation to the plan. We made contributions to the plan and charged operations \$2.0 million during 2008, \$1.7 million during 2007, and \$1.6 million during 2006.

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(14) COMMITMENTS AND CONTINGENCIES

On November 3, 2008, a putative collective action complaint was filed against us in the United States District Court for the Eastern District of Texas on behalf of current and former customer support analysts, client liaisons, engineers, trainers, and education services specialists. The petition alleges that we misclassified these groups of employees as exempt rather than non-exempt under the Fair Labor Standards Act; therefore, the petition alleges that we failed to properly pay overtime wages. The suit was initiated by six former employees working out of our Longview, Texas, office and seeks to recover damages in the form of lost overtime pay since October 31, 2005, liquidated damages equal to the amount of lost overtime pay, interest, costs, and attorneys fees. We intend to vigorously defend the action. Given the preliminary nature of the alleged claims and the inherent unpredictability of litigation, we cannot at this time estimate the possible outcome of any such action.

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.

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

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**Table of Contents****(15) QUARTERLY FINANCIAL INFORMATION (unaudited)**

The following table contains selected financial information from unaudited statements of operations for each quarter of 2008 and 2007.

|   | Quarters Ended |          |                        |          |          |          |          |          |
|---|----------------|----------|------------------------|----------|----------|----------|----------|----------|
|   | 2008           |          |                        |          |          | 2007     |          |          |
|   | Dec. 31        | Sept. 30 | June 30 <sup>(A)</sup> | Mar. 31  | Dec. 31  | Sept. 30 | June 30  | Mar. 31  |
| Revenues  | \$69,544       | \$68,637 | \$67,569               | \$59,351 | \$60,420 | \$54,932 | \$54,112 | \$50,332 |
| Gross profit  | 28,945         | 29,950   | 29,089                 | 21,803   | 24,436   | 21,630   | 20,337   | 18,022   |
| Income before<br>income taxes                                   | 9,845          | 12,335   | 2,026                  | 5,070    | 10,128   | 8,369    | 6,160    | 3,923    |
| Net income  | 5,131          | 6,359    | 246                    | 3,126    | 6,190    | 5,160    | 3,750    | 2,401    |
| Earnings per<br>diluted share                                   | 0.14           | 0.16     | 0.01                   | 0.08     | 0.15     | 0.12     | 0.09     | 0.06     |
| Shares used in<br>computing<br>diluted<br>earnings per<br>share | 37,604         | 40,019   | 39,633                 | 39,527   | 40,358   | 41,395   | 41,448   | 42,066   |

(A) 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.

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