TYLER TECHNOLOGIES INC
Form 10-Q
October 26, 2006

Table of Contents

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

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

For the quarterly period ended September 30, 2006

OR

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

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

DELAWARE	75-2303920
(State or other jurisdiction of incorporation or organization)	(I.R.S. employer identification no.)

5949 SHERRY LANE, SUITE 1400
DALLAS, TEXAS
75225
(Address of principal executive offices)
(Zip code)
(972) 713-3700
(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.
(Check one): Large accelerated filer o Accelerated filer þ Non-accelerated filer o
Indicated by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act.) Yes o No þ
Number of shares of common stock of registrant outstanding at October 24, 2006: 38,817,719

TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION
- ITEM 1. Financial Statements
- ITEM 1A. Risk Factors
- ITEM 2. Management s Discussion and Analysis of Financial Condition and Results of Operations
- ITEM 3. Quantitative and Qualitative Disclosures About Market Risk
- ITEM 4. Evaluation of Disclosure Controls and Procedures

Part II. OTHER INFORMATION
- ITEM 1. Legal Proceedings
- ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds
- ITEM 3. Defaults Upon Senior Securities
- ITEM 4. Submission of Matters to a Vote of Security Holders
- ITEM 5. Other Information
- ITEM 6. Exhibits

SIGNATURES
Certification Pursuant to Section 302
Certification Pursuant to Section 302
Certification Pursuant to Section 906
Certification Pursuant to Section 906

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

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

	Three months ended September 30,		Nine months ended September 30,	
	2006	2005	2006	2005
Revenues:				
Software licenses	$ 10,422	$ 7,153	$ 27,817	$ 21,362
Software services	14,497	13,103	42,678	38,824
Maintenance	18,847	16,655	54,220	47,882
Appraisal services	4,920	4,147	14,727	13,931
Hardware and other	1,453	1,248	4,706	4,151
Total revenues	50,139	42,306	144,148	126,150
Cost of revenues:				
Software licenses	2,500	2,159	7,592	6,683
Acquired software	353	198	1,007	595
Software services and maintenance	22,647	20,171	67,341	60,047
Appraisal services	3,386	3,027	10,246	11,045
Hardware and other	1,096	929	3,397	2,993
Total cost of revenues	29,982	26,484	89,583	81,363
Gross profit	20,157	15,822	54,565	44,787
Selling, general and administrative expenses	13,201	11,445	38,072	34,652
Restructuring charge				1,260
Amortization of customer and trade name intangibles	326	317	973	950
Operating income	6,630	4,060	15,520	7,925
Other income, net	306	224	603	603
Income before income taxes	6,936	4,284	16,123	8,528
Income tax provision	2,523	1,703	5,938	3,456
Net income	$ 4,413	$ 2,581	$ 10,185	$ 5,072
Earnings per common share:				
Basic	$ 0.11	$ 0.07	$ 0.26	$ 0.13

Diluted	$ 0.11	$ 0.06	$ 0.24	$ 0.12
Basic weighted average common shares outstanding	38,705	39,104	38,947	39,659
Diluted weighted average common shares outstanding	41,898	41,771	41,911	42,160

See accompanying notes.

Table of Contents

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

	September 30, 2006 (Unaudited)	December 31, 2005
ASSETS		
Current assets:		
Cash and cash equivalents	$ 21,052	$ 20,733
Short-term investments available-for-sale	12,025	11,750
Restricted certificate of deposit	5,000	4,750
Accounts receivable (less allowance for losses of $2,303 in 2006 and $1,991 in 2005)	44,632	49,644
Prepaid expenses	5,937	5,158
Other current assets	2,783	2,201
Deferred income taxes	2,128	2,128
Total current assets	93,557	96,364
Accounts receivable, long-term portion	1,500	1,547
Property and equipment, net	7,233	5,759
Other assets:		
Restricted certificate of deposit		250
Goodwill	65,889	53,709
Customer related intangibles, net	17,816	17,696
Software, net	16,062	17,645
Trade name, net	1,217	1,262
Sundry	178	205
	$ 203,452	$ 194,437
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 3,655	$ 3,330
Accrued liabilities	16,516	16,027
Deferred revenue	52,845	51,304
Income taxes payable		289
Total current liabilities	73,016	70,950
Deferred income taxes	9,659	11,290
Commitments and contingencies		

Shareholders equity:		
Preferred stock, $10.00 par value; 1,000,000 shares authorized, none issued		
Common stock, $0.01 par value; 100,000,000 shares authorized;		
48,147,969 shares issued in 2006 and 2005	481	481
Additional paid-in capital	151,463	151,515
Accumulated earnings	13,954	3,769
Treasury stock, at cost; 9,329,395 and 9,273,342 shares in 2006 and 2005, respectively	(45,121)	(43,568)
Total shareholders equity	120,777	112,197
	$ 203,452	$ 194,437

See accompanying notes.

Table of Contents

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

	Nine months ended September 30,	
	2006	2005
Cash flows from operating activities:		
Net income	$ 10,185	$ 5,072
Adjustments to reconcile net income to net cash provided by operations:		
Depreciation and amortization	7,592	7,857
Share-based compensation	1,529	
Purchased in-process research and development charge	140	
Non cash item	307	
Deferred income taxes	(141)	
Gain on disposal of assets		(85)
Changes in operating assets and liabilities, exclusive of effects of acquired companies:		
Accounts receivable	5,496	5,523
Income tax payable	(2,201)	(2,328)
Prepaid expenses and other current assets	(591)	(604)
Accounts payable	177	(360)
Accrued liabilities	(103)	(531)
Deferred revenue	297	2,156
Net cash provided by operating activities	22,687	16,700
Cash flows from investing activities:		
Proceeds from sale of short-term investments	14,691	13,176
Purchases of short-term investments	(14,966)	(10,032)
Cost of acquisitions	(12,237)	
Investment in software development costs	(203)	(951)
Additions to property and equipment	(3,288)	(1,196)
Other	(6)	15
Net cash (used by) provided by investing activities	(16,009)	1,012
Cash flows from financing activities:		
Purchase of treasury shares	(9,923)	(15,429)
Proceeds from employee stock purchase plan	719	896
Proceeds from exercise of stock options	2,420	349
Other	425	(31)
Net cash used by financing activities	(6,359)	(14,215)

Net increase in cash and cash equivalents	319	3,497
Cash and cash equivalents at beginning of period	20,733	12,573
Cash and cash equivalents at end of period	$ 21,052	$ 16,070

See accompanying notes.

Table of Contents

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

(1) Basis of Presentation

We prepared the accompanying condensed consolidated financial statements following the requirements of the Securities and Exchange Commission (SEC) and accounting principles generally accepted in the United States, or GAAP, for interim reporting. As permitted under those rules, certain footnotes or other financial information that are normally required by GAAP can be condensed or omitted for interim periods. Balance sheet amounts are as of September 30, 2006 and December 31, 2005 and operating result amounts are for the three and nine months ended September 30, 2006 and 2005, and include all normal and recurring adjustments that we considered necessary for the fair summarized presentation of our financial position and operating results. As these are condensed financial statements, one should also read the financial statements and notes included in our latest Form 10-K for the year ended December 31, 2005. Revenues, expenses, assets and liabilities can vary during each quarter of the year. Therefore, the results and trends in these interim financial statements may not be the same as those for the full year.

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

In addition, certain other amounts for the previous year have been reclassified to conform to the current year presentation.

(2) Revenue Recognition

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

Software Arrangements:

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

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

If the arrangement does not require significant modification or customization, 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

Table of Contents

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. 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

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. 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.

For arrangements that include significant customization or modification 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 methodology generally results in the recognition of reasonably consistent profit margins over the life of a contract since we have the ability to produce reasonably dependable estimates of contract billings and contract costs. We use the level of profit margin that is most likely to occur on a contract. If the most likely profit margin cannot be precisely determined, the lowest probable level of profit in the range of estimates is used until the results can be estimated more precisely. These arrangements are often implemented over an extended time period and occasionally require us to revise total cost estimates. Amounts recognized in revenue are calculated using the progress-to-completion measurement after giving effect to any changes in our cost estimates. Changes to total estimated contract costs, if any, are recorded in the period they are determined. Estimated losses on uncompleted contracts are recorded in the period in which we first determine that a loss is apparent. Certain contracts that include significant customization or modification of the software may contain a general right of return that lapses upon customer acceptance. For these contracts we generally recognize revenue upon customer acceptance. This may result in revenue being recognized in irregular increments.

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

Software Services

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

Computer Hardware Equipment

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

Table of Contents

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 or upon renewal rates quoted in the contracts.

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:

Deferred revenue consists primarily of unearned support and maintenance revenue that has been billed based on contractual terms in the underlying arrangement with the remaining balance consisting of payments received in advance of revenue being earned under software licensing, software 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 third party subcontractor payments and commissions associated with arrangements for which revenue recognition has been deferred. Such costs are expensed at the time the related revenue is recognized.

(3) Acquisitions

In late January 2006, we completed the acquisitions of all of the capital stock of MazikUSA, Inc. (Mazik) and TACS, Inc. (TACS). The total value of these transactions, including transaction costs, was approximately $14.6 million, which was comprised of $11.7 million in cash and 325,000 shares of Tyler common stock valued at $2.9 million.

Mazik provides an integrated software solution for schools that combines the functionalities of student performance monitoring, student tracking, financial accounting, human resources and reporting.

TACS provides pension and retirement software solutions that assist public and private pension institutions in increasing operational efficiency and accuracy.

We acquired assets of approximately $400,000 and assumed liabilities of approximately $1.5 million. We recorded goodwill of $12.2 million, all of which is expected to be deductible for tax purposes, and other intangible assets of $3.4 million. The $3.4 million of intangible assets is attributable to acquired software and customer relationships that will be amortized over a weighted average period of approximately five years, and purchased in-process research and development of $140,000 which we expensed during the first quarter of 2006. Our consolidated balance sheet as of September 30, 2006 reflects the allocation of the purchase price to the assets acquired and liabilities assumed based on their estimated fair values at the date of acquisition. The operating results of the acquired business are included in our results of operations since their respective dates of acquisition in late January 2006.

Table of Contents

In September 2006, we also purchased certain maintenance and support agreements associated with one of our financial products for approximately $580,000. These costs have been capitalized and will be amortized over 13 years.

(4) Restructuring Charge

Because of unsatisfactory financial performance early in 2005, we made significant organizational changes in the second quarter of 2005 to those areas of our business that were not performing to our expectations. Our goal was to bring costs in line with expected levels of revenue while improving the efficiency of our organizational structure to ensure that clients continue to receive superior service.

We reorganized our appraisal services business to eliminate levels of management and reduce overhead expense. We also took actions to reduce headcount and costs in our appraisal and tax software division, and we consolidated certain senior management positions at the corporate office. These cost reductions were made in the second quarter of 2005. As a result, we eliminated approximately 120 positions, including management, staff and project-related personnel.

In connection with the reorganization, we incurred certain charges which were primarily comprised of employee severance costs and related fringe benefits, and totaled approximately $1.3 million before income taxes. The related payments were paid in 2005.

(5) Shareholders Equity

The following table details activity in our common stock:

	Nine months ended September 30,			
	2006		2005	
	Shares	Amount	Shares	Amount
Repurchases of common stock	(987)	$(9,923)	(2,181)	$(15,429)
Stock option exercises	526	2,420	169	349
Employee stock plan purchases	80	700	134	896
Shares issued for acquisitions	325	2,891		

As of September 30, 2006 we have authorization from our board of directors to repurchase up to 1.1 million additional shares of Tyler common stock.

(6) Income Tax Provision

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

	Three months ended September 30		Nine months ended September 30	
	2006	2005	2006	2005
Income tax provision	$2,523	$1,703	$5,938	$3,456
Effective income tax rate	36.4%	39.8%	36.8%	40.5%

The effective income tax rates were different from the statutory United States federal income tax rate of 35% primarily due to the state income taxes, the qualified manufacturing activities deduction, non-deductible meals and entertainment costs and in 2006 the rate is also impacted by non-deductible share-based compensation expense.

The effective rate for the three months ended September 30, 2006 was lower than the prior year mainly due to a benefit from previously unclaimed tax credits resulting from the completion of state income tax audits. The effective rate for the nine months ended September 30, 2006 was lower than the prior year mainly due to changes in the Texas franchise tax law and rates enacted in the second quarter of 2006, favorable state income tax audit results and lower state income taxes as a result of a change in our corporate structure implemented in early 2005.

We made federal and state income tax payments, net of refunds, of $7.9 million in the nine months ended September 30, 2006, compared to $5.9 million in net payments for the same period of the prior year.

Table of Contents

(7) Earnings Per Share

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

	Three months ended September 30,		Nine months ended September 30,	
	2006	2005	2006	2005
Numerator for basic and diluted earnings per share:				
Net income	$ 4,413	$ 2,581	$ 10,185	$ 5,072
Denominator:				
Weighted-average basic common shares outstanding	38,705	39,104	38,947	39,659
Assumed conversion of dilutive securities:				
Stock options	1,921	1,567	1,734	1,446
Warrants	1,272	1,100	1,230	1,055
Potentially dilutive common shares	3,193	2,667	2,964	2,501
Weighted-average common shares outstanding, assuming full dilution	41,898	41,771	41,911	42,160
Earnings per common share:				
Basic	$ 0.11	$ 0.07	$ 0.26	$ 0.13
Diluted	$ 0.11	$ 0.06	$ 0.24	$ 0.12

(8) 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. Options become fully exercisable after three to five years of continuous employment and expire ten years after the grant date. Once options become exercisable, the employee can purchase shares of our common stock at the market price on the date we granted the option. Effective January 1, 2006, we adopted the provisions of Statement of Financial Accounting Standards (SFAS) No. 123R, Share-Based Payment, which establishes accounting for share-based awards exchanged for employee services, using the modified prospective application transition method. Under this transition method, compensation cost recognized in the three and nine months ended September 30, 2006, includes the applicable amounts of: (a) compensation cost of all share-based payments granted prior to, but not yet vested as of, January 1, 2006 (based on the grant-date fair value estimated in accordance with the original provisions of SFAS No. 123, Accounting for Stock-Based Compensation, and previously presented in the pro forma footnote disclosures), and (b) compensation cost for all share-based

payments granted subsequent to January 1, 2006 (based on the grant-date fair value estimated in accordance with the new provisions of SFAS No. 123R). Results for prior periods have not been restated. For prior periods we applied Accounting Principles Board Opinion (APB) No. 25, Accounting for Stock Issued to Employees, and related Interpretations, and provided the required pro forma disclosures under SFAS No. 123.

Determining Fair Value Under SFAS No. 123R

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

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

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

Table of Contents

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

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

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

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option valuation model. We granted options for 120,000 shares and 1.0 million shares for the three months ended September 30, 2006 and 2005, respectively. We granted options for 237,000 shares and 1.1 million shares for the nine months ended September 30, 2006 and 2005, respectively. A summary of the weighted average assumptions and results for options granted during the three and nine months ended September 30, 2006 and 2005 is as follows:

	Three months ended September 30		Nine months ended September 30	
	2006	2005	2006	2005
Expected life (in years)	6.5	5.0	6.0	5.0
Expected volatility	44.7%	47.9%	45.0%	49.0%
Risk-free interest rate	5.0%	4.1%	4.9%	4.1%
Expected dividend yield	0%	0%	0%	0%
Expected forfeiture rate	3%	0%	3%	0%

Share-Based Compensation Under SFAS No. 123R

The following table summarizes share-based compensation expense related to share-based awards under SFAS No. 123R for the three and nine months ended September 30, 2006, which is recorded in the statement of operations:

	Three months ended September 30, 2006	Nine months ended September 30, 2006
Cost of software services and maintenance	$ 37	$ 110
Selling, general and administrative expense	517	1,419
Total share-based compensation expense	$ 554	$ 1,529

The amount included in selling, general and administrative expense includes share-based compensation expense related to a non-employee consultant of $115,000 for three months ended September 30, 2006 and $227,000 for nine months ended September 30, 2006.

At September 30, 2006 we had unvested options to purchase 1.4 million shares with a weighted average grant date fair value of $3.81. As of September 30, 2006, we had $4.7 million of total unrecognized compensation cost related to unvested options, net of expected forfeitures, which is expected to be amortized over the following periods:

2006 (last three months)	$ 427
2007	1,541

2008	1,215
2009	875
2010	576
2011	70

Table of Contents

As a result of adopting SFAS No. 123R on January 1, 2006, our income before income taxes and net income for the nine months ended September 30, 2006, are $1.3 million and $913,000 lower, respectively, than if we had continued to account for share-based compensation under APB No. 25. Basic and diluted earnings per share for the nine months ended September 30, 2006 are both $0.02 lower than if we had continued to account for share-based compensation under APB No. 25.

Stock Option Activity

As of September 30, 2006, we had options to purchase an aggregate of 4.2 million shares outstanding, and options to purchase an additional 949,000 shares were authorized for future grants under the plan.

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

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value
Outstanding at December 31, 2005	4,608	$ 4.99		
Options granted	237	10.76		
Options exercised	(526)	4.61		
Options forfeited	(110)	6.72		
Options expired				
Outstanding at September 30, 2006	4,209	5.32	6	$ 32,050
Exercisable at September 30, 2006	2,786	4.21	5	$ 24,287

Other information pertaining to option activity during the nine months ended September 30 was as follows:

	2006	2005
Weighted average grant-date fair value of stock options granted	$ 5.42	$ 3.53
Total fair value of stock options vested	1,397	1,264
Total intrinsic value of stock options exercised	3,334	902

The following table summarizes information about outstanding and exercisable options at September 30, 2006:

Range of Exercise Prices	Number Outstanding	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
$ 0.00 - $ 1.27	70	4.5	$ 1.14	70	$ 1.14
$ 1.27 - $ 2.54	685	4.6	1.68	685	1.68
$ 2.54 - $ 3.80	86	5.8	3.35	83	3.34
$ 3.80 - $ 5.07	1,394	5.5	4.47	1,114	4.44
$ 5.07 - $ 6.34	603	3.4	5.47	554	5.45
$ 6.34 - $ 7.61	909	8.8	7.52	169	7.52

$ 7.61 - $ 8.88	105	7.1	7.98	27	7.70
$ 8.88 - $10.14	132	7.7	9.27	74	9.15
$10.14 - $11.41	205	9.3	10.63	10	10.19
$11.41 - $13.50	20	10.0	12.68		
	4,209	6.1	$ 5.32	2,786	$ 4.21

Prior Period Pro Forma Presentations

Prior to 2006, our share-based compensation plan was accounted for using the intrinsic value method prescribed in APB No. 25 and related Interpretations. No share-based compensation was reflected in net income in the three and nine months ended September 30, 2005, as all stock options granted under the plan had an exercise price equal to the market value of the underlying common stock on the date of grant. Had compensation cost for the plan been determined based on the fair value at the grant dates

Table of Contents

for awards under the plan consistent with the method of SFAS No. 123R, our net income and basic and diluted net income per share would have been changed to the pro forma amounts indicated below for the three and nine months ended September 30, 2005:

	Three months ended September 30, 2005	Nine months ended September 30, 2005
Net income as reported	$ 2,581	$ 5,072
Add: share-based compensation included in net income, net of tax		
Deduct: total share-based compensation determined under fair value based method for all awards, net of tax	(230)	(706)
Pro forma net income	$ 2,351	$ 4,366
Basic net income per share:		
As reported	$ 0.07	$ 0.13
Pro forma	$ 0.06	$ 0.11
Diluted net income per share:		
As reported	$ 0.06	$ 0.12
Pro forma	$ 0.06	$ 0.10

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 September 30, 2006, there were 705,000 shares available for future grants under the ESPP from the 1.0 million shares originally reserved for issuance.

(9) Commitments and Contingencies

As disclosed in our prior public filings including our Quarterly Report on Form 10-Q for the period ended June 30, 2006, on September 9, 2005, Affiliated Computer Services, Inc. (ACS) filed litigation in Dallas County, Texas against Tyler Technologies alleging that we breached the non-competition and non-solicitation covenants set forth in the Stock Purchase Agreement dated December 29, 2000 between ACS and us, pursuant to which we sold to ACS for cash all of the issued and outstanding capital stock of Business Resources Corporation, which comprised a significant portion of our then existing property records business. We denied all allegations contained in the lawsuit and filed counterclaims against ACS, including claims for business disparagement and defamation. On September 28, 2006, we entered into a settlement agreement with ACS in which ACS agreed to dismiss and release all claims against us in exchange for our release and dismissal of all claims against ACS. No other consideration was exchanged by ACS or us. An order of dismissal with prejudice was entered into by the 116th Judicial District Court of Dallas County, Texas on October 6, 2006.

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

(10) Recent Accounting Pronouncements

In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 (FIN 48), which clarifies the accounting for uncertainty in tax positions. FIN 48 requires that we recognize the impact of a tax position in our financial statements if that position is more likely than not of being sustained on audit, based on technical merits of this position. The provisions of FIN 48 become effective as of January 1, 2007, with any cumulative effect of the change in accounting principle to be recorded as an adjustment to our accumulated earnings at that date. We are currently evaluating the impact of adopting FIN 48 on our financial statements, and we currently believe that such adoption should not be material to us.

Table of Contents

ITEM 1A. Risk Factors

No material changes.

ITEM 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

FORWARD-LOOKING STATEMENTS

The statements in this discussion that are not historical statements are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements include statements about our business, financial condition, business strategy, plans and the objectives of our management, and future prospects. In addition, we have made in the past and may make in the future other written or oral forward-looking statements, including statements regarding future operating performance, short- and long-term revenue and earnings growth, the timing of the revenue and earnings impact for new contracts, backlog, the value of new contract signings, business pipeline, and industry growth rates and our performance relative thereto. Any forward-looking statements may rely on a number of assumptions concerning future events and be subject to a number of uncertainties and other factors, many of which are outside our control, which could cause actual results to differ materially from such statements. These include, but are not limited to: our ability to improve productivity and achieve synergies from acquired businesses; technological risks associated with the development of new products and the enhancement of existing products; changes in the budgets and regulating environments of our government customers; competition in the industry in which we conduct business and the impact of competition on pricing, revenues and margins; with respect to customer contracts accounted for under the percentage-of-completion method of accounting, the performance of such contracts in accordance with our cost and revenue estimates; our ability to maintain health and other insurance coverage and capacity due to changes in the insurance market and the impact of increasing insurance costs on the results of operations; the costs to attract and retain qualified personnel, changes in product demand, the availability of products, economic conditions, costs of compliance with corporate governance and public disclosure requirements as issued by the Sarbanes-Oxley Act of 2002 and New York Stock Exchange rules, changes in tax risks and other risks indicated in our filings with the Securities and Exchange Commission. The factors described in this paragraph and other factors that may affect Tyler, its management or future financial results, as and when applicable, are discussed in Tyler s filings with the Securities and Exchange Commission, on its Form 10-K for the year ended December 31, 2005. Except to the extent required by law, we are not obligated to update or revise any forward-looking statements whether as a result of new information, future events or otherwise. When used in this Quarterly Report, the words believes, plans, estimates, expects, anticipa intends, continue, may, will, should, projects, forecast, might, could or the negative of such terms expressions as they relate to Tyler or our management are intended to identify forward-looking statements.

GENERAL

We provide integrated information management solutions and services for local governments. We develop and market a broad line of software products and services to address the information technology (IT) needs of cities, counties, schools and other local government entities. In addition, we provide professional IT services to our customers, including software and hardware installation, data conversion, training and for certain customers, product modifications, along with continuing maintenance and support for customers using our systems. We also provide property appraisal outsourcing services for taxing jurisdictions.

In January 2006, we acquired two companies, MazikUSA, Inc. and TACS, Inc. The combined purchase price for the two companies was approximately $14.6 million, comprised of approximately $11.7 million in cash and 325,000 shares of Tyler common stock. See Note 3 in the Notes to the Unaudited Condensed Consolidated Financial Statements.

As disclosed in Note 8 in the Notes to the Unaudited Condensed Consolidated Financial Statements we implemented the Financial Accounting Standards Board s Statement of Financial Accounting Standard No. 123R, Share-Based Payments. In the three and nine months ended September 30, 2006, the total share-based compensation

expense was $554,000 and $1.5 million, respectively, or 1% of total revenue for both periods. The distribution of this expense for the nine months ended September 30, 2006 was $1.4 million to selling, general and administrative expense and $110,000 to cost of software services and maintenance.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The discussion and analysis of our financial condition and results of operations are based upon our condensed consolidated financial statements. These condensed consolidated financial statements have been prepared following the requirements of accounting principles generally accepted in the United States (GAAP) for interim periods and require us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates, including those related to revenue recognition and amortization

Table of Contents

and potential impairment of intangible assets and goodwill. As these are condensed financial statements, one should also read our Form 10-K for the year ended December 31, 2005 regarding expanded information about our critical accounting policies and estimates.

ANALYSIS OF RESULTS OF OPERATIONS

Revenues

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

	Third Quarter				%	Nine Months				%
($ in thousands)	2006	% of Total	2005	% of Total	Increase/ (Decrease)	2006	% of Total	2005	% of Total	Increase/ (Decrease)
Software licenses	$ 10,422	21%	$ 7,153	17%	46%	$ 27,817	19%	$ 21,362	17%	30%
Software services	14,497	29	13,103	31	11	42,678	30	38,824	31	10
Maintenance	18,847	37	16,655	39	13	54,220	38	47,882	38	13
Appraisal services	4,920	10	4,147	10	19	14,727	10	13,931	11	6
Hardware and other	1,453	3	1,248	3	16	4,706	3	4,151	3	13
Total revenues	$ 50,139	100%	$ 42,306	100%	19%	$ 144,148	100%	$ 126,150	100%	14%

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

Software license revenue related to financial products, which comprises approximately 75% of our software license revenues, increased significantly for the three and nine months ended September 30, 2006 compared to the prior year periods primarily due to growth from geographic expansion and increased success in winning larger deals. Third party software revenue also increased over the comparable prior year period because we sold more financial software modules that utilize third party software. Also, in late 2005 we simplified the implementation process for one of our financial products, which has enabled us to deliver the product more rapidly.

Software license revenue related to our other products in the aggregate experienced strong increases for the three months and nine months ended September 30, 2006 compared to the prior year periods. These increases were mainly due to continued market acceptance of our Odyssey courts and justice products as a result of the product maturing, successful early implementations and leveraging our existing customer base.

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

Software services revenue related to financial products, which comprises more than half of our software services revenue, increased significantly compared to the three and nine months ended September 30, 2005, as a result of a general increase in the volume of software license transactions and higher implementation staff levels. Typically, contracts for software licenses include services such as installation of the software, converting the customers data to be compatible with the software and training customer personnel to use the software.

Software services revenue related to Odyssey courts and justice products was up significantly compared to the three and nine months ended September 30, 2005, reflecting increased contract volume. Since March 31, 2005, we have increased our presence with Odyssey in Texas and Florida and added one contract in both Nevada and Michigan.

Maintenance. We provide maintenance and support services for our software products and third party software. Maintenance revenues increased over the prior year periods due to growth in our installed customer base and slightly higher maintenance rates on certain product lines.

Appraisal services. The appraisal services business is driven in part by revaluation cycles in various states. Appraisal services revenue increased over the prior year periods due to activity related to Ohio s revaluation cycle

which occurs every six years as well as the addition of new customers.

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 periods presented as of September 30:

	Third Quarter				Nine Months			
($ in thousands)	2006	% of Related Revenues	2005	% of Related Revenues	2006	% of Related Revenues	2005	% of Related Revenues
Software licenses	$ 2,500	24.0%	$ 2,159	30.2%	$ 7,592	27.3%	$ 6,683	31.3%
Acquired software	353	3.4	198	2.8	1,007	3.6	595	2.8
Software services and maintenance	22,647	67.9	20,171	67.8	67,341	69.5	60,047	69.3
Appraisal services	3,386	68.8	3,027	73.0	10,246	69.6	11,045	79.3
Hardware and other	1,096	75.4	929	74.4	3,397	72.2	2,993	72.1
Total cost of revenue	$ 29,982	59.8%	$ 26,484	62.6%	$ 89,583	62.1%	$ 81,363	64.5%

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

	Third Quarter			Nine Months		
Gross Margin Percentage	2006	2005	Change	2006	2005	Change
Software licenses & acquired software	72.6%	67.0%	5.6%	69.1%	65.9%	3.2%
Software services and maintenance	32.1	32.2	(0.1)	30.5	30.7	(0.2)
Appraisal services	31.2	27.0	4.2	30.4	20.7	9.7
Hardware	24.6	25.6	(1.0)	27.8	27.9	(0.1)
Total gross margin	40.2%	37.4%	2.8%	37.9%	35.5%	2.4%

Software licenses. For the three and nine months ended September 30, 2006 software license gross margins have increased due to significantly higher software license revenues and slightly lower amortization expense of software development costs as some products became fully amortized during the first quarter of 2006. Approximately half of our cost of software license revenues is amortization expense for capitalized development costs on certain software products. Amortization costs are fixed in nature and do not change with revenue changes. Once a product is released, we begin to amortize over the estimated useful life of the product the 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.

Software services and maintenance. For the three and nine months ended September 30, 2006, the software services and maintenance gross margin was comparable to the prior year periods because software services and maintenance revenues grew at the same rate as the related costs. The cost of software services and maintenance increased because we added to our implementation and support staff to support new sales growth and deliver sales backlog. Cost of software services and maintenance primarily consists of expenses, such as personnel costs related to installation of our software licenses, conversion of customer data, training customer personnel and support activities.

Appraisal services. The appraisal services gross margin increased for the three months ended September 30, 2006, because results in the prior year period included cost inefficiencies associated with one large contract. The appraisal services gross margin increased for the nine months ended September 30, 2006 mainly due to significant organizational changes and headcount reductions we made in the second quarter of 2005 to our appraisal services business to bring costs in line with expected levels of revenue.

Table of Contents

The overall gross margin rose mainly due to a revenue mix that included more software license revenues, as well as lower costs as a result of the restructuring of our appraisal services business in the second quarter of 2005. Software license revenue inherently has higher gross margins than other revenues such as software services and hardware.

Selling, General and Administrative Expenses

The following table sets forth a comparison of our selling, general and administrative expenses (SG&A) for the periods presented as of September 30:

	Third Quarter				Nine Months			
			Change				Change	
($ in thousands)	2006	2005	$	%	2006	2005	$	%
Selling, general and administrative expenses	$13,201	$11,445	$1,756	15%	$38,072	$34,652	$3,420	10%
Percent of revenues	26%	27%			26%	27%		

For the nine months ending September 30, 2006, SG&A includes a non-cash purchased in-process research and development charge of $140,000 relating to one of our acquisitions in January 2006 and $1.4 million of non-cash share-based compensation expense as a result of implementing SFAS No. 123R in January 2006. Slightly offsetting these charges was lower SG&A relating to our appraisal services and appraisal and tax software businesses due to the restructuring of those businesses in the second quarter of 2005.

Restructuring Charge

Because of unsatisfactory financial performance early in 2005, we made significant organizational changes in the second quarter of 2005 to those areas of our business that were not performing to our expectations. Our goal was to bring costs in line with expected levels of revenue while improving the efficiency of our organizational structure to ensure that clients continue to receive superior service.

We reorganized the appraisal services business to eliminate levels of management and reduce overhead expense. We also took actions to reduce headcount and costs in our appraisal and tax software division, and we consolidated certain senior management positions at the corporate office. These cost reductions were made in the second quarter of 2005. As a result, we eliminated approximately 120 positions, including management, staff and project-related personnel.

In connection with the reorganization, we incurred certain charges which were primarily comprised of employee severance costs and related fringe benefits, and totaled approximately $1.3 million before income taxes. The related payments were paid in 2005.

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 and amortizable software, customer and trade name intangibles with the remainder allocated to goodwill that is not subject to amortization. However, amortization expense related to acquired software is included with cost of revenues while amortization expense of customer and trade name intangibles is recorded as operating expense. The following table sets forth a comparison of amortization of customer and trade name intangibles for the periods presented as of September 30:

	Third Quarter				Nine Months			
			Change				Change	
($ in thousands)	2006	2005	$	%	2006	2005	$	%
Amortization of customer and trade name intangibles	$326	$317	$9	3%	$973	$950	$23	2%

In January 2006 we completed two acquisitions which increased amortizable customer intangibles by $217,000. This amount will be amortized over five to seven years. In September 2006 we acquired certain maintenance and support agreements associated with one of our financial products which increased customer intangibles by $795,000 and will be amortized over 13 years.

Income Tax Provision

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

	Third Quarter				Nine Months			
			Change				Change	
($ in thousands)	2006	2005	$	%	2006	2005	$	%
Income tax provision	$2,523	$1,703	$820	48%	$5,938	$3,456	$2,482	72%
Effective income tax rate	36.4%	39.8%			36.8%	40.5%		

The effective income tax rates were different from the statutory United States federal income tax rate of 35% primarily due to the state income taxes, the qualified manufacturing activities deduction, non-deductible meals and entertainment costs. In 2006 the rate is also impacted by non-deductible share-based compensation expense.

The effective rate for the three months ended September 30, 2006 was lower than the prior year mainly due to a benefit from previously unclaimed tax credits resulting from the completion of state income tax audits. The effective rate for the nine months ended September 30, 2006 was lower than the prior year mainly due to changes in the Texas franchise tax law and rates enacted in the second quarter of 2006, favorable state income tax audit results and lower state income taxes as a result of a change in our corporate structure implemented in early 2005.

FINANCIAL CONDITION AND LIQUIDITY

As of September 30, 2006, we had cash and cash equivalents of $21.1 million and short-term investments of $12.0 million, compared to cash and cash equivalents of $20.7 million and short-term investments of $11.7 million at December 31, 2005. Cash provided by operating activities was $22.7 million in the nine months ended September 30, 2006 compared to $16.7 million for the same period in 2005.

At September 30, 2006, our days sales outstanding (DSO) was 80 days compared to DSO of 101 days at December 31, 2005. DSO decreased compared to the fourth quarter of 2005 because of annual maintenance billing collections. Our maintenance billings typically peak in December and June of each year and are followed by collections in the subsequent quarter. DSO is calculated based on total accounts receivable divided by the quotient of annualized quarterly revenues divided by 360 days.

Investing activities used cash of $16.0 million in the first nine months of 2006 compared to $1.0 million cash provided from investing activities for the same period in 2005. In January 2006, we acquired two companies, MazikUSA, Inc. and TACS, Inc. The combined purchase price, including transaction costs, for the two companies

was approximately $14.6 million, comprised of

Table of Contents

approximately $11.7 million in cash and 325,000 shares of Tyler common stock. In September 2006 we also purchased certain maintenance and support agreements associated with one of our financial products for approximately $580,000. Other investing activities in the nine months ended September 30, 2006 were primarily comprised of investments of $3.3 million in property and equipment. The property and equipment expenditures related to 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. In the comparable prior year period, investing activities were comprised of a liquidation of $3.1 million of short term investments and investments of $951,000 in software development and $1.2 million in property and equipment. Capital expenditures were funded from cash generated from operations.

On February 11, 2005, we entered into a revolving bank credit agreement (the Credit Facility). The Credit Facility matures February 11, 2008 and provides for total borrowings of up to $30.0 million and a $10.0 million Letter of Credit facility under which the banks will issue cash collateralized letters of credit. As of September 30, 2006, our effective interest rate was 6.8% under the Credit Facility. As of September 30, 2006 we had no debt and outstanding letters of credit totaling $5.0 million to secure surety bonds required by some of our customer contracts. These letters of credit expire through mid 2007.

Financing activities used cash of $6.4 million in the first nine months of 2006 compared to $14.2 million in the same period for 2005. Cash used in financing activities was primarily comprised of purchases of treasury shares, net of proceeds from stock option exercises and employee stock purchase plan activity.

During the nine months ended September 30, 2006, we purchased 987,000 shares of our common stock for an aggregate purchase price of $9.9 million. We currently have authorization to repurchase up to 1.1 million additional shares of Tyler common stock. A summary of the repurchase activity during the nine months ended September 30, 2006 is as follows:

Period	Total number of shares purchased	Average cost per share	Maximum number of shares that may be purchased under current authorization
January 1 through January 31	250	$ 8.75	1,814
February 1 through February 28			1,814
March 1 through March 31			1,814
April 1 through April 30	86	10.74	1,728
May 1 through May 31	291	10.35	1,437
June 1 through June 30	206	10.39	1,231
July 1 through July 31	119	10.53	1,112
August 1 through August 31	35	11.63	1,077
September 1 through September 30			1,077
Total nine months ended September 30, 2006	987	$ 10.05	1,077

The repurchase program, which was approved by our board of directors, was announced in October 2002, and was amended in April and July 2003, October 2004 and October 2005. There is no expiration date specified for the

authorization and we intend to repurchase stock under the plan from time to time in the future. Our credit agreement includes a covenant which limits repurchases of our common stock to $20 million in any trailing twelve month period beginning after February 11, 2005.

We made federal and state income tax payments, net of refunds, of $7.9 million in the nine months ended September 30, 2006 compared to $5.9 million in the comparable prior year.

From time to time we engage in discussions regarding potential acquisitions. In order to consummate any such acquisitions, which could require significant commitments of capital, we may incur debt or issue additional potentially dilutive securities in the future. No assurance can be given as to our future acquisitions and how such acquisitions may be financed. In the absence of future acquisitions, we believe our current cash balances and expected future cash flows from operations will be sufficient to meet our anticipated cash needs for working capital, capital expenditures and other activities through the next twelve months. If operating cash flows are not sufficient to meet our needs, we may borrow under our credit agreement.

Table of Contents

ITEM 3. Quantitative and Qualitative Disclosures About Market Risk

Market risk represents the risk of loss that may affect us due to adverse changes in financial market prices and interest rates. As of September 30, 2006, we had funds invested in auction rate municipal securities, which we accounted for in accordance with SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities. These investments were treated as available-for-sale under SFAS No. 115. The carrying value of these investments approximates fair market value. Due to the nature of this investment, we are not subject to significant market rate risk.

We have no outstanding debt at September 30, 2006, and are therefore not subject to any interest rate risk.

In order to enhance our ability to manage foreign currency risk associated with a contract denominated in Canadian dollars we contracted in December 2005 with a commercial bank to enter into a series of forward contracts, at no material cost to us, to acquire Canadian dollars through 2009 at fixed prices. These forward contracts have been entered into for periods consistent with the related underlying exposure in this contract and do not constitute positions independent of this exposure. If the applicable exchange rate was to increase or decrease 10% from the rate at September 30, 2006, our current risk management liabilities/assets would increase or decrease approximately $210,000. We do not enter into derivative contracts for speculative purposes, nor are we a party to any leveraged derivative instrument.

ITEM 4. Evaluation of Disclosure Controls and Procedures

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

Part II. OTHER INFORMATION

ITEM 1. Legal Proceedings

As disclosed in our prior public filings including our Quarterly Report on Form 10-Q for the period ended June 30, 2006, on September 9, 2005, Affiliated Computer Services, Inc. (ACS) filed litigation in Dallas County, Texas against Tyler Technologies alleging that we breached the non-competition and non-solicitation covenants set forth in the Stock Purchase Agreement dated December 29, 2000 between ACS and us pursuant to which we sold to ACS for cash all of the issued and outstanding capital stock of Business Resources Corporation, which comprised a significant portion of our then existing property records business. We denied all allegations contained in the lawsuit and filed counterclaims against ACS, including claims for business disparagement and defamation. On September 28, 2006, we entered into a settlement agreement with ACS in which ACS agreed to dismiss and release all claims against us in exchange for our release and dismissal of all claims against ACS. No other consideration was exchanged by ACS or us. An order of dismissal with prejudice was entered into by the 116th Judicial District Court of Dallas County, Texas on October 6, 2006.

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

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

None

ITEM 3. Defaults Upon Senior Securities

None

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

None

Table of Contents

ITEM 5. Other Information

None

ITEM 6. Exhibits

Exhibit 31.1	Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
Exhibit 31.2	Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
Exhibit 32.1	Certification Pursuant to 18 U.S.C. Section 1350, as adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
Exhibit 32.2	Certification Pursuant to 18 U.S.C. Section 1350, as adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

TYLER TECHNOLOGIES, INC.

By: /s/ Brian K. Miller

Brian K. Miller
Senior Vice President and Chief Financial Officer
(principal financial officer and an authorized signatory)

Date: October 24, 2006

20