TYLER TECHNOLOGIES INC
Form 10-Q
April 29, 2011

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

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

For the quarterly period ended March 31, 2011

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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data file required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o 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 (Do not check if a smaller reporting company)	Smaller Reporting Company o

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

The number of shares of common stock of registrant outstanding on April 26, 2011 was 32,041,000.

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PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

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

	Three months ended March 31, 2011	2010
Revenues:		
Software licenses	$ 6,822	$ 8,449
Subscriptions	6,964	5,253
Software services	16,764	17,056
Maintenance	35,512	33,416
Appraisal services	6,197	4,275
Hardware and other	1,134	1,371
Total revenues	73,393	69,820
Cost of revenues:		
Software licenses	795	707
Acquired software	295	398
Software services, maintenance and subscriptions	35,180	34,881
Appraisal services	3,824	2,877
Hardware and other	676	938
Total cost of revenues	40,770	39,801
Gross profit	32,623	30,019
Selling, general and administrative expenses	17,288	17,561
Research and development expense	4,549	3,516
Amortization of customer and trade name intangibles	804	806
Operating income	9,982	8,136
Other expense, net	(500)	(42)
Income before income taxes	9,482	8,094
Income tax provision	3,754	3,222
Net income	$ 5,728	$ 4,872
Earnings per common share:		
Basic	$ 0.18	$ 0.14

Diluted	$ 0.17	$ 0.13
Basic weighted average common shares outstanding	32,086	35,101
Diluted weighted average common shares outstanding	33,720	36,655

See accompanying notes.

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

	March 31, 2011 (Unaudited)	December 31, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	$ 2,248	$ 2,114
Short-term investments available-for-sale		25
Accounts receivable (less allowance for losses of $952 in 2011 and $1,603 in 2010)	66,474	81,860
Prepaid expenses	7,915	7,801
Other current assets	1,896	3,543
Deferred income taxes	3,106	3,106
Total current assets	81,639	98,449
Accounts receivable, long-term portion	1,403	1,231
Property and equipment, net	41,386	34,851
Non-current investments available-for-sale	2,126	2,126
Other assets:		
Goodwill	92,831	92,831
Other intangibles, net	31,106	32,307
Sundry	1,912	2,237
	$ 252,403	$ 264,032
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 2,446	$ 2,626
Accrued liabilities	19,908	19,433
Deferred revenue	91,792	102,590
Income taxes payable	1,448	
Total current liabilities	115,594	124,649
Revolving line of credit	22,500	26,500
Deferred income taxes	5,911	5,911
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 2011 and 2010	481	481
Additional paid-in capital	153,969	153,576
Accumulated other comprehensive loss, net of tax	(275)	(275)

Retained earnings	108,286	102,558
Treasury stock, at cost; 16,084,010 and 15,854,205 shares in 2011 and 2010, respectively	(154,063)	(149,368)
Total shareholders equity	108,398	106,972
	$ 252,403	$ 264,032

See accompanying notes.

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

	Three months ended March 31, 2011	Three months ended March 31, 2010
Cash flows from operating activities:		
Net income	$ 5,728	$ 4,872
Adjustments to reconcile net income to net cash provided by operations:		
Depreciation and amortization	2,585	2,649
Share-based compensation expense	1,449	1,465
Excess tax benefit from exercises of share-based arrangements	(272)	(48)
Changes in operating assets and liabilities, exclusive of effects of acquired companies:		
Accounts receivable	15,214	18,078
Income tax payable	3,592	1,215
Prepaid expenses and other current assets	(343)	180
Accounts payable	(180)	(740)
Accrued liabilities	492	(7,448)
Deferred revenue	(10,798)	(13,289)
Net cash provided by operating activities	17,467	6,934
Cash flows from investing activities:		
Proceeds from sale of investments	25	50
Cost of acquisitions, net of cash acquired		(9,623)
Additions to property and equipment	(7,804)	(2,238)
Decrease in restricted investments		1,000
Decrease (increase) in other	214	(25)
Net cash used by investing activities	(7,565)	(10,836)
Cash flows from financing activities:		
Purchase of treasury shares	(6,839)	(2,317)
Decrease in net borrowings on revolving line of credit	(4,000)	
Contributions from employee stock purchase plan	456	447
Proceeds from exercise of stock options	343	79
Excess tax benefit from exercises of share-based arrangements	272	48
Net cash used by financing activities	(9,768)	(1,743)
Net increase (decrease) in cash and cash equivalents	134	(5,645)
Cash and cash equivalents at beginning of period	2,114	9,696

Cash and cash equivalents at end of period	$ 2,248	$ 4,051

See accompanying notes.

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

(1) Basis of Presentation

We prepared the accompanying condensed financial statements following the requirements of the Securities and Exchange Commission (SEC) and accounting principles generally accepted in the United States, or GAAP, for interim reporting. As permitted under those rules, certain footnotes or other financial information that are normally required by GAAP can be condensed or omitted for interim periods. Balance sheet amounts are as of March 31, 2011 and December 31, 2010 and operating result amounts are for the three months ended March 31, 2011 and 2010, 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, 2010. 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.

(2) Financial Instruments

Assets recorded at fair value in the balance sheet as of March 31, 2011 are categorized based upon the level of judgment associated with the inputs used to measure their fair value. Hierarchical levels, defined by Accounting Standards Codification (ASC) 820, Fair Value Measurements and Disclosures, which are directly related to the amount of subjectivity associated with the inputs to fair valuation of these assets, are as follows:

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

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

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

As of March 31, 2011 we held certain items that are required to be measured at fair value on a recurring basis. The following table summarizes the fair value of these financial assets:

	Total	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Cash and cash equivalents	$ 2,248	$ 2,248	$	$
Investments available-for-sale	2,126			2,126
Total	$ 4,374	$ 2,248	$	$ 2,126

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 two auction rate municipal securities (ARS) which are collateralized debt obligations supported by municipal agencies and do not include mortgage-backed securities. These ARS are debt instruments with stated maturities ranging from 21 to 32 years, for which the interest rate is designed to be reset through Dutch auctions approximately every 30 days. However, due to events in the credit markets, auctions for these securities have not occurred since February 2008. Both of our ARS have had a series of very small partial redemptions at par in the period from July 2009 through

February 2011. As of March 31, 2011 we have continued to earn and collect interest on both of our ARS.

Because quoted prices in active markets are no longer available 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. Since there can be no assurances that auctions for these securities will be successful in the near future, we have classified our ARS as non-current investments.

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The par and carrying values, and related cumulative unrealized loss for our non-current ARS as of March 31, 2011 are as follows:

	Par Value	Temporary Impairment	Carrying Value
Investments available-for-sale	$ 2,550	$ 424	$ 2,126

We consider the impairment in our ARS as temporary because we do not have the intent to sell, nor is it more-likely-than-not that we will be required to sell these securities before recovery of their cost basis. We believe that this decline in fair value is temporary, because the underlying assets of these securities are supported by municipal 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 AA. 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, both ARS have had a series of very small partial redemptions at par in the period July 2009 through February 2011. We did not record any unrealized gains or losses on our ARS in the three months ended March 31, 2011. Based on our cash and cash equivalents balance of $2.2 million, expected operating cash flows and a $150.0 million credit line, we do not believe a lack of liquidity associated with our ARS will adversely affect our ability to conduct business, and believe we have the ability to hold the securities throughout the currently estimated recovery period. We will continue to evaluate any changes in the market value of our 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 three months ended March 31, 2011:

Balance as of December 31, 2010	$ 2,126
Transfers into level 3	
Transfers out of level 3	
Unrealized gains included in accumulated other comprehensive loss	
Balance as of March 31, 2011	$ 2,126

(3) Shareholders Equity

The following table details activity in our common stock:

	Three months ended March 31,			
	2011		2010	
	Shares	Amount	Shares	Amount
Purchases of common stock	(335)	$ (6,839)	(129)	$ (2,411)
Stock option exercises	78	343	18	79
Employee stock plan purchases	27	473	25	425

As of March 31, 2011 we had authorization from our board of directors to repurchase up to 2.4 million additional shares of Tyler common stock.

(4) Revolving Line of Credit

In August 2010, we entered into a $150.0 million Credit Agreement (the Credit Facility) and a related pledge and security agreement with a group of seven financial institutions with Bank of America, N.A., as Administrative Agent. The Credit Facility provides for a revolving credit line of $150.0 million (which may be increased up to $200.0 million subject to our obtaining commitments for such increase), with a $25.0 million sublimit for letters of credit. The Credit Facility matures on August 11, 2014. Borrowings under the Credit Facility may be used for general corporate purposes, including working capital requirements, acquisitions and share repurchases.

Borrowings under the Credit Facility bear interest at a rate of either (1) the Bank of America s prime rate plus a margin of 1.50% to 2.75% or (2) the 30, 60, 90 or 180-day LIBOR rate plus a margin of 2.50% to 3.75%, with the margin determined by our consolidated leverage ratio. As of March 31, 2011, our effective average interest rate for borrowings during the three months

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ended March 31, 2011 was 3.0%. As of March 31, 2010, our interest rate was 3.25%. The Credit Facility is secured by substantially all of our assets, excluding real 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, and limits incurrence of additional indebtedness and liens. As of March 31, 2011, we were in compliance with those covenants.

As of March 31, 2011, we had $22.5 million in outstanding borrowings and unused available borrowing capacity of $119.2 million under the Credit Facility. In addition, as of March 31, 2011, our bank had issued outstanding letters of credit totaling $8.3 million to secure surety bonds required by some of our customer contracts. These letters of credit reduce our available borrowing capacity and expire through early 2012.

(5) Income Tax Provision

For the three months ended March 31, 2011, we had an effective income tax rate of 39.6% compared to 39.8% for the three months ended March 31, 2010. The effective income tax rates for the periods presented were different from the statutory United States federal income tax rate of 35% primarily due to state income taxes, non-deductible share-based compensation expense, the qualified manufacturing activities deduction, research and development tax credit and non-deductible meals and entertainment costs.

We made federal and state income tax payments, net of refunds, of $174,000 in the three months ended March 31, 2011, compared to $2.0 million in net payments for the same period of the prior year.

(6) Earnings Per Share

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

	Three months ended March 31,	
	2011	2010
Numerator for basic and diluted earnings per share:		
Net income	$ 5,728	$ 4,872
Denominator:		
Weighted-average basic common shares outstanding	32,086	35,101
Assumed conversion of dilutive securities:		
Stock options	1,634	1,554
Denominator for diluted earnings per share Adjusted weighted-average shares	33,720	36,655
Earnings per common share:		
Basic	$ 0.18	$ 0.14
Diluted	$ 0.17	$ 0.13

For the three months ended March 31, 2011 and the three months ended March 31, 2010, stock options representing the right to purchase common stock of approximately 1.0 million shares and 2.1 million shares, respectively, were not included in the computation of diluted earnings per share because their inclusion would have had an anti-dilutive effect.

(7) Share-Based Compensation

The following table summarizes share-based compensation expense related to share-based awards recorded in the statements of operations, pursuant to ASC 718, Stock Compensation:

	Three months ended March 31,	
	2011	2010
Cost of software services, maintenance and subscriptions	$ 196	$ 165
Selling, general and administrative expense	1,253	1,300
Total share-based compensation expense	$ 1,449	$ 1,465

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(8) Segment and Related Information

We are a major provider of integrated information management solutions and services for the public sector, with a focus on local governments.

We provide our software systems and services and appraisal services through four business units which focus on the following products:

- financial management and education software solutions;
- financial management, municipal courts software solutions and land and vital records;
- courts and justice software solutions; and
- appraisal and tax software solutions and property appraisal services.

In accordance with ASC 280-10, Segment Reporting, the financial management and education software solutions unit, financial management, municipal courts and land and vital records software solutions unit and the courts and justice software solutions unit meet the criteria for aggregation and are presented in one segment, Enterprise Software Solutions (ESS). The ESS segment provides municipal and county governments and schools with software systems to meet their information technology and automation needs for mission-critical back-office functions such as financial management and courts and justice processes. The Appraisal and Tax Software Solutions and Services (ATSS) segment provides systems and software that automate the appraisal and assessment of real and personal property as well as property appraisal outsourcing services for local governments and taxing authorities. Property appraisal outsourcing services include: the physical inspection of commercial and residential properties; data collection and processing; computer analysis for property valuation; preparation of tax rolls; community education; and arbitration between taxpayers and the assessing jurisdiction.

We evaluate performance based on several factors, of which the primary financial measure is business segment operating income. We define segment operating income as income before noncash amortization of intangible assets associated with their acquisition, share-based compensation expense, interest expense and income taxes. Segment operating income includes intercompany transactions. The majority of intercompany transactions relate to contracts involving more than one unit and are valued based on the contractual arrangement. Segment operating income for corporate primarily consists of compensation costs for the executive management team and certain accounting and administrative staff and share-based compensation expense for the entire company.

For the three months ended March 31, 2011	ESS	ATSS	Corporate	Totals
Revenues				
Software licenses	$ 6,287	$ 535	$	$ 6,822
Subscriptions	6,837	127		6,964
Software services	14,263	2,501		16,764
Maintenance	31,632	3,880		35,512
Appraisal services		6,197		6,197
Hardware and other	1,134			1,134
Intercompany	407		(407)	
Total revenues	$ 60,560	$ 13,240	$ (407)	$ 73,393
Segment operating income	$ 12,348	$ 2,635	$ (3,902)	$ 11,081

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For the three months ended March 31, 2010	ESS	ATSS	Corporate	Totals
Revenues				
Software licenses	$ 7,922	$ 527	$	$ 8,449
Subscriptions	5,174	79		5,253
Software services	14,555	2,501		17,056
Maintenance	29,709	3,707		33,416
Appraisal services		4,275		4,275
Hardware and other	1,364	7		1,371
Intercompany	325		(325)	
Total revenues	$ 59,049	$ 11,096	$ (325)	$ 69,820
Segment operating income	$ 11,262	$ 1,793	$ (3,715)	$ 9,340

Reconciliation of reportable segment operating income to the Company s consolidated totals:	For the three months ended March 31, 2011	2010
Total segment operating income	$ 11,081	$ 9,340
Amortization of acquired software	(295)	(398)
Amortization of customer and trade name intangibles	(804)	(806)
Other expense, net	(500)	(42)
Income before income taxes	$ 9,482	$ 8,094

(9) Commitments and Contingencies

As of March 31, 2011, our accounts receivable balance includes $4.2 million associated with one customer that terminated its arrangement with us for convenience and, in addition, has disputed certain amounts we invoiced the customer prior to the termination of the arrangement. We believe the receivable is a valid and enforceable claim under the terms of the arrangement, and we intend to aggressively pursue collection.

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

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

CAUTIONARY NOTE CONCERNING FORWARD-LOOKING STATEMENTS

This document contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 that are not historical in nature and typically address future or anticipated events, trends, expectations or beliefs with respect to our financial condition, results of operations or business. Forward-looking statements often contain words such as believes, expects, anticipates, foresees, forecas estimates, plans, intends, continues, may, will, should, projects, might, could or other similar wo Similarly, statements that describe our business strategy, outlook, objectives, plans, intentions or goals also are forward-looking statements. We believe there is a reasonable basis for our forward-looking statements, but they are inherently subject to risks and uncertainties and actual results could differ materially from the expectations and beliefs reflected in the forward-looking statements. We presently consider the following to be among the important factors that could cause actual results to differ materially from our expectations and beliefs: (1) changes in the budgets or regulatory environments of our customers, primarily local and state governments, that could negatively impact information technology spending; (2) our ability to achieve our financial forecasts due to various factors, including project delays by our customers, reductions in transaction size, fewer transactions, delays in delivery of new products or releases or a decline in our renewal rates for service agreements; (3) economic, political and market conditions, including the global economic and financial crisis, and the general tightening of access to debt or equity capital; (4) technological and market risks associated with the development of new products or services or of new versions of existing or acquired products or services; (5) our ability to successfully complete acquisitions and achieve growth or operational synergies through the integration of acquired businesses, while avoiding unanticipated costs and disruptions to existing operations; (6)

competition in the industry in which we conduct business and the impact of competition on pricing, customer retention and pressure for new products or services; (7) the ability to attract and retain qualified personnel and dealing with the loss or retirement of key members of management or other key personnel; and (8) costs of compliance and any failure to comply with government and stock exchange regulations. A detailed discussion of these factors and other risks that affect our business are described in our filings with the Securities and Exchange Commission, including the detailed Risk Factors contained in our most recent annual report on Form 10-K. We expressly disclaim any obligation to publicly update or revise our 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, and 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 (ASP) arrangements and other hosting services as well as property appraisal outsourcing services for taxing jurisdictions.

Our products generally automate three major functional areas: (1) financial management and education, (2) courts and justice and (3) property appraisal, and tax and we report our results in two segments. The Enterprise Software Solutions (ESS) segment provides municipal and county governments and schools with software systems to meet their information technology and automation needs for mission-critical back-office functions such as financial management and courts and justice processes. The Appraisal and Tax Software Solutions and Services (ATSS) segment provides systems and software that automate the appraisal and assessment of real and personal property as well as property appraisal outsourcing services for local governments and taxing authorities. Property appraisal outsourcing services include: the physical inspection of commercial and residential properties; data collection and processing; computer analysis for property valuation; preparation of tax rolls; community education; and arbitration between taxpayers and the assessing jurisdiction.

During the three months ended March 31, 2011, we purchased 335,000 shares of our common stock for an aggregate purchase price of $6.8 million.

In March 2011, we paid $6.6 million for approximately 27 acres of land and a building in Plano, Texas.

Our total employee count declined from 2,034 at March 31, 2010 to 2,019 at March 31, 2011.

Outlook

Consistent with 2010, we expect to continue to invest aggressively in product development in 2011. We believe that our competitive position is strong and that we are well-positioned to take advantage of an eventual return to a stronger economic environment. However, until we see signs of sustained improvement, we are expecting that the new business environment in 2011 will continue to be both challenging and unpredictable, and that growth will come primarily from recurring revenues.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The discussion and analysis of our financial condition and results of operations are based upon our condensed financial statements. These condensed financial statements have been prepared following the requirements of accounting principles generally accepted in the United States (GAAP) for interim periods and require us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates, including those related to revenue recognition and amortization and potential impairment of intangible assets and goodwill and share-based compensation expense. As these are condensed financial statements, one should also read expanded information about our critical accounting policies and estimates provided in Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations, included in our Form 10-K for the year ended December 31, 2010. There have been no material changes to our critical accounting policies and estimates from the information provided in our 10-K for the year ended December 31, 2010.

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ANALYSIS OF RESULTS OF OPERATIONS

Revenues

	Percentage of Total Revenues First Quarter	
	2011	2010
Revenues:		
Software licenses	9.3%	12.1%