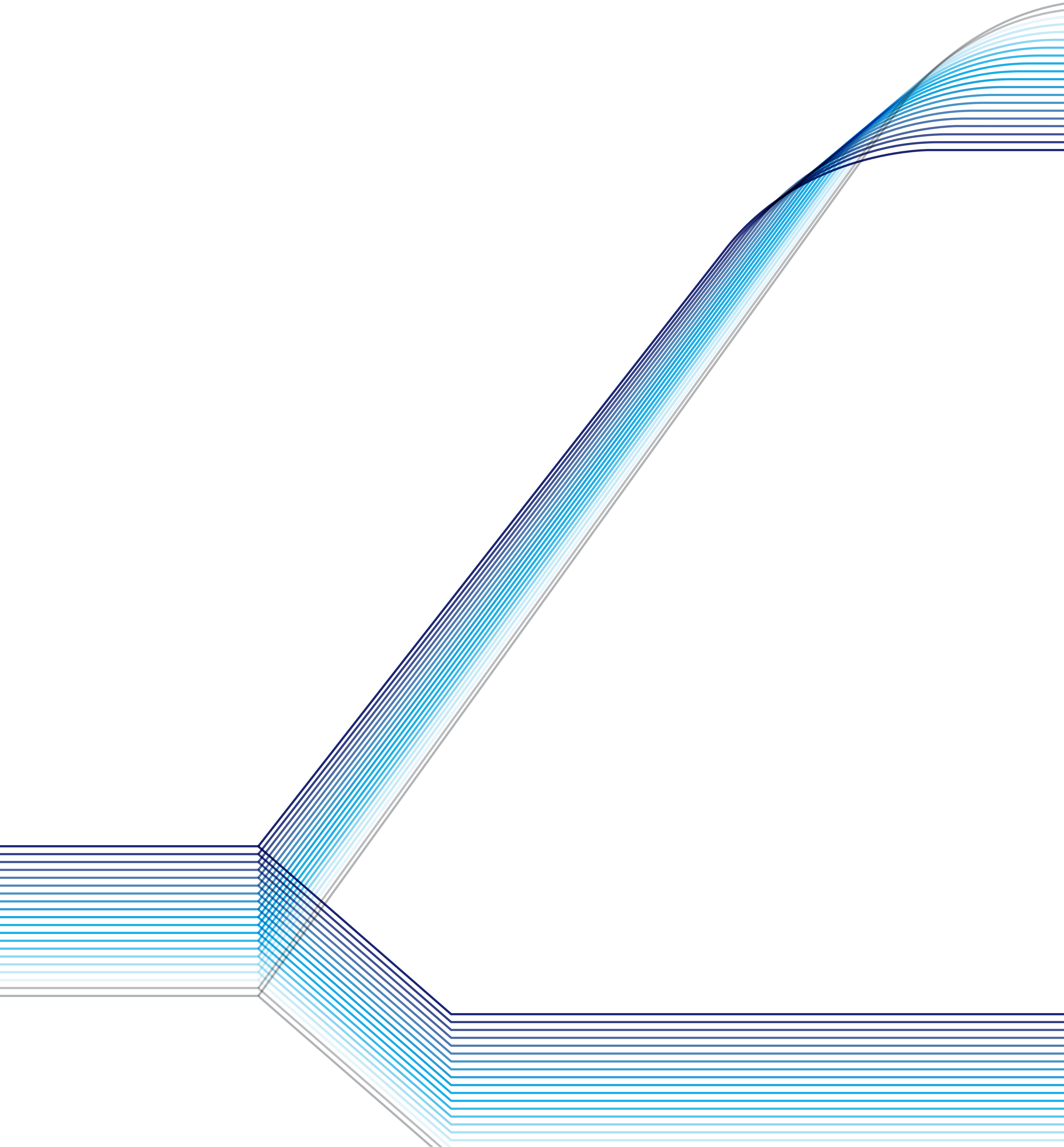
CHANNELING SUCCESS

Tyler Technologies 2006 Annual Report



Tyler Technologies has a singular focus: delivering enterprise software solutions that help local governments better manage their day-to-day operations. With a broad portfolio of solutions and deep expertise in the business of local government, we are channeling success every day, proving that Tyler not only works—we truly deliver.

CHANNELING RESULTS

To Our Shareholders: In 2006, Tyler posted its best annual operating results as a technology company. We closed 2006 with 15 percent revenue growth over 2005, a gross margin gain of 220 basis points, and operating income of $21.8 million, up 71 percent over the previous year. Our free cash flow, a significant indicator of our overall performance, also hit an all-time high of $22.5 million, an increase of 22 percent over 2005.

The fourth quarter of 2006 represented our 23rd consecutive quarter of profitability. Our performance was driven in large part by continued above-market growth in our software-related revenues. Software license revenues grew faster than our overall growth rate, with a 27 percent increase over last year. We were also extremely pleased with the turnaround of our appraisal services business, which, following a major restructuring in 2005, exceeded our expectations in 2006 with consistently profitable performance. As we end 2006 and look to the future, we are pleased with our financial strength, competitive position, and opportunities for growth.

EXECUTING OUR STRATEGY

With a strong vision and clear focus, Tyler is channeling new growth by consistently executing our strategy: expanding geographically, extending our customer base, moving into larger clients, and broadening our product lineup. Based on the outcomes of 2006, we believe we are on the right path.

As it has for several years, our Financials Division generated steady revenue growth for Tyler in 2006. We believe this will continue to be the case, particularly as we expand geographically and win larger deals. In early 2006, for example, we secured a $3.6 million deal with the U.S. Virgin Islands for our MUNIS software.

Revenues in our Courts and Justice Division grew faster than our overall growth rate, largely because of robust sales of our Odyssey product. With contracts in place with six of the 20 largest U.S. counties and two states, Odyssey has become the market leader in court case management systems. In early 2006, we also secured a $12.4 million license agreement for our Odyssey Case Manager with the Texas Conference of Urban Counties, a consortium of the 34 largest counties in the state. Each member county that implements the product will pay separate service and maintenance fees, which we expect will provide Tyler a stream of revenues over the next several years.

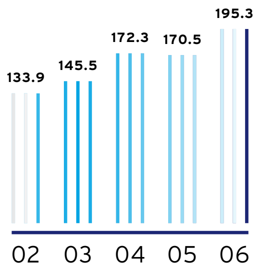
In the Appraisal and Tax Division, we continued to generate solid revenues from our iasWorld solution,

CONSISTENT EXECUTION

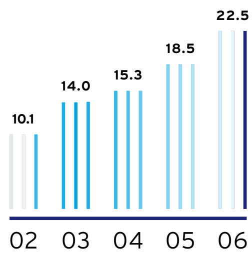
Tyler Technologies channels success to our customers because we help build community. The Tyler neighborhood of products and services enable cities, counties, and states of all sizes to strategically address their day-to-day business issues—financial, education, pension, public safety, tax and appraisal, citizen services, and courts and justice.

JOHN M. YEAMAN
Chairman of the Board

JOHN S. MARR, JR
President and Chief Executive Officer



Total Annual Revenues
IN MILLIONS



Free Cash Flow
IN MILLIONS

Tyler Technologies' core software revenues and free cash flow have steadily grown each year. In 2006, we posted our best operating results since entering the market in 1998.

with major implementations underway for the state of New Jersey and the province of Nova Scotia. Our new Orion tax and appraisal product, which is built on the same platform as Odyssey, is still maturing and is being implemented in counties across the state of Kansas, as well as in Texas, Nebraska and Montana. And in our Document Management Division, we also experienced excellent revenue growth as we began delivering our new EagleSoftware integrated land records solutions, with launch contracts from seven Utah counties.

ADDING VALUE

At Tyler, we continuously seek the best ways to maximize our shareholders' investments and build upon our success. Over the past five years, our software business, including software licenses, services, and maintenance, has generated a compound growth rate of 17 percent. In particular, we have seen a significant increase in our software license revenues. License growth drives higher margins, as well as additional revenue from our software services, maintenance, and support.

Tyler's free cash flow continues to be very strong. With over $10 million in depreciation and amortization and relatively low capital expenditures, our free cash flow in 2006 was 57 percent greater than our GAAP net income. Throughout 2006, we used $10.5 million of our cash flow to repurchase more than 1.0 million shares of our common stock.

Our consistently solid free cash flow also provides us the flexibility to take advantage of strategic growth opportunities, either through acquisitions or internal product builds. On the acquisition front, we will carefully evaluate opportunities to add new assets. Specifically, we seek acquisitions that will augment our existing offerings and technologies and/or broaden our customer base, when such deals can be completed at reasonable prices.

In 2006, we used $12.2 million of cash for acquisitions. To broaden our software portfolio, Tyler added two new complementary products through acquisitions in early 2006. With these additions, we now offer the Tyler Education Management solution for K-12 schools and the Tyler Pension Management solution for local governments. Both products align well with our existing financial solutions and are being leveraged across our sales and implementation channels to provide expected avenues for future growth.

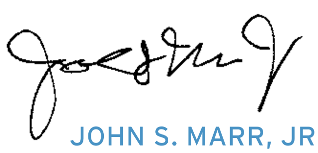
BUILDING ALLIANCES

In January 2007, we announced an exciting new strategic alliance with Microsoft Corporation. As part of this arrangement, Tyler will develop the core public sector functionality for the Microsoft Dynamics AX business management solution. Tyler will also become a reseller of the Microsoft Dynamics AX solution in the public sector market. We will receive license and maintenance royalties on all direct and indirect sales of this solution —including sales by other Microsoft partners. We believe this alliance and the Microsoft brand will strengthen our position in the financial systems arena, particularly in larger "Tier 1" opportunities. In addition, this alliance will give us the opportunity to generate revenues from a much broader market than we would likely address directly in the foreseeable future, including federal and international markets. Moving forward, we expect to explore other opportunities to align ourselves with strategic partners that can help make our products more competitive or expand our market presence.

DELIVERING FUTURE SUCCESS

Entering 2007, Tyler Technologies has the right components in place to continue channeling results. Thanks to our broad portfolio of feature-rich solutions, deep domain expertise, and an exceptional employee group that regularly exceeds customer expectations, we are uniquely positioned to capitalize on a large and growing market that remains very fragmented. And through the consistent execution of our key strategies, we expect to continue to achieve above-market growth in the coming years. With a record high backlog of $206 million at the end of 2006, we have good visibility into the coming year. As our newer products continue to mature and gain scale we expect that margins will continue to expand over the long term.

An essential component of any company's success is anticipating needs. At Tyler, because we serve only state and local governments, we truly understand the unique and complex requirements of our customers and look to the future with those needs in mind. We stay intensely focused on constantly improving the competitive position of our offerings. Based on our solid performance in 2006, we believe the coming years will provide continued opportunity and growth for Tyler Technologies.



JOHN S. MARR, JR.
President and
Chief Executive Officer

CROSS-SELLING TO OUR CUSTOMER BASE

CHANNELING PROGRESS

UNIQUELY TYLER

City by city, county by county, and state by state, Tyler Technologies works to help communities work. As our nation grows, local governments face a myriad of responsibilities and challenges to keep pace with citizens' demand for cost-effective, easy-to-use services. Cities, counties, school districts, and other local authorities and agencies are seeking to convey their services efficiently and effectively. At Tyler, we focus solely on supporting governments. Our software solutions help local government agencies strategically address their day-to-day business issues—whether financial, education, pension, public safety, tax and appraisal, citizen services, or courts and justice. Increasingly, governments of all sizes are turning to Tyler because of our extensive experience in developing solutions for the public sector that maximize resources and deliver results. Yet we also back up our products with unparalleled service and support. Many of our more than 1,500 employees have worked in the public sector and have extensive knowledge of the issues local government agencies face.

This deep domain expertise, combined with exceptional product efficiency, enables us to leverage costs and expand margins as we grow. For our clients, this means faster, easier, and more predictable implementations, driving a high level of satisfaction and improving our competitive position. At Tyler, we know that to build long-term relationships with customers, we must help them stay on the leading edge of technology well into the future. That is why our development team is continually improving our products through enhancements and new releases that present customers with innovative features and increased functionality. Our responsiveness translates to real value for our customers and a strong competitive position for Tyler.

Competing in a highly fragmented, continuously growing market, we believe we are in a prime position to capitalize on this dynamic market, which is estimated at $13 billion in 2007. In 2006, Tyler's revenues grew by 15 percent—roughly double the overall market growth rate. With more than 6,000 software installations in all 50 states, Canada, Puerto Rico, the U.S. Virgin Islands, and the United Kingdom, we have many opportunities to leverage our existing customer base, while moving into untapped markets in new geographic areas.

Tyler's commitment to customers is evidenced by the many long-term relationships we have established. In fact, we have maintained an annual customer retention rate of approximately 98 percent over the past 20-plus years. With our solid past performance and our vision for the future, Tyler works by channeling the right solutions for local governments and the right value for our shareholders.

OUR STRATEGY FOR SUCCESS

In recent years, Tyler has honed our focus even further, executing a growth strategy that is helping us realize our potential. In the last two years we have refined our organizational structure to effectively utilize our management strength and streamlined operations to create greater efficiencies—opening new channels for growth. Sharpening our vision has enabled us to more effectively provide our customers with products and services that emphasize functionality and deliver results. And for our shareholders, this commitment translates to a stronger return on their investment. With this solid base and consistent performance, we are well positioned to capture increased market share and grow revenues, earnings, and cash flow. With vision and discipline, we will continue building on this foundation in the future.

EXPANDING OUR FOOTPRINT

Historically, many of Tyler's products have had a regional presence, targeting specific geographic areas and customer markets. With a unified national sales channel and increased marketing and branding activities, we have broadened our efforts to market and sell each of our software solutions in geographic areas where we previously had limited or no presence.

Today, our products are offered nationwide and are delivering outstanding growth from geographic expansion. Our INCODE financial solution, for example, historically had a regional presence primarily in the Southwest. In 2006, we signed our first INCODE customers in New York and Maryland.

Tyler Technologies helps city, county, and state agencies of all sizes manage the complex network of services they deliver to local citizens.

CHANNELING **CONNECTIONS**

Our MUNIS and EDEN financial products, which traditionally enjoyed very strong market share on the East and West coasts, respectively, signed deals with clients in 25 different states and the U.S. Virgin Islands during 2006 and now together have customers in 44 states and two territories. And our new courts and justice solution, Odyssey, has enjoyed success across the nation, from Florida to Michigan and Nevada to New Hampshire. We believe that expanding Tyler's geographic footprint will continue to offer considerable growth opportunities for Tyler.

BUILDING ON OUR CUSTOMER BASE

Today, Tyler has more than 6,000 installations with clients in all 50 states, Puerto Rico, the U.S. Virgin Islands, Canada, and the United Kingdom. We are committed to building strong relationships with the communities we serve. For us, it goes beyond managing information. It is about delivering and supporting the tools that empower local government agencies to harness their information and in turn improve the lives of their local citizens. We believe in taking full ownership at every turn, which is why we primarily implement our solutions and provide support services ourselves, rather than through third-party integrators. From development and implementation to training, consulting, and post-implementation support, Tyler works for our customers.

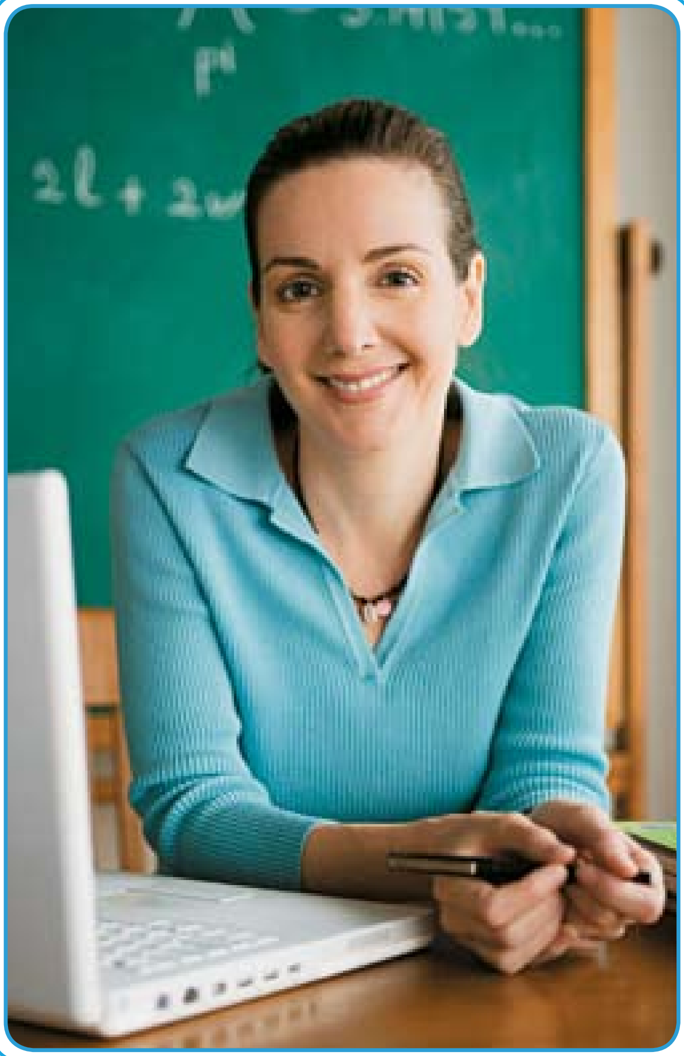
While our existing customers provide a stable foundation of recurring revenues, they are also an essential component of our future growth. In 2006, we reorganized our sales and marketing teams to create greater efficiencies across our product families, helping us better address a very broad market and leverage our current customer base to cross-sell solutions. We can act as a one-source provider for a multitude of local governments' varying needs—connecting them to our entire Tyler neighborhood of financial, tax and appraisal, pension, education, public safety, courts and justice, land records, and document management products.

For many local agencies, upgrading their in-house systems is resource-intensive, both financially and in technical staff support. Given Tyler's established reputation, we are a trusted source for agencies looking to update or replace legacy software with turnkey solutions that simplify their complex systems. In 2006, for instance, we secured a $3 million deal with Columbia County, Georgia, and a $1.1 million contract with Anderson County, Texas, for multi-suite packages that include our financial, tax, and courts and justice systems. In addition, a number of our existing financial systems clients added our municipal court and public safety solutions. While these types of multi-suite and follow-on software deals have represented a relatively

OFFERING INCREASED FLEXIBILITY

Tyler Technologies seeks to provide customers with the best user experience possible. That's why we provide installation services, training, maintenance, and support ourselves, rather than outsourcing to third parties.

TAX & APPRAISAL



Tyler Technologies has built a solid reputation in the communities we serve. We believe in building long-term relationships with our customers, which is part of the reason we have sustained a customer retention rate of approximately 98 percent over the past 20-plus years.

small portion of our business to date, they have the potential to generate significant revenue contributions in the future.

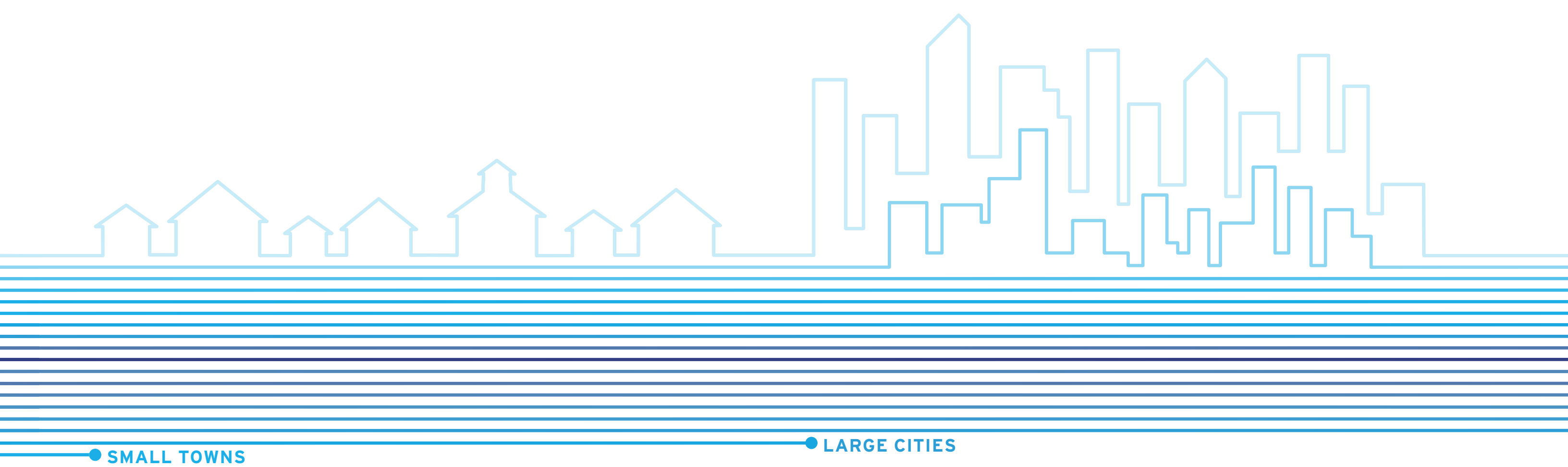
No matter how large or small, all local government agencies want to obtain the best return on their investment today—and in the future. Tyler's deep experience in technology innovation and working with the public sector helps us better anticipate our customers' needs. And in a market that's highly fragmented, this keen understanding and responsiveness gives us an advantage. Unlike many of our competitors, which either narrowly focus on a few applications or allocate resources across many vertical markets, Tyler empowers local government with the right tools to get the right results.

MOVING INTO LARGER OPPORTUNITIES

With small and mid-sized cities and counties composing the majority of local governments, Tyler's business has historically focused on serving these customers. Although we remain firmly committed to this segment of the market, we are also successfully moving into larger opportunities. At Tyler, we have the strength to devote substantial resources to product development and have upgraded products by introducing technologies that are very competitive. As our brand reputation and presence have increased, we are winning more of these higher-end deals, as prospects are increasingly recognizing the value of our government-specific solutions and our reputation for completing implementations on time and on budget.

Our Odyssey courts and justice solution has been particularly successful in larger opportunities, with contracts from six of the top 20 counties nationwide and two statewide implementations. In 2005, we moved into Miami-Dade County, Florida, with a $4.1 million contract and Clark County (Las Vegas), Nevada, with a $4.5 million deal, the 8th and 16th largest U.S. counties, respectively. Carrying this momentum into 2006, we secured our largest software license contract to date—a $12.4 million software license agreement for Odyssey with the Texas Conference of Urban Counties, a consortium composed of 34 member counties representing nearly 80 percent of the state's population. This deal also presents significant potential for recurring revenues. Each member county that adopts Odyssey is responsible for the fees associated with implementation services, modifications and enhancements, and maintenance. Since signing the deal with the Conference of Urban Counties, we have already brought on several new customers from the member counties, including Collin County, Texas, which signed a $1.7 million deal. As with Odyssey, we are also winning larger contracts with our other products. Our MUNIS financial solution, for example, was awarded a contract worth $3.6 million with the U.S. Virgin Islands in 2006.

As with our small and mid-sized clients, we are successfully competing for larger clients because we have the right combination of proven industry-specific experience and a legacy of innovation. This broad customer



CHANNELING GROWTH

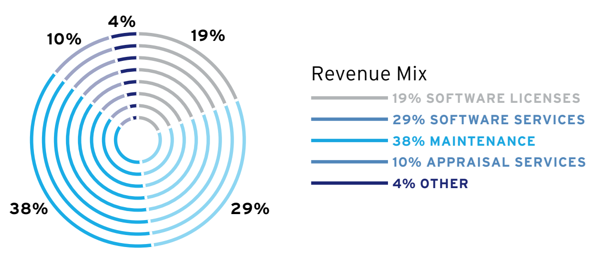
base is generating a growing stream of recurring revenues, helping us fund more product development. Our team of more than 425 developers is working to ensure that our software solutions reflect the most innovative technologies and user-friendly features and functionality in the market.

BROADENING OUR PRODUCT OFFERINGS

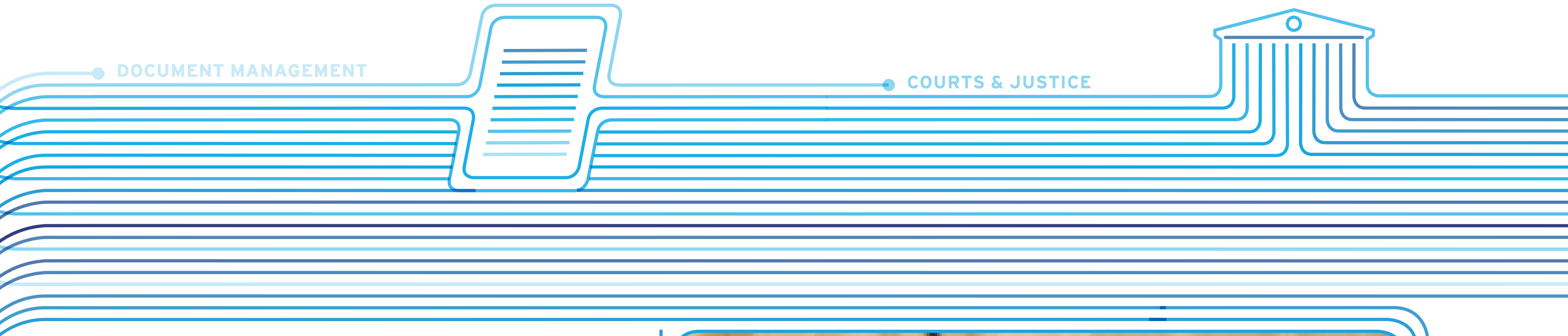
Tyler's healthy balance sheet and strong free cash flow provide us with exceptional financial flexibility, and when growth opportunities arise, we can respond. In part, our future success hinges on our ability to create, deliver, and support technologies tailored to the specifications of local governments. Whether through completing strategic acquisitions, developing new products internally, or enhancing existing products, Tyler seeks to continually evolve its portfolio to deliver the most competitive solutions possible.

In early 2006, we broadened our solutions mix with two acquisitions. Through the acquisition of MazikUSA, Inc., we are now offering the Tyler Education Management Solution, a versatile product suite designed to provide K-12 schools and school districts software applications to help manage student information functions such as grades, attendance, and scheduling. We also added a feature-rich product to help local governments better administer and manage pensions through the acquisition of TACS, Inc. Both solutions complement our existing portfolio of financial software products for local governments and schools, and we believe they will contribute additional revenue streams in the future. At Tyler, we are always looking for ways to intelligently put our cash to work and carefully evaluate each opportunity to ensure it coincides with our long-term strategy and profitability objectives.

While acquisitions are one way Tyler seeks to grow, we also know that succeeding



Tyler Technologies channels results for our stakeholders through steady growth and a business model with strong operational leverage. With a clear strategy, healthy balance sheet, and competitive products, we believe Tyler is perfectly positioned for continued success in a large and growing market.

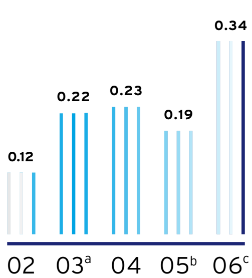


In recent years, Tyler Technologies has successfully expanded into larger clients. Our Odyssey courts and justice solution has now been purchased by six of the 20 largest U.S. counties.

Tyler Technologies' deep experience in technology innovation and keen understanding of the public sector help us anticipate customers' needs. Our development team is dedicated to continuously improving our existing products and creating new solutions, ensuring customers the best return on their investment today—and in the future.

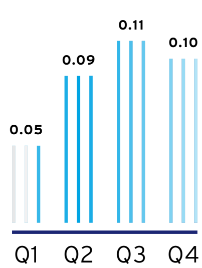
HIGHLY FOCUSED STRATEGY

in today's market means continually innovating. Our experienced team of developers is committed to enhancing our existing systems and creating new turnkey solutions. We use proven, scalable platforms to create best-in-industry features and functionality. For example, the Tyler Public Safety solution, which was developed internally to meet our clients' needs for police record management, has been on the market for just four years and is now installed in over 85 agencies in 10 states. We have a history of providing evolutionary enhancements through version upgrades as part of our support agreements, as well as offering migrations to new technology platforms at reasonable costs. This not only eliminates disruptions, it also provides customers with the most up-to-date features and functionality. At Tyler, we want to ensure our products evolve along with clients' changing needs so that we can channel real, long-term value.



Diluted Annual EPS-
Continuing Operations
DOLLARS

(a) excludes gain on sale of investment of $0.36
(b) includes restructuring charge of $0.02
(c) includes non-cash stock compensation expense of $0.04



2006 Quarterly EPS
DOLLARS

Providing our customers even more flexibility, Tyler offers an application service provider (ASP) model, giving agencies secure access to hosted Tyler software and data solutions. This arrangement is particularly effective for local governments who prefer to devote resources to needs other than managing these systems in-house. With approximately 75 clients and 100 percent renewal rates to date, our ASP model makes sense for our customers and is financially attractive for Tyler, as it provides growth through predictable, recurring revenues. Looking to the future, we have the right components in place to continue expanding our product portfolio.

At Tyler Technologies, we have put the infrastructure in place to support our long-term growth strategies—helping us better respond to customer demands, technological developments, and market changes.

ESTABLISHING NEW ALLIANCES

Another growth opportunity for Tyler lies in forging new relationships with other technology leaders. In January 2007, we entered into a strategic alliance with Microsoft Corporation to enhance the Microsoft Dynamics AX business management solution with core public sector-specific functionality. Utilizing our vast knowledge of the government market, we will broaden the functionality of Microsoft Dynamics AX to address the unique accounting needs of public sector organizations worldwide. Tyler will resell Microsoft Dynamics AX solutions directly into the government market. And we will also receive license and maintenance royalties on direct and indirect sales of these solutions through Microsoft's worldwide distribution channels. Although we don't expect to see significant revenues from this relationship before 2010, we expect that the Microsoft Dynamics AX product will provide us greater visibility in the upper end of the market, as well as a new presence in the federal and international markets. By leveraging our strengths to align with the right partners, Tyler is looking for new opportunities to accelerate our organic growth in the years to come.

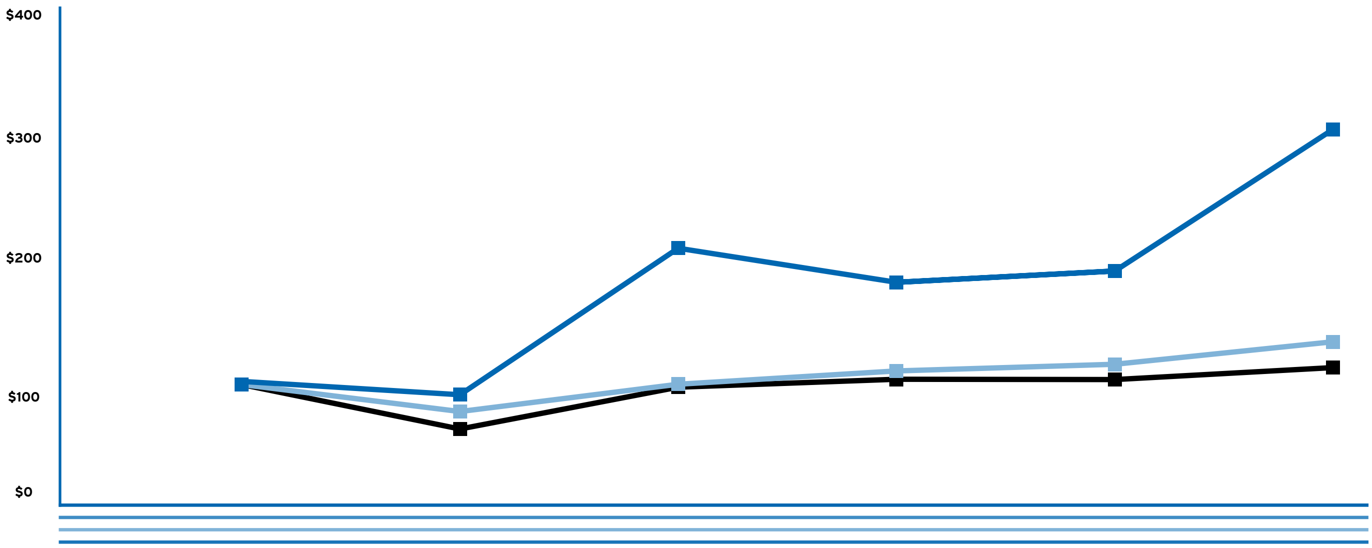
A BRIGHT FUTURE

As expected, Tyler showed consistent growth in 2006 with our 23rd consecutive profitable quarter and revenue and free cash flow at all-time highs. At Tyler, our strong financial value is underscored by our deep domain experience and singular focus on delivering a broad portfolio of cost-effective, results-oriented solutions for local governments. As we look to the future, we plan to continue executing the strategies that have produced such strong results to date: growing our geographic footprint, deepening our customer base, moving into larger markets, broadening our product offerings, and establishing new alliances. These strategies are effective both in helping us grow our customer base and the markets we serve, and in creating a strong return for our stakeholders. From our feature-rich software solutions to the commitment and expertise of our more than 1,500 employees, it's clear that Tyler truly works...and delivers.

With a clear focus on serving local governments and a proven strategy, Tyler Technologies' growth in 2006 was steady and strong. Once again, we demonstrated our ability to channel success to our customers, our shareholders and our employees. The following financials detail our performance over the last year.

PERFORMANCE GRAPH

The following table compares total shareholder returns for Tyler Technologies over the last five years to the Standard and Poor's 500 Stock Index and the Standard and Poor's 600 Information Technology Index assuming a $100 investment made on December 31, 2001. Each of the three measures of cumulative total return assumes reinvestment of dividends. The stock performance shown on the graph below is not necessarily indicative of future price performance.



	2001	2002	2003	2004	2005	2006
Tyler	100.00	91.65	211.65	183.74	192.97	309.01
S&P 500	100.00	77.90	100.25	111.15	116.61	135.03
S&P 600 IT	100.00	63.58	97.83	104.33	104.08	113.89

Our common stock is traded on the New York Stock Exchange under the symbol "TYL." At December 31, 2006, we had approximately 2,225 stockholders of record. A number of our stockholders hold their shares in street name; therefore, there are substantially more than 2,225 beneficial owners of our common stock.

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

		HIGH	LOW
2005:	First Quarter	$ 8.45	$ 6.29
	Second Quarter	7.90	5.25
	Third Quarter	8.69	7.25
	Fourth Quarter	9.15	7.88
2006:	First Quarter	**$11.00**	**$ 8.40**
	Second Quarter	**11.50**	**9.80**
	Third Quarter	**13.36**	**10.27**
	Fourth Quarter	**14.99**	**12.41**

We did not pay any cash dividends in 2006 or 2005. During 2006 our bank credit agreement contained restrictions on the payment of cash dividends. We terminated this credit agreement in January 2007. We intend to retain earnings for use in the operation and expansion of our business, and, therefore, we do not anticipate declaring a cash dividend in the foreseeable future.

During 2006, we purchased approximately 1.0 million shares of our common stock for an aggregate cash purchase price of $10.5 million. Our 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. As of December 31, 2006, we had remaining authorization to repurchase up to 1.0 million additional shares of our common stock. There is no expiration date specified for the authorization and we intend to repurchase stock under the plan from time to time in the future.

SELECTED FINANCIAL DATA

(IN THOUSANDS, EXCEPT PER SHARE DATA)

FOR THE YEARS ENDED DECEMBER 31,	2006	2005	2004	2003	2002
STATEMENT OF OPERATIONS DATA[1]:					
Revenues	**$195,303**	$170,457	$172,270	$145,454	$133,897
Costs and expenses:					
Cost of revenues [2]	**120,499**	108,970	108,432	90,627	88,347
Selling, general and administrative expenses [2]	**51,711**	46,242	45,451	38,390	33,914
Restructuring charge	**–**	1,260	–	–	–
Amortization of customer and trade name intangibles	**1,318**	1,266	1,267	925	897
Operating income	**21,775**	12,719	17,120	15,512	10,739
Realized gain on sale of investment in H.T.E., Inc. [3]	**–**	–	–	23,233	–
Other income (expense), net	**1,080**	906	317	339	(698)
Income from continuing operations before income taxes	**22,855**	13,625	17,437	39,084	10,041
Income tax provision	**8,493**	5,432	7,309	13,106	3,869
Income from continuing operations	**$ 14,362**	$ 8,193	$ 10,128	$ 25,978	$ 6,172
Income from continuing operations per diluted share	**$ 0.34**	$ 0.19	$ 0.23	$ 0.58	$ 0.12
Weighted average diluted shares	**41,868**	42,075	44,566	45,035	49,493
STATEMENT OF CASH FLOWS DATA:					
Cash flows provided by operating activities	**$ 26,804**	$ 21,187	$ 22,159	$ 22,535	$ 19,845
Cash flows (used by) provided by investing activities	**(24,326)**	1,820	(9,914)	(590)	(7,974)
Cash flows used by financing activities	**(5,999)**	(14,847)	(9,940)	(25,421)	(3,398)
BALANCE SHEET DATA:					
Total assets	**$220,276**	$194,437	$190,487	$186,396	$169,845
Long-term obligations, less current portion	**–**	–	–	–	2,550
Shareholders' equity	**125,875**	112,197	118,400	117,907	118,656

(1) In December 2003, we acquired Eden Systems, Inc. ("Eden"), a provider of financial, personnel and citizen services software for local governments. These results include the results of the operations of Eden from the date of its acquisition.

(2) Effective January 1, 2006, we adopted the fair value recognition provisions of Statement of Financial Accounting Standards No. 123R, "Share-Based Payment" using the modified-prospective method. In 2006 cost of revenues include $147,000 share-based compensation expense and selling, general and administrative expenses include $1.8 million share-based compensation expense. In accordance with the standard, results of operations for the years prior to 2006 are reported under the previous accounting standard and no expense was recorded.

(3) On March 25, 2003, we received cash proceeds of $39.3 million in connection with a transaction to sell all of our 5.6 million shares of H.T.E., Inc. ("HTE") common stock to SunGard Data Systems Inc. for $7.00 cash per share. Our original cost basis in the HTE shares was $15.8 million. After transaction and other costs, we recorded a gross realized gain of $23.2 million ($16.2 million or $0.36 per diluted share after income taxes of $7.0 million) for the year ended December 31, 2003.

FORWARD LOOKING STATEMENTS

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

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

OVERVIEW

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.

Our products are generally grouped into four major areas:

- Financials;
- Courts and Justice;
- Property Appraisal and Tax; and
- Document Management.

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

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

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

- **Selling, General and Administrative ("SG&A") Expenses –** The primary components of SG&A expense are administrative and sales personnel salaries and commissions, marketing expense, research and development costs, rent and professional fees. Sales commissions generally fluctuate with revenues but other administrative expenses tend to grow at a slower rate than revenues; however, these costs have recently grown disproportionately because of the requirements of corporate governance legislation. Research and development costs fluctuate from year-to-year depending on product development activity.

- **Liquidity and Cash Flows –** The primary driver of our cash flows is net income. Uses of cash include acquisitions, capital investments in software development and property and equipment and the discretionary purchases of treasury stock. During 2006 we used cash of $12.2 million to acquire two small companies and certain maintenance and support agreements. In 2006, we also purchased 1.0 million shares of our common stock at an aggregate cash purchase price of $10.5 million. Our working capital needs are fairly stable throughout the year with the significant components of cash outflows being payment of personnel expenses offset by cash inflows representing collection of accounts receivable and cash receipts from customers in advance of revenue being earned.

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

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our discussion and analysis of financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP"). The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets and liabilities at the date of the financial statements, the reported amounts of revenues, cost of revenues and expenses during the reporting period, and related disclosure of contingent assets and liabilities. The Notes to the Consolidated Financial Statements included as part of this Annual Report describe our significant accounting policies used in the preparation of the consolidated financial statements. On an on-going basis, we evaluate our estimates, including, but not limited to, those related to intangible assets, bad debts and our service contracts. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

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

Revenue Recognition. We recognize revenues in accordance with the provisions of Statement of Position ("SOP") 97-2, "Software Revenue Recognition," as amended by SOP 98-4 and SOP 98-9, as well as Technical Practice Aids issued from time to time by the American Institute of Certified Public Accountants, and in accordance with the Securities and Exchange Commission Staff Accounting Bulletin No. 104 "Revenue Recognition." We recognize revenue on our appraisal services contracts using the proportionate performance method of accounting, with considerations for the provisions of Emerging Issue Task Force No. 00-21, "Revenue Arrangements with Multiple Deliverables." Our revenues are derived from sale of software licenses, appraisal services, maintenance and support, and services that typically range from installation, training and basic consulting to software modification and customization to meet specific customer needs. For multiple element software arrangements, which do not entail the performance of services that are considered essential to the functionality of the software, we generally record revenue when the delivered products or performed services result in a legally enforceable and non-refundable claim. We maintain allowances for doubtful accounts and sales adjustments, which are provided at the time the revenue is recognized. Because most of our customers are governmental entities, we rarely incur a loss resulting from the inability of a customer to make required payments. In a limited number of cases, we encounter a customer who is dissatisfied with some aspect of the software product or our service, and we may offer a "concession" to such customer. In those limited situations where we grant a concession, we rarely reduce the contract arrangement fee, but alternatively may perform additional services, such as additional training or programming a minor feature the customer had in their prior software solution. These amounts have historically been considered nominal. In connection with our customer contracts and the adequacy of related allowances and measures of progress towards contract completion, our project managers are charged with the responsibility to continually review the status of each customer on a specific contract basis. Also, we review, on at least a quarterly basis, significant past due accounts receivable and the adequacy of related reserves. Events or changes in circumstances that indicate that the carrying amount for the allowances for doubtful accounts and sales adjustments may require revision, include, but are not limited to, deterioration of a customer's financial condition, failure to manage our customer's expectations regarding the scope of the services to be delivered, and defects or errors in new versions or enhancements of our software products.

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

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

In connection with certain of our contracts, we have recorded retentions receivable or unbilled receivables consisting of costs and estimated profit in excess of billings as of the balance sheet date. Many of the contracts which give rise to unbilled receivables at a given balance sheet date are subject to billings in the subsequent accounting period. Management reviews unbilled receivables and related contract provisions to ensure we are justified in recognizing revenue prior to billing the customer and that we have objective evidence which allows us to recognize such revenue. In addition, we have a sizable amount of deferred revenue which represents billings in excess of revenue earned. The majority of this liability consists of maintenance billings in which payments are made in advance and the revenue is ratably earned over the maintenance period, generally one year. We also have deferred revenue for those contracts in which we receive a deposit and the conditions in which to record revenue for the service or product has not been met. On a periodic basis, we review by customer the detail components of our deferred revenue to ensure our accounting remains appropriate.

Intangible Assets and Goodwill. Our business acquisitions typically result in the creation of goodwill and other intangible asset balances, and these balances affect the amount and timing of future period amortization expense, as well as expense we could possibly incur as a result of an impairment charge. The cost of acquired companies is allocated to identifiable tangible and intangible assets based on estimated fair value, with the excess allocated to goodwill. Accordingly, we have a significant balance of acquisition date intangible assets, including software, customer related intangibles, trade name and goodwill. In addition, we capitalize software development costs incurred subsequent to the establishment of technological feasibility.

These intangible assets are amortized over their estimated useful lives. All intangible assets with definite and indefinite lives are reviewed for impairment annually or whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of goodwill is generally measured by a comparison of the carrying amount of an asset to its fair value, generally determined by estimated future net cash flows expected to be generated by the asset. Recoverability of other intangible assets is generally measured by comparison of the carrying amount to estimated undiscounted future cash flows. The assessment of recoverability or of the estimated useful life for amortization purposes will be affected if the timing or the amount of estimated future operating cash flows is not achieved. Events or changes in circumstances that indicate the carrying amount may not be recoverable include, but are not limited to, a significant decrease in the market value of the business or asset acquired, a significant adverse change in the extent or manner in which the business or asset acquired is used, or a significant adverse change in the business climate. In addition, products, capabilities, or technologies developed by others may render our software products obsolete or non-competitive.

Share-based Compensation. We have a stock option plan that provides for the grant of stock options to key employees, directors and non-employee consultants. Prior to January 1, 2006, we accounted for share-based compensation utilizing the intrinsic value method in accordance with the provisions of Accounting Principles Board Opinion ("APB") No. 25, "Accounting for Stock Issued to Employees," and related Interpretations. Accordingly no compensation expense was recorded because the exercise prices of the stock options equaled the market prices of the underlying stock on the dates of grants. However, prior to adoption of Statement of Financial Accounting Standards ("SFAS") No. 123R, share-based compensation had been included in pro forma disclosures in the financial statement footnotes for periods prior to 2006.

Effective January 1, 2006, we adopted the provisions of SFAS No. 123R, "Share-Based Payment," which establishes accounting for share-based awards exchanged for employee services, using the modified prospective application transition method. Subsequently, we recorded compensation expense in our statement of operations over the service period that the awards are expected to vest. Compensation cost recognized in 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).

We estimate the fair value of share-based awards on the date of grant using the Black-Scholes option valuation model. Share-based compensation expense includes the estimated effects of forfeitures, which will be adjusted over the requisite service period to the extent actual forfeitures differ, or are expected to differ from such estimates. Changes in estimated forfeitures are recognized in the period of change and will also impact the amount of expense to be recognized in future periods. Forfeiture rate assumptions are derived from historical data. We estimate stock price volatility at the date of grant based on the historical volatility of our common stock. Estimated option life is determined using the "simplified method" in accordance with Staff Accounting Bulletin No. 107. Determining the appropriate fair-value model and calculating the fair value of share-based awards at the grant date requires considerable judgment, including estimating stock price volatility, expected option life and forfeiture rates.

ANALYSIS OF RESULTS OF OPERATIONS AND OTHER

The following discussion compares the historical results of operations on a basis consistent with GAAP for the years ended December 31, 2006, 2005 and 2004.

2006 Compared to 2005

Revenues

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

($ IN THOUSANDS)	2006	% OF TOTAL	2005	% OF TOTAL	CHANGE $	CHANGE %
Software licenses	**$ 37,414**	**19%**	$ 29,552	17%	$ 7,862	27%
Software services	**57,588**	**29**	51,532	30	6,056	12
Maintenance	**73,413**	**38**	64,728	38	8,685	13
Appraisal services	**19,755**	**10**	18,374	11	1,381	8
Hardware and other	**7,133**	**4**	6,271	4	862	14
Total revenues	**$195,303**	**100%**	$ 170,457	100%	$24,846	15%

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

- Software license revenue related to financial products, which comprise over 70% of our software license revenues in the years presented, increased significantly compared to the prior year primarily due to growth from geographic expansion and increased success in winning larger contracts. Third party software revenue also increased over the comparable prior year 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. Our financial software products automate accounting systems for cities, counties, school districts, public utilities and not-for-profit organizations.

- In 2006 software license revenue related to our products other than financial systems experienced strong increases in the aggregate compared to 2005. Software license revenues from our Odyssey courts and justice products experienced a substantial increase over the prior year as a result of the product maturing following successful early implementations and leveraging our existing customer base. In addition, licenses of our tax and appraisal products and a document management product were much higher than the prior year due to several new Java based product releases and increased appraisal revaluation activity. Our appraisal software license volume varies from period to period dependent upon the special needs and timing of our customers. Local government taxing entities normally reappraise properties from time to time to update values for tax assessment purposes and to maintain equity in the taxing process. While certain of these taxing jurisdictions contract with our appraisal services division to perform the reappraisals, it is not always necessary for the customer to purchase new software in order to process the appraisals. In some cases, a customer may simply add additional appraisal software modules to enhance the functionality of its existing software.

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

- Software services revenue related to financial products, which comprise more than half of our software service revenue in the years presented, increased significantly in 2006 compared to the prior year reflecting increased contract volume and additions to training staff which enabled us to deliver our backlog at a faster rate. Typically, software contracts include services such as installing the software, converting the customers' data to be compatible with the software and training customer personnel to use the software. Our application service provider ("ASP") hosting and disaster recovery services also contributed to the increase as a result of geographic expansion, primarily in the South in the aftermath of hurricane Katrina.

- Software services revenue related to Odyssey courts and justice products was up moderately in 2006 compared to 2005 reflecting increased contract volume. Since March 31, 2005, we have increased our presence with Odyssey in Texas, Florida and Michigan and added one contract in Nevada. Odyssey software services revenue did not increase as strongly as Odyssey software license revenue because the prior year included a $1.4 million contract for follow-on services to an existing customer that had previously implemented and accepted the software.

- Software services revenue related to our document management products experienced strong increases in 2006 due to several new Java based product releases.

Maintenance. We provide maintenance and support services for our software products and third party software. Maintenance revenues increased due to growth in our installed customer base as evidenced by our software license revenue and slightly higher maintenance rates on most of our 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 mainly due to activity related to Ohio's revaluation cycle, which occurs every six years as well as the addition of new customers. The Ohio revaluation cycle was nearly complete by the end of 2006. The level of appraisal services revenues in 2007 will depend on our ability to replace appraisal services revenues associated with the Ohio revaluation.

Cost of Revenues and Gross Margins

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

($ IN THOUSANDS)	2006	% OF RELATED REVENUES	2005	% OF RELATED REVENUES	CHANGE $	CHANGE %
Software licenses	**$ 9,980**	**27%**	$ 9,101	31%	$ 879	10%
Acquired software	**1,360**	**4**	794	3	566	71
Software services and maintenance	**90,330**	**69**	80,347	69	9,983	12
Appraisal services	**13,563**	**69**	14,188	77	(625)	(4)
Hardware and other	**5,266**	**74**	4,540	72	726	16
Total cost of revenues	**$120,499**	**62%**	$108,970	64%	$ 11,529	11%

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

GROSS MARGIN PERCENTAGES	2006	2005	CHANGE
Software licenses and acquired software	**69.7%**	66.5%	3.2%
Software services and maintenance	**31.0**	30.9	0.1
Appraisal services	**31.3**	22.8	8.5
Hardware	**26.2**	27.6	(1.4)
Overall gross margin	**38.3%**	36.1%	2.2%

Cost of software license revenues. Our software license gross margin percentage in 2006 increased due to substantially 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 with the remainder consisting of costs related to third-party software. 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.

Cost of software services and maintenance revenues. The software services and maintenance gross margin percentage in 2006 was comparable to the 2005. The cost of software services and maintenance increased because we added to our implementation and support staff to increase our capacity 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 and various other services such as ASP and disaster recovery.

Cost of appraisal services revenues. The appraisal services gross margin percentage increased in 2006 compared to 2005 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. In addition, margins in 2005 were negatively affected by cost inefficiencies associated with one large contract.

The overall gross margin percentage 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 ("SG&A") expenses for the following years ended December 31:

($ IN THOUSANDS)	2006	% OF REVENUES	2005	% OF REVENUES	CHANGE $	CHANGE %
Selling, general and administrative expenses	**$51,711**	**26%**	$46,242	27%	$ 5,469	12%

In 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 $2.0 million of non-cash share-based compensation expense as a result of implementing SFAS No. 123R in January 2006. Partially offsetting these charges were lower SG&A expenses 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.

Amortization of Customer and Trade Name Intangibles

Acquisition intangibles are composed of the excess of the purchase price over the fair value of net tangible assets acquired that is allocated to acquired 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 other expense. The estimated useful lives of both customer and trade name intangibles are 5 to 25 years. The following table sets forth a comparison of amortization of customer and trade name intangibles for the following years ended December 31:

			CHANGE	
($ IN THOUSANDS)	2006	2005	$	%
Amortization of customer and trade name intangibles	**$ 1,318**	$1,266	$ 52	4%

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

2007	$1,348
2008	1,323
2009	1,237
2010	1,237
2011	1,221

Other

Interest income is the main component of other income, which also includes non-usage and other fees associated with a credit agreement we terminated in January 2007, gain on sale of certain assets, gains and losses on risk management liabilities and assets associated with a foreign exchange contract and miscellaneous other items. Interest income in 2006 was $1.4 million compared to $900,000 in 2005.

Income Tax Provision

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

			CHANGE	
($ IN THOUSANDS)	2006	2005	$	%
Income tax provision	**$8,493**	$5,432	$ 3,061	56%
Effective income tax rate	**37.2%**	39.9%		

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

The effective rate for 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.

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

2005 Compared to 2004

Revenues

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

($ IN THOUSANDS)	2005	% OF TOTAL	2004	% OF TOTAL	CHANGE $	CHANGE %
Software licenses	$ 29,552	17%	$ 30,258	18%	$ (706)	(2)%
Software services	51,532	30	49,786	29	1,746	4
Maintenance	64,728	38	57,760	33	6,968	12
Appraisal services	18,374	11	27,394	16	(9,020)	(33)
Hardware and other	6,271	4	7,072	4	(801)	(11)
Total revenues	$170,457	100%	$172,270	100%	$(1,813)	(1)%

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

- Software license revenue related to financial products, which comprise approximately 80% of our software license revenues in the years presented, increased slightly compared to the prior year primarily due to third party software products which enhance the functionality of our proprietary software.
- Software license revenue related to our Odyssey courts and justice products declined in 2005 compared to 2004. The prior year was unusually high because it included approximately $900,000 of license fees earned upon final acceptance for two original Odyssey installation sites. In 2005 we had fifteen Odyssey contracts in process compared to seven Odyssey contracts in 2004. The implementation cycle for Odyssey products ranges from nine to thirty-six months depending on the scope of the contract and modification complexity. We have recognized revenue on these contracts using contract accounting.

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

- Software services revenue related to financial products, which comprise more than half of our software service revenue in the years presented, increased moderately in 2005 compared to the prior year. Approximately one-half of our financial software services revenue increase related to training and the remaining increases were due to new customers for our application service provider hosting and disaster recovery services and other miscellaneous services. We increased our training staff in 2005 which enabled us to deliver our backlog at a faster rate.
- Software services revenue related to our Odyssey courts and justice products increased significantly in 2005 compared to the prior year mainly due to a new $1.4 million contract for follow-on services to an existing customer that had previously implemented and accepted the software.
- Software services revenue related to appraisal and tax products declined substantially in 2005. This decline was mainly associated with the completion of several legacy appraisal and tax contracts in 2004 and early 2005.

Maintenance. We provide maintenance and support services for our software products and third party software. Maintenance revenues increased due to growth in our installed customer base as evidenced by our software license revenue and slightly higher maintenance rates on most of our product lines.

Appraisal services. The decrease in appraisal services revenues is due to the completion in 2004 of certain significant appraisal contracts. These larger projects are often relatively discretionary in nature compared to smaller projects which tend to occur on a more consistent basis, and the larger projects we recently completed have not been replaced by similar projects. The appraisal services business is driven in part by revaluation cycles in various states.

Cost of Revenues and Gross Margins

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

($ IN THOUSANDS)	2005	% OF RELATED REVENUES	2004	% OF RELATED REVENUES	CHANGE $	CHANGE %
Software licenses	$ 9,101	31%	$ 8,819	29%	$ 282	3%
Acquired software	794	3	1,447	5	(653)	(45)
Software services and maintenance	80,347	69	72,609	68	7,738	11
Appraisal services	14,188	77	20,132	73	(5,944)	(30)
Hardware and other	4,540	72	5,425	77	(885)	(16)
Total cost of revenues	$108,970	64%	$108,432	63%	$ 538	0%

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

GROSS MARGIN PERCENTAGES	2005	2004	CHANGE
Software licenses and acquired software	66.5%	66.1%	0.4%
Software services and maintenance	30.9	32.5	(1.6)
Appraisal services	22.8	26.5	(3.7)
Hardware	27.6	23.3	4.3
Overall gross margin	36.1%	37.1%	(1.0)%

Cost of software license revenues. Amortization expense for capitalized software products declined from $6.1 million in 2004 to $5.9 million in 2005, because certain software products became fully amortized during 2005, which offset new amortization expense from software products released in 2004.

Cost of acquired software. In 2005 cost of acquired software declined compared to the prior year because certain acquired software assets recorded for previous acquisitions became fully amortized.

Cost of software services and maintenance revenues. In 2005 cost of software services and maintenance grew 11% while the related software services and maintenance revenues increased 8% compared to the prior year period. During 2005, costs increased at a faster rate than related software services and maintenance revenues, which reflects lower utilization of personnel in our appraisal and tax software division, costs to support our recently released Orion products, a shift in the roles of certain of our development personnel whose costs were capitalized in 2004 to projects that were expensed in 2005, and higher health care costs.

Cost of appraisal services revenues. The decline in the cost of appraisal services revenues is the result of lower appraisal services revenues. We often hire temporary employees to assist in appraisal projects whose term of employment generally ends with the projects' completion. In addition, in the second quarter of 2005 we made significant organizational changes to our appraisal services division because of the declining gross margins.

Gross margin percentage. The overall gross margin percentage decline was due to cost inefficiencies associated with lower appraisal services revenues and efforts and costs to support our recently released Orion products, as well as a shift in the roles of certain of our development personnel whose costs were capitalized in 2004 to projects that are being expensed in 2005 and higher health care costs.

Selling, General and Administrative Expenses

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

($ IN THOUSANDS)	2005	% OF REVENUES	2004	% OF REVENUES	CHANGE $	CHANGE %
Selling, general and administrative expenses	$46,242	27%	$45,451	26%	$791	2%

SG&A increased mainly due to higher health care costs and an increase in the number of marketing personnel. These increases were offset somewhat by lower consulting fees associated with documenting our internal control processes.

Other

Interest income is the main component of other income, which also includes non-usage and other fees associated with a credit agreement we terminated in January 2007, gain on sale of certain assets, gain on risk management assets associated with a foreign exchange contract and miscellaneous other items. Other income increased compared to 2004 mainly due to higher interest rates and a small gain on sale of certain assets.

Income Tax Provision

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

($ IN THOUSANDS)	2005	2004	CHANGE $	CHANGE %
Income tax provision	$5,432	$7,309	$ (1,877)	(26)%
Effective income tax rate	39.9%	41.9%		

The effective income tax rate declined 2% from 2004 due to the qualified manufacturing activities deduction enacted in 2005 and a corporate reorganization in 2005 which favorably impacted our state income tax provision.

FINANCIAL CONDITION AND LIQUIDITY

Historically, we have funded our operations and capital expenditures primarily with cash generated from operating activities. As of December 31, 2006, our combined cash and cash equivalents and short-term investments (including restricted cash equivalents and a restricted certificate of deposit) balance was $41.7 million compared to $37.5 million at December 31, 2005. Cash provided by operating activities was $26.8 million in 2006 compared to $21.2 million in 2005 and $22.2 million in 2004. Cash and short-term investments increased primarily due to continued strong operating performance and higher deferred revenue due to additional maintenance customers and new contract signings.

At December 31, 2006, our days sales outstanding ("DSOs") were 102 days compared to DSOs of 101 days at December 31, 2005. DSOs are calculated based on accounts receivable (excluding long-term receivables) divided by the quotient of annualized quarterly revenues divided by 360 days.

Investing activities used cash of $24.3 million in 2006, while investing activities provided cash of $1.8 million in 2005 and used cash of $9.9 million in 2004. 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 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 during 2006 were capital expenditures of $4.3 million, including $4.1 million for computer hardware and purchased software for internal use, including a new enterprise-wide customer relationship management system, and other asset additions to support internal growth. In 2005 and 2004 investing activities primarily consisted of investments in software development and property and equipment. Investing activities in 2004 also included adjustments to the acquisition of Eden Systems, Inc. ("Eden"). Pursuant to our purchase agreement, two of the shareholders of Eden were granted the right to "put" their remaining shares to Tyler and we were also granted the right to "call" the remaining shares. In 2004, we purchased the remaining 2,500 shares for $725,000 in cash.

We purchased $26.8 million of short-term investments during 2006. Proceeds from sales of short-term investments were $19.0 million during 2006. During 2006, the short-term investments earned interest income of $438,000 which was reinvested. We also earned interest income of $962,000 from money market investments and a restricted certificate of deposit.

Financing activities used cash of $6.0 million in 2006 compared to $14.8 million in 2005 and $9.9 million in 2004. Cash used in financing activities was primarily comprised of purchases of treasury shares, net of proceeds from stock option exercises and contributions from our employee stock purchase plan.

During 2006, we purchased approximately 1.0 million shares of our common stock for an aggregate cash purchase price of $10.5 million.

In 2006, we received $2.9 million from the exercise of options to purchase approximately 623,000 shares of our common stock under our employee stock option plan. During 2005 we issued 436,000 shares of common stock and received $1.8 million in aggregate proceeds, upon exercise of stock options and during 2004 we issued 680,000 shares of common stock and received $1.9 million in aggregate proceeds upon exercise of stock options.

In both 2006 and 2005, we received $1.0 million for contributions to the Tyler Technologies, Inc. Employee Stock Purchase Plan ("ESPP"). The ESPP was adopted by our shareholders in May 2004.

Subsequent to December 31, 2006 and through February 23, 2007 we purchased approximately 188,000 shares of our common stock for an aggregate cash purchase price of $2.6 million.

We maintain a $10.0 million Letter of Credit facility under which the bank will issue cash collateralized letters of credit. As of December 31, 2006 we had outstanding letters of credit totaling $5.0 million to secure surety bonds required by some of our customer contracts.

In the first quarter of 2007 we acquired two small companies and a building for a combined cash purchase price of $5.0 million. We have not finalized the allocation of the excess purchase price over the fair value of the net identifiable assets of the acquired companies but expect this allocation will result in non-cash charges that may have a small dilutive effect on earnings per share in 2007.

Excluding acquisitions, we anticipate that 2007 capital spending will be between $3.5 million and $4.0 million, the majority of which will be related to computer equipment and software for infrastructure expansions. We currently do not expect to capitalize significant amounts related to software development in 2007 but the actual amount and timing of those costs, and whether they are capitalized or expensed may result in additional capitalized software development. Capital spending in 2007 is expected to be funded from existing cash balances and cash flows from operations.

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

We lease office facilities, as well as transportation, computer and other equipment used in our operations under non-cancelable operating lease agreements expiring at various dates through 2013. Most leases contain renewal options and some contain purchase options. Following are the future obligations under non-cancelable leases at December 31, 2006 (in thousands):

	2007	2008	2009	2010	2011	THEREAFTER	TOTAL
Future rental payments under operating leases	$4,591	$4,365	$4,124	$2,843	$2,077	$1,465	$19,465

It is not our usual business practice to enter into off-balance sheet arrangements or to issue guarantees to third parties. As of December 31, 2006 we have no material purchase commitments, except for the operating lease commitments listed above.

CAPITALIZATION

At December 31, 2006, our capitalization consisted of $125.9 million of shareholders' equity.

NEW 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 and disclosure for uncertainty in tax positions, as defined. FIN 48 seeks to reduce the diversity in practice associated with certain aspects of the recognition and measurement related to accounting for income taxes. This interpretation is effective for fiscal years beginning after December 15, 2006. We do not expect the interpretation will have a material impact on our results from operations or financial position.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements." SFAS No. 157 defines fair value, establishes a framework for measuring fair value in accordance with accounting principles generally accepted in the United States, and expands disclosures about fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007, with earlier application encouraged. Any amounts recognized upon adoption as a cumulative effect adjustment will be recorded to the opening balance of retained earnings in the year of adoption. We have not yet determined the impact of SFAS No. 157 on our financial condition and results of operations.

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 December 31, 2006, we had funds invested in auction rate municipal securities and state and municipal bonds, 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 December 31, 2006, and we therefore are not subject to any interest rate risk.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders
Tyler Technologies, Inc.

We have audited the accompanying consolidated balance sheets of Tyler Technologies, Inc. and subsidiaries as of December 31, 2006 and 2005, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2006. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Tyler Technologies, Inc. and subsidiaries at December 31, 2006 and 2005, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2006, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1 in the Notes to the Consolidated Financial Statements, the Company changed its method of accounting for share-based compensation effective January 1, 2006.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Tyler Technologies, Inc.'s internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 20, 2007 expressed an unqualified opinion thereon.

Ernst + Young LLP

Dallas, Texas
February 20, 2007

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders
Tyler Technologies, Inc.

We have audited management's assessment, included in the accompanying Management's Report on Internal Controls over Financial Reporting, that Tyler Technologies, Inc. maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Tyler Technologies, Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the company's internal control over financial reporting based on our audit.

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

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

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

In our opinion, management's assessment that Tyler Technologies, Inc. maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, Tyler Technologies, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Tyler Technologies, Inc. as of December 31, 2006 and 2005, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2006 and our report dated February 20, 2007 expressed an unqualified opinion thereon.

Ernst & Young LLP

Dallas, Texas
February 20, 2007

MANAGEMENT'S ASSESSMENT OF EFFECTIVENESS OF THE COMPANY'S INTERNAL CONTROL OVER FINANCIAL REPORTING

Evaluation of Disclosure Controls and Procedures — Our chief executive officer and our chief financial officer have evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Securities Exchange Act Rules 13a-15(e)) as of December 31, 2006. Based on such evaluation, our chief executive officer and chief financial officer have concluded that as of December 31, 2006 such disclosure controls and procedures were effective and designed to ensure that information required to be disclosed by us in the reports we file or submit under the Securities Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms, and include controls and procedures designed to ensure that information required to be disclosed by us in such reports is accumulated and communicated to our management, including the chief executive officer and chief financial officer, as appropriate to allow timely decisions regarding required disclosure.

Internal Control Over Financial Reporting — During the quarter ended December 31, 2006, there were no changes in our internal controls over financial reporting, as defined in Securities Exchange Act Rule 13a-15(f) and 15d-15(f), that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Management's Report on Internal Control Over Financial Reporting — Tyler's management is responsible for establishing and maintaining effective internal control over financial reporting as defined in Securities Exchange Act Rule 13a-15(f). Tyler's internal control over financial reporting is designed to provide reasonable assurance to Tyler's management and board of directors regarding the preparation and fair presentation of published financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

Management assessed the effectiveness of Tyler's internal control over financial reporting as of December 31, 2006. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control – Integrated Framework. Based on our assessment, we believe that, as of December 31, 2006, Tyler's internal control over financial reporting is effective based on those criteria.

Management's assessment of the effectiveness of internal control over financial reporting as of December 31, 2006 has been audited by Ernst & Young, LLP, the independent registered public accounting firm who also audited Tyler's consolidated financial statements. Ernst & Young's attestation report on management's assessment of Tyler's internal control over financial reporting appears on page 33 hereof.

CONSOLIDATED STATEMENTS OF OPERATIONS

FOR THE YEARS ENDED DECEMBER 31 IN THOUSANDS, EXCEPT PER SHARE AMOUNTS	2006	2005	2004
Revenues:			
Software licenses	**$ 37,414**	$ 29,552	$ 30,258
Software services	**57,588**	51,532	49,786
Maintenance	**73,413**	64,728	57,760
Appraisal services	**19,755**	18,374	27,394
Hardware and other	**7,133**	6,271	7,072
Total revenues	**195,303**	170,457	172,270
Cost of revenues:			
Software licenses	**9,980**	9,101	8,819
Acquired software	**1,360**	794	1,447
Software services and maintenance	**90,330**	80,347	72,609
Appraisal services	**13,563**	14,188	20,132
Hardware and other	**5,266**	4,540	5,425
Total cost of revenues	**120,499**	108,970	108,432
Gross profit	**74,804**	61,487	63,838
Selling, general and administrative expenses	**51,711**	46,242	45,451
Restructuring charge	**–**	1,260	–
Amortization of customer and trade name intangibles	**1,318**	1,266	1,267
Operating income	**21,775**	12,719	17,120
Other income, net	**1,080**	906	317
Income before income taxes	**22,855**	13,625	17,437
Income tax provision	**8,493**	5,432	7,309
Net income	**$ 14,362**	$ 8,193	$ 10,128
Earnings per common share:			
Basic	**$ 0.37**	$ 0.21	$ 0.25
Diluted	**$ 0.34**	$ 0.19	$ 0.23
Basic weighted average common shares outstanding	**38,817**	39,439	41,288
Diluted weighted average common shares outstanding	**41,868**	42,075	44,566

See accompanying notes.

CONSOLIDATED BALANCE SHEETS

DECEMBER 31	2006	2005
IN THOUSANDS, EXCEPT SHARE AND PER SHARE AMOUNTS		
ASSETS		
Current assets:		
Cash and cash equivalents	**$ 17,212**	$ 20,733
Restricted cash equivalents	**4,962**	–
Short-term investments available-for-sale	**19,543**	11,750
Restricted certificate of deposit	**–**	4,750
Accounts receivable (less allowance for losses of $2,971 in 2006 and $1,991 in 2005)	**58,188**	49,644
Prepaid expenses	**6,864**	5,158
Other current assets	**2,326**	2,201
Deferred income taxes	**2,579**	2,128
Total current assets	**111,674**	96,364
Accounts receivable, long-term portion	**1,675**	1,547
Property and equipment, net	**7,390**	5,759
Other assets:		
Goodwill	**66,127**	53,709
Customer related intangibles, net	**17,502**	17,696
Software, net	**14,554**	17,645
Trade name, net	**1,188**	1,262
Restricted certificate of deposit	**–**	250
Sundry	**166**	205
	$220,276	$194,437
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	**$ 5,063**	$ 3,330
Accrued liabilities	**17,735**	16,027
Deferred revenue	**62,387**	51,304
Income taxes payable	**–**	289
Total current liabilities	**85,185**	70,950
Deferred income taxes	**9,216**	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	**151,627**	151,515
Accumulated other comprehensive loss, net of tax	**(10)**	–
Retained earnings	**18,131**	3,769
Treasury stock, at cost; 9,255,783 and 9,273,342 shares in 2006 and 2005, respectively	**(44,354)**	(43,568)
Total shareholders' equity	**125,875**	112,197
	$220,276	$194,437

See accompanying notes.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

FOR THE YEARS ENDED DECEMBER 31, 2006, 2005 AND 2004

IN THOUSANDS	COMMON STOCK SHARES	COMMON STOCK AMOUNT	ADDITIONAL PAID-IN CAPITAL	ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)	RETAINED EARNINGS (DEFICIT)	TREASURY STOCK SHARES	TREASURY STOCK AMOUNT	TOTAL SHAREHOLDERS' EQUITY
Balance at December 31, 2003	48,148	$ 481	$ 156,201	$ (32)	$ (14,552)	(6,704)	$ (24,191)	$117,907
Comprehensive income:								
Net income	–	–	–	–	10,128	–	–	10,128
Unrealized loss on investment securities, net of tax	–	–	–	(37)	–	–	–	(37)
Reclassification adjustment, net of income taxes of $37	–	–	–	69	–	–	–	69
Total comprehensive income								10,160
Issuance of shares pursuant to stock compensation plan	–	–	(3,704)	–	–	680	5,644	1,940
Treasury stock purchases	–	–	–	–	–	(1,459)	(12,518)	(12,518)
Stock warrant exercises	–	–	(143)	–	–	16	143	–
Issuance of shares pursuant to Employee Stock Purchase Plan	–	–	(66)	–	–	44	395	329
Federal income tax benefit related to exercise of stock options	–	–	582	–	–	–	–	582
Balance at December 31, 2004	48,148	481	152,870	–	(4,424)	(7,423)	(30,527)	118,400
Comprehensive income:								
Net income	–	–	–	–	8,193	–	–	8,193
Unrealized loss on investment securities, net of tax	–	–	–	(8)	–	–	–	(8)
Reclassification adjustment, net of income taxes of $5	–	–	–	8	–	–	–	8
Total comprehensive income								8,193
Issuance of shares pursuant to stock compensation plan	–	–	(1,570)	–	–	436	3,370	1,800
Stock compensation	–	–	18	–	–	–	–	18
Treasury stock purchases	–	–	–	–	–	(2,457)	(17,683)	(17,683)
Issuance of shares pursuant to Employee Stock Purchase Plan	–	–	(116)	–	–	171	1,272	1,156
Federal income tax benefit related to exercise of stock options	–	–	313	–	–	–	–	313
Balance at December 31, 2005	48,148	481	151,515	–	3,769	(9,273)	(43,568)	112,197
Comprehensive income:								
Net income	**–**	**–**	**–**	**–**	**14,362**	**–**	**–**	**14,362**
Unrealized loss on investment securities, net of tax	**–**	**–**	**–**	**(10)**	**–**	**–**	**–**	**(10)**
Total comprehensive income								**14,352**
Issuance of shares pursuant to stock compensation plan	**–**	**–**	**(3,158)**	**–**	**–**	**623**	**6,074**	**2,916**
Stock compensation	**–**	**–**	**1,960**	**–**	**–**	**–**	**–**	**1,960**
Treasury stock purchases	**–**	**–**	**–**	**–**	**–**	**(1,033)**	**(10,531)**	**(10,531)**
Issuance of shares pursuant to Employee Stock Purchase Plan	**–**	**–**	**22**	**–**	**–**	**102**	**918**	**940**
Federal income tax benefit related to exercise of stock options	**–**	**–**	**1,150**	**–**	**–**	**–**	**–**	**1,150**
Issuance of shares for acquisitions	**–**	**–**	**138**	**–**	**–**	**325**	**2,753**	**2,891**
Balance at December 31, 2006	**48,148**	**$481**	**$ 151,627**	**$ (10)**	**$ 18,131**	**(9,256)**	**$(44,354)**	**$125,875**

See accompanying notes.

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED DECEMBER 31 IN THOUSANDS	2006	2005	2004
Cash flows from operating activities:			
Net income	**$14,362**	$ 8,193	$10,128
Adjustments to reconcile net income to net cash provided by operations:			
Depreciation and amortization	**10,102**	10,443	11,386
Share-based compensation expense	**1,960**	–	–
Realized net losses on sales of investment securities	**–**	–	106
Purchased in-process research and development charge	**140**	–	–
Non-cash interest and other charges	**220**	(73)	88
Provision for losses – accounts receivable	**2,077**	1,641	796
Deferred income tax benefit	**(2,520)**	(2,200)	(300)
Changes in operating assets and liabilities, exclusive of effects of acquired companies:			
Accounts receivable	**(10,400)**	(7,031)	(3,760)
Income tax payable	**(78)**	(421)	1,063
Prepaid expenses and other current assets	**(1,496)**	(2,117)	(1,084)
Accounts payable	**1,626**	561	511
Accrued liabilities	**972**	2,428	(961)
Deferred revenue	**9,839**	9,763	4,186
Net cash provided by operating activities	**26,804**	21,187	22,159
Cash flows from investing activities:			
Purchases of short-term investments	**(26,825)**	(16,882)	(12,277)
Proceeds from sales of short-term investments	**19,016**	18,964	10,055
Cost of acquisitions, net of cash acquired	**(12,237)**	–	(946)
Decrease in restricted investments	**38**	2,500	–
Investment in software development costs	**(236)**	(1,002)	(4,575)
Additions to property and equipment	**(4,088)**	(1,734)	(2,267)
Other	**6**	(26)	96
Net cash (used by) provided by investing activities	**(24,326)**	1,820	(9,914)
Cash flows from financing activities:			
Purchase of treasury shares	**(10,531)**	(17,683)	(12,518)
Contributions from employee stock purchase plan	**1,002**	1,036	673
Proceeds from exercise of stock options	**2,916**	1,800	1,940
Excess tax benefits from share-based compensation expense	**614**	–	–
Payments on notes payable	**–**	–	(35)
Net cash used by financing activities	**(5,999)**	(14,847)	(9,940)
Net (decrease) increase in cash and cash equivalents	**(3,521)**	8,160	2,305
Cash and cash equivalents at beginning of year	**20,733**	12,573	10,268
Cash and cash equivalents at end of year	**$17,212**	$20,733	$12,573

See accompanying notes.

(TABLES IN THOUSANDS, EXCEPT PER SHARE DATA)

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

DESCRIPTION OF BUSINESS

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

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

PRINCIPLES OF CONSOLIDATION

In 2005, we merged all of our subsidiaries into the parent company. The consolidated financials as of December 31, 2004 include our parent company and our subsidiaries, all of which were wholly-owned.

CASH, CASH EQUIVALENTS, SHORT-TERM INVESTMENTS AND OTHER

Cash equivalents include items almost as liquid as cash, such as money market investments with insignificant interest rate risk and original maturities of three months or less at the time of purchase. For purposes of the statements of cash flows, we consider all investments with original maturities of three months or less to be cash equivalents.

In accordance with Statement of Financial Accounting Standards ("SFAS") No. 115, "Accounting for Certain Investments in Debt and Equity Securities," we determine the appropriate classification of debt and equity securities at the time of purchase and re-evaluate the classification as of each balance sheet date. At December 31, 2006 and 2005, we classified our short-term investments as available-for-sale securities pursuant to SFAS No. 115. Investments which are classified as available-for-sale are recorded at fair value as determined by quoted market price and unrealized holding gains and losses, net of the related tax effect, if any, are not reflected in earnings but are reported as a separate component of other comprehensive income until realized. Interest and dividends earned on these securities are reinvested in the securities. The cost basis of securities sold is determined using the average cost method. Following is a summary of short-term investments:

DECEMBER 31, 2006	COST	UNREALIZED GAINS	UNREALIZED LOSSES	ESTIMATED FAIR VALUE
Auction rate municipal securities	**$14,875**	**$ –**	**$ –**	**$14,875**
State and municipal bonds	**4,684**	**–**	**(16)**	**4,668**
	$19,559	**$ –**	**$ (16)**	**$19,543**

DECEMBER 31, 2005	COST	UNREALIZED GAINS	UNREALIZED LOSSES	ESTIMATED FAIR VALUE
Auction rate municipal securities	$11,750	$ –	$ –	$11,750

We maintain a $10.0 million Letter of Credit facility under which the bank will issue cash collateralized letters of credit. As of December 31, 2006 approximately $5.0 million of our cash equivalents are restricted and designated as collateral for our letters of credit issued in connection with our surety bond program. These letters of credit expire during 2007.

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 Securities and Exchange Commission ("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 involve significant production, modification or customization of the software, or where software services are otherwise considered essential to the functionality of the software in the customer's environment, we use contract accounting and apply the provisions of SOP 81-1 "Accounting for Performance of Construction – Type and Certain Production – Type Contracts."

If the arrangement does not require significant production, modification or customization or where the software services are not considered essential to the functionality of the software, revenue is recognized when all of the following conditions are met:

i. persuasive evidence of an arrangement exists;
ii. delivery has occurred;
iii. our fee is fixed or determinable; and
iv. collectibility is probable.

For multiple element arrangements, each element of the arrangement is analyzed and we allocate a portion of the total arrangement fee to the elements based on the fair value of the element using vendor-specific objective evidence of fair value ("VSOE"), regardless of any separate prices stated within the contract for each element. Fair value is considered the price a customer would be required to pay if the element was sold separately based on our historical experience of stand-alone sales of these elements to third parties. For PCS, we use renewal rates for continued support arrangements to determine fair value. For software services, we use the fair value we charge our customers when those services are sold separately. We monitor our transactions to insure we maintain and periodically revise VSOE to reflect fair value. In software arrangements in which we have the fair value of all undelivered elements but not of a delivered element, we apply the "residual method" as allowed under SOP 98-9 in accounting for any element of a multiple element arrangement involving software that remains undelivered such that any discount inherent in a contract is allocated to the delivered element. Under the residual method, if the fair value of all undelivered elements is determinable, the fair value of the undelivered elements is deferred and the remaining portion of the arrangement fee is allocated to the delivered element(s) and is recognized as revenue assuming the other revenue recognition criteria are met. In software arrangements in which we do not have VSOE for all undelivered elements, revenue is deferred until fair value is determined or all elements for which we do not have VSOE have been delivered. Alternatively, if sufficient VSOE does not exist and the only undelivered element is services that do not involve significant modification or customization of the software, the entire fee is recognized over the period during which the services are expected to be performed.

Software Licenses

We recognize the revenue allocable to software licenses and specified upgrades upon delivery of the software product or upgrade to the customer, unless the fee is not fixed or determinable or collectibility is not probable. If the fee is not fixed or determinable, including new customers whose payment terms are three months or more from shipment, revenue is generally recognized as payments become due from the customer. If collectibility is not considered probable, revenue is recognized when the fee is collected. Arrangements that include software services, such as training or installation, are evaluated to determine whether those services are essential to the product's functionality.

A majority of our software arrangements involve "off-the-shelf" software. We consider software to be off-the-shelf software if it can be added to an arrangement with minor changes in the underlying code and it can be used by the customer for the customer's purpose upon installation. For off-the-shelf software arrangements, we recognize the software license fee as revenue after delivery has occurred, customer acceptance is reasonably assured, that portion of the fee represents a non-refundable enforceable claim and is probable of collection, and the remaining services such as training are not considered essential to the product's functionality.

For arrangements that involve significant production, modification or customization of the software, or where software services are otherwise considered essential, we recognize revenue using contract accounting. We generally use the percentage-of-completion method to recognize revenue from these arrangements. We measure progress-to-completion primarily using labor hours incurred, or value added. The percentage-of-completion method generally results in the recognition of reasonably consistent profit margins over the life of a contract 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.

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.

Postcontract Customer Support

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

Appraisal Services:

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

Other:

The majority of deferred revenue consists of unearned support and maintenance revenue that has been billed based on contractual terms in the underlying arrangement with the remaining balance consisting of payments received in advance of revenue being earned under software licensing, software and appraisal services and hardware installation. Unbilled revenue is not billable at the balance sheet date but is recoverable over the remaining life of the contract through billings made in accordance with contractual agreements. The termination clauses in most of our contracts provide for the payment for the fair value of products delivered and services performed in the event of an early termination.

Prepaid expenses and other current assets include direct and incremental costs, consisting primarily of commissions associated with arrangements for which revenue recognition has been deferred and third party subcontractor payments. Such costs are expensed at the time the related revenue is recognized.

USE OF ESTIMATES

The preparation of our consolidated financial statements in conformity with accounting principles generally accepted in the United States ("GAAP") requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant items subject to such estimates and assumptions include the application of the percentage-of-completion and proportionate performance methods of revenue recognition, the carrying amount and estimated useful lives of intangible assets and valuation allowance for receivables. In addition we are primarily self-insured for employee health care and base our self-insurance liability on claims filed and an estimate of claims incurred but not yet reported. Actual results could differ from estimates.

PROPERTY AND EQUIPMENT, NET

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

RESEARCH AND DEVELOPMENT COSTS

Research and development costs are included with selling, general and administrative expenses and are expensed when incurred. We expensed research and development costs of $3.3 million during 2006, $2.4 million during 2005 and $2.5 million during 2004.

INCOME TAXES

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

STOCK COMPENSATION

Prior to January 1, 2006, we accounted for stock options using the intrinsic value method under Accounting Principles Board Opinion ("APB") No. 25, "Accounting for Stock Issued to Employees" and related interpretations, as permitted by SFAS No. 123, "Accounting for Stock-Based Compensation", under which no compensation expense was recognized for stock option grants. Accordingly, share-based compensation related to our stock options for periods prior to 2006 are included as a pro forma disclosure in the financial statement footnotes.

Effective January 1, 2006, we adopted the fair value recognition provisions of SFAS No. 123R, "Share-Based Payment" using the modified-prospective method. Under this transition method, compensation cost recognized in 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, 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.

As a result of adopting SFAS No. 123R on January 1, 2006, our earnings before income taxes and net earnings for 2006 were $2.0 million and $1.6 million lower, respectively, than if we had continued to account for share-based compensation under APB No. 25. Basic and diluted earnings per share for 2006 would have been $0.04 higher, had we continued to account for share-based compensation under APB No. 25.

Prior to the adoption of SFAS No. 123R, we presented all tax benefits of deductions resulting from the exercise of options as operating cash flows in the Consolidated Statements of Cash Flows. SFAS No. 123R requires the cash flows resulting from tax deductions in excess of the compensation cost recognized for those options (excess tax benefits) to be classified as financing cash flows. The $614,000 excess tax benefit classified as a financing cash inflow for 2006 would have been classified as an operating cash inflow if we had not adopted SFAS No. 123R.

If compensation expense for our stock-based awards to employees had been recognized using the fair value method of SFAS No. 123R rather than the intrinsic value method under APB No. 25, net income and earnings per share would have been reduced to the pro forma amounts below for 2005 and 2004.

YEARS ENDED DECEMBER 31,	2005	2004
Net income as reported	$ 8,193	$10,128
Add stock-based employee compensation cost included in net income, net of related tax benefit	–	–
Deduct total stock-based employee compensation expense determined under fair-value-based method for all awards, net of related tax benefit	(831)	(1,086)
Pro forma net income	$7,362	$ 9,042
Basic earnings per share:		
As reported	$ 0.21	$ 0.25
Pro forma	$ 0.19	$ 0.22
Diluted earnings per share:		
As reported	$ 0.19	$ 0.23
Pro forma	$ 0.17	$ 0.20

See Note 9 for further information on our share-based compensation plans.

SEGMENT AND RELATED INFORMATION

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

GOODWILL AND OTHER INTANGIBLE ASSETS

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

Under SFAS No. 142, "Goodwill and Other Intangible Assets," we evaluate goodwill for impairment annually as of April 1st, or more frequently if impairment indicators arise. An impairment loss is recognized to the extent that the carrying amount exceeds the asset's fair value. In the implementation of SFAS No. 142, we identified two reporting units for impairment testing. The appraisal services and appraisal software stand-alone business unit qualified as a reporting unit since it is one level below an operating segment, discrete financial information exists for the business unit and the executive management group directly reviews this business unit. The other software business units were aggregated into the other single reporting unit. The appraisal services and appraisal software stand-alone business unit is organized in such a manner that both of its revenue sources are tightly integrated with each other and discrete financial information at the operating profit level does not exist for this business unit's respective revenue sources.

IMPAIRMENT OF LONG-LIVED ASSETS

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

COSTS OF COMPUTER SOFTWARE

Software development costs have been accounted for in accordance with SFAS No. 86, ''Accounting for the Costs of Computer Software to be Sold, Leased, or Otherwise Marketed.'' Under SFAS No. 86, capitalization of software development costs begins upon the establishment of technological feasibility and prior to the availability of the product for general release to customers. We capitalized software development costs of approximately $236,000 during 2006, $1.0 million during 2005, and $4.6 million during 2004. Software development costs primarily consist of personnel costs and rent for related office space. We begin to amortize capitalized costs when a product is available for general release to customers. Amortization expense is determined on a product-by-product basis at a rate not less than straight-line basis over the product's remaining estimated economic life, but not to exceed five years. Amortization of software development costs was approximately $5.1 million in 2006, $5.9 million in 2005, and $6.1 million in 2004 and is included in cost of software license revenue in the accompanying consolidated statements of operations.

FAIR VALUE OF FINANCIAL INSTRUMENTS

Cash and cash equivalents, accounts receivables, accounts payables, deferred revenues and certain other assets at cost approximate fair value because of the short maturity of these instruments. Our available-for-sale investments are recorded at fair value based on quoted market prices.

CONCENTRATIONS OF CREDIT RISK AND UNBILLED RECEIVABLES

Concentrations of credit risk with respect to receivables are limited due to the size and geographical diversity of our customer base. Historically, our credit losses have not been significant. As a result, we do not believe we have any significant concentrations of credit risk as of December 31, 2006.

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

The termination clauses in most of our contracts provide for the payment for the fair value of products delivered or services performed in the event of early termination. Our property appraisal outsourcing service contracts can range up to three years and, in one case, as long as six years in duration. In connection with these contracts, as well as certain software service contracts, we may perform work prior to when the software and services are billable and/or payable pursuant to the contract. We have historically recorded such unbilled receivables (costs and estimated profit in excess of billings) in connection with (1) property appraisal services contracts accounted for using proportionate performance accounting in which the revenue is earned based upon activities performed in one accounting period but the billing normally occurs shortly thereafter and may span another accounting period; (2) software services contracts accounted for using the percentage-of-completion method of revenue recognition using labor hours as a measure of progress towards completion in which the services are performed in one accounting period but the billing for the software element of the arrangement may be based upon the specific phase of the implementation; (3) software revenue for which we have objective evidence that the customer-specified objective criteria has been met but the billing has not yet been submitted to the customer; and (4) in a limited number of cases, we may grant extended payment terms generally to existing customers with whom we have a long-term relationship and favorable collection history. In addition, certain of our property appraisal outsourcing contracts are required by law to have an amount withheld from a progress billing (generally a 10% retention) until final and satisfactory project completion is achieved, typically upon the completion of fieldwork or formal hearings.

In connection with this activity, we have recorded unbilled receivables of $10.1 million and $8.6 million at December 31, 2006 and 2005, respectively, with billing primarily dependent on fixed payment schedules based on specific calendar dates. We also have recorded retention receivable of $3.8 million and $1.7 million at December 31, 2006 and 2005, respectively, and these retentions become payable upon the completion of the contract or completion of our field work and formal hearings. Unbilled receivables and retention receivables expected to be collected in excess of one year have been classified as non-current receivables in the accompanying consolidated balance sheets.

INDEMNIFICATION

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

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

NEW ACCOUNTING PRONOUNCEMENTS

In 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 and disclosure for uncertainty in tax positions, as defined. FIN 48 seeks to reduce the diversity in practice associated with certain aspects of the recognition and measurement related to accounting for income taxes. This interpretation is effective for fiscal years beginning after December 15, 2006. We do not expect the interpretation will have a material impact on our results from operations or financial position.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements." SFAS No. 157 defines fair value, establishes a framework for measuring fair value in accordance with accounting principles generally accepted in the United States, and expands disclosures about fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007, with earlier application encouraged. Any amounts recognized upon adoption as a cumulative effect adjustment will be recorded to the opening balance of retained earnings in the year of adoption. We have not yet determined the impact of SFAS No. 157 on our financial condition and results of operations.

(2) ACQUISITIONS

In 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 believe the products offered by Mazik and TACS will complement our business model and give us additional opportunities to provide our customers with solutions tailored specifically for local governments.

We acquired assets of approximately $300,000 and assumed liabilities of approximately $1.7 million. We recorded goodwill of $12.4 million, all of which is expected to be deductible for tax purposes, and other intangible assets of $3.3 million. The $3.3 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 December 31, 2006 reflects the allocation of the purchase price to the assets acquired and liabilities assumed based on their fair values at the date of acquisition. The operating results of the acquired businesses are included in our results of operations since their respective dates of acquisition in late January 2006.

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

(3) 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.

(4) PROPERTY AND EQUIPMENT, NET

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

	USEFUL LIVES (YEARS)	2006	2005
Land	–	**$ 115**	$ 115
Transportation equipment	5	**359**	389
Computer equipment and purchased software	3-7	**15,240**	11,722
Furniture and fixtures	5	**4,452**	4,347
Building and leasehold improvements	5-25	**2,426**	2,376
		22,592	18,949
Accumulated depreciation and amortization		**(15,202)**	(13,190)
Property and equipment, net		**$ 7,390**	$ 5,759

Depreciation expense was $2.4 million during 2006, $2.5 million during 2005, and $2.5 million during 2004.

(5) GOODWILL AND OTHER INTANGIBLE ASSETS

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

	2006	2005
Gross carrying amount of acquisition intangibles:		
Goodwill	**$ 66,127**	$ 53,709
Customer related intangibles	**25,291**	24,278
Software acquired	**19,113**	16,023
Trade name	**1,681**	1,643
	112,212	95,653
Accumulated amortization	**(23,449)**	(20,771)
Acquisition intangibles, net	**$ 88,763**	$ 74,882
Post acquisition software development costs	**$ 36,715**	$ 36,478
Accumulated amortization	**(26,107)**	(21,048)
Post acquisition software costs, net	**$ 10,608**	$ 15,430

Total amortization expense for acquisition related intangibles and post acquisition software development costs was $7.7 million during 2006, $8.0 million during 2005, and $8.8 million during 2004.

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

	DECEMBER 31, 2006			DECEMBER 31, 2005		
	GROSS CARRYING AMOUNT	WEIGHTED AVERAGE AMORTIZATION PERIOD	ACCUMULATED AMORTIZATION	GROSS CARRYING AMOUNT	WEIGHTED AVERAGE AMORTIZATION PERIOD	ACCUMULATED AMORTIZATION
Non-amortizable intangibles:						
Goodwill	**$ 66,127**	**–**	**$ –**	$ 53,709	–	$ –
Amortizable intangibles:						
Customer related intangibles	**25,291**	**21 years**	**7,789**	24,278	22 years	6,582
Software acquired	**19,113**	**5 years**	**15,167**	16,023	5 years	13,808
Trade name	**1,681**	**21 years**	**493**	1,643	21 years	381

The changes in the carrying amount of goodwill for the two years ended December 31, 2006 are as follows:

Balance as of December 31, 2004 and December 31, 2005	$ 53,709
Goodwill acquired during the year related to the purchase of MazikUSA, Inc.	10,198
Goodwill acquired during the year related to the purchase of TACS, Inc.	2,220
Balance as of December 31, 2006	**$ 66,127**

Estimated annual amortization expense relating to acquisition intangibles, including acquired software for which the amortization expense is recorded as cost of revenues, is as follows:

YEARS ENDING DECEMBER 31,	
2007	$ 2,708
2008	2,621
2009	1,855
2010	1,855
2011	1,273

(6) ACCRUED LIABILITIES

Accrued liabilities consist of the following at December 31:

	2006	2005
Accrued wages, bonuses and commissions	**$10,392**	$ 9,381
Other accrued liabilities	**4,416**	3,907
Accrued health claims	**1,302**	1,379
Accrued third party contract costs	**1,625**	1,360
	$ 17,735	$16,027

(7) INCOME TAX

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

YEARS ENDED DECEMBER 31,	2006	2005	2004
Current:			
Federal	**$ 9,701**	$ 6,340	$ 5,978
State	**1,312**	1,292	1,631
	11,013	7,632	7,609
Deferred	**(2,520)**	(2,200)	(300)
	$8,493	$5,432	$7,309

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

YEARS ENDED DECEMBER 31,	2006	2005	2004
Income tax expense at statutory rate	**$7,999**	$ 4,769	$ 6,103
State income tax, net of federal income tax benefit	**430**	778	1,060
Non-deductible business expenses	**518**	182	195
Qualified manufacturing activities	**(263)**	(149)	–
Other, net	**(191)**	(148)	(49)
	$8,493	$ 5,432	$ 7,309

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

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

	2006	2005
Deferred income tax assets:		
Operating expenses not currently deductible	**$ 1,801**	$ 1,530
Employee benefit plans	**1,224**	819
Property and equipment	**49**	–
Total deferred income tax assets	**3,074**	2,349
Deferred income tax liabilities:		
Property and equipment	**–**	(94)
Intangible assets	**(9,535)**	(11,202)
Other	**(176)**	(215)
Total deferred income tax liabilities	**(9,711)**	(11,511)
Net deferred income tax liabilities	**$(6,637)**	$ (9,162)

Although realization is not assured, we believe it is more likely than not that all the deferred tax assets at December 31, 2006 and 2005 will be realized. Accordingly, we believe no valuation allowance is required for the deferred tax assets. However, the amount of the deferred tax asset considered realizable could be adjusted in the future if estimates of reversing taxable temporary differences are revised.

We paid income taxes, net of refunds received, of $10.4 million in 2006, $8.1 million in 2005, and $6.5 million in 2004.

(8) SHAREHOLDERS' EQUITY

The following table details activity in our common stock:

	2006		2005		2004	
YEARS ENDED DECEMBER 31,	SHARES	AMOUNT	SHARES	AMOUNT	SHARES	AMOUNT
Purchases of common stock	**(1,033)**	**$ (10,531)**	(2,457)	$(17,683)	(1,459)	$(12,518)
Stock option exercises	**623**	**2,916**	436	1,800	680	1,940
Employee stock plan purchases	**102**	**940**	171	1,156	44	329
Shares issued for acquisitions	**325**	**2,891**	–	–	–	–

Subsequent to December 31, 2006 and through February 23, 2007, we repurchased 188,000 shares for an aggregate purchase price of $2.6 million. As of February 23, 2007 we had authorization from our board of directors to repurchase up to 843,000 additional shares of our common stock.

As of December 31, 2006, we had warrants outstanding to purchase 1.6 million shares of common stock at $2.50 per share. These warrants expire in September 2007.

(9) 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 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 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 APB No. 25, "Accounting for Stock Issued to Employees," and related Interpretations, and provided the required pro forma disclosures under SFAS No. 123.

As of December 31, 2006, there were 974,000 shares available for future grants under the plan from the 8.5 million shares previously approved by the stockholders.

Determining Fair Value Under SFAS No. 123R

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

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

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.

The following weighted average assumptions were used for options granted:

YEARS ENDED DECEMBER 31,	2006	2005	2004
Expected life (in years)	**6**	5	5
Expected volatility	**45.0%**	48.4%	79.1%
Risk-free interest rate	**4.9%**	4.1%	3.7%
Expected forfeiture rate	**3%**	0%	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 which is recorded in the statement of operations for year ending December 31, 2006:

Cost of software services and maintenance	**$ 147**
Selling, general and administrative expense	**1,813**
Total share-based compensation expense	**1,960**
Tax benefit	**(336)**
Net decrease in net income	**$ 1,624**

Share-based compensation expense recorded in the statement of operations for 2005 and 2004 was zero.

At December 31, 2006 we had unvested options to purchase 1.4 million shares with a weighted average grant date fair value of $4.08. As of December 31, 2006, we had $4.6 million of total unrecognized compensation cost related to unvested options, net of expected forfeitures, which is expected to be amortized over a weighted average amortization period of 2.2 years.

Stock Option Activity

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
Options outstanding at December 31, 2003	4,630	$ 3.94		
Granted	62	9.18		
Exercised	(680)	2.85		
Forfeited	(48)	3.18		
Options outstanding at December 31, 2004	3,964	4.21		
Granted	1,135	7.49		
Exercised	(436)	4.12		
Forfeited	(55)	7.49		
Options outstanding at December 31, 2005	4,608	4.99		
Granted	**237**	**10.76**		
Exercised	**(623)**	**4.68**		
Forfeited	**(127)**	**6.42**		
Expired	**(8)**	**5.21**		
Options outstanding at December 31, 2006	**4,087**	**5.32**	**6**	**$35,703**
Options exercisable at December 31, 2006	**2,727**	**$4.25**	**5**	**$26,760**

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

	2006	2005	2004
Weighted average grant-date fair value of stock options granted	**$ 6.13**	$ 3.47	$ 6.03
Total fair value of stock options vested	**1,757**	1,519	2,719
Total intrinsic value of stock options exercised	**4,227**	1,753	4,362

Employee Stock Purchase Plan

Under our Employee Stock Purchase Plan ("ESPP") participants may contribute up to 15% of their annual compensation to purchase common shares of Tyler. The purchase price of the shares is equal to 85% of the closing price of Tyler shares on the last day of each quarterly offering period. As of December 31, 2006, there were 683,000 shares available for future grants under the ESPP from the 1.0 million shares originally reserved for issuance.

(10) EARNINGS PER SHARE

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

YEARS ENDED DECEMBER 31,	2006	2005	2004
Numerator:			
Net income for basic and diluted earnings per share	**$14,362**	$ 8,193	$ 10,128
Denominator:			
Denominator for basic earnings per share – Weighted-average shares	**38,817**	39,439	41,288
Effect of dilutive securities:			
Employee stock options	**1,799**	1,561	2,114
Warrants	**1,252**	1,075	1,164
Potentially dilutive shares	**3,051**	2,636	3,278
Denominator for diluted earnings per share – Adjusted weighted-average shares	**41,868**	42,075	44,566
Basic earnings per share	**$ 0.37**	$ 0.21	$ 0.25
Diluted earnings per share	**$ 0.34**	$ 0.19	$ 0.23

Stock options representing the right to purchase common stock of 13,000 shares in 2006, 229,000 shares in 2005, and 110,000 shares in 2004, had exercise prices greater than the average quoted market price of our common stock. These options were outstanding during 2006, 2005 and 2004, but were not included in the computation of diluted earnings per share because their inclusion would have had an antidilutive effect.

(11) LEASES

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

Rent expense was approximately $4.9 million in 2006, $4.6 million in 2005, and $4.6 million in 2004, which included rent expense associated with related party lease agreements of $1.7 million in 2006, $1.5 million in 2005, and $1.4 million in 2004.

Future minimum lease payments under all noncancelable leases at December 31, 2006 are as follows:

YEARS ENDING DECEMBER 31,	
2007	$ 4,591
2008	4,365
2009	4,124
2010	2,843
2011	2,077
Thereafter	1,465
	$19,465

Included in future minimum lease payments are noncancelable payments due to related parties of $1.7 million each in 2007, 2008 and 2009; $552,000 in 2010 and none thereafter.

(12) EMPLOYEE BENEFIT PLANS

We provide a defined contribution plan for the majority of our employees meeting minimum service requirements. The employees can contribute up to 30% of their current compensation to the plan subject to certain statutory limitations. We contribute up to a maximum of 2.5% of an employee's compensation to the plan. We made contributions to the plan and charged operations $1.6 million during 2006, $1.0 million during 2005, and $801,000 during 2004.

(13) COMMITMENTS AND CONTINGENCIES

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

(14) SUBSEQUENT EVENTS

In the first quarter of 2007 we acquired two small companies and a building for a combined cash purchase price of $5.0 million. We have not finalized the allocation of the excess purchase price over the fair value of the net identifiable assets of the acquired companies but expect this allocation will result in non-cash charges that may have a small dilutive effect on earnings per share in 2007.

(15) QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

The following tables contain selected financial information from unaudited consolidated statements of operations for each quarter of 2006 and 2005.

	2006 [B]				2005 [C]			
QUARTER ENDED	DEC. 31	SEP. 30	JUNE 30	MAR. 31	DEC. 31	SEP. 30	JUNE 30	MAR. 31
Revenues	**$51,155**	**$50,139**	**$49,151**	**$44,858**	$44,307	$42,306	$43,185	$40,659
Gross profit [A]	**20,239**	**20,157**	**18,946**	**15,462**	16,700	15,822	16,050	12,915
Income before income taxes	**6,732**	**6,936**	**5,828**	**3,359**	5,097	4,284	3,444	800
Net income	**4,177**	**4,413**	**3,760**	**2,012**	3,121	2,581	2,021	470
Earnings per diluted share	**0.10**	**0.11**	**0.09**	**0.05**	0.07	0.06	0.05	0.01
Shares used in computing diluted earnings per share	**42,163**	**41,898**	**41,946**	**41,894**	41,869	41,771	41,943	42,735

[A] In the fourth quarter of 2005 we reclassified amortization cost of acquired software from amortization of acquisition intangibles to cost of revenues. The reconciliation of gross profit to the 2005 Form 10-Qs is as follows:

2005	DEC. 31	SEP. 30	JUNE 30	MAR. 31
Gross profit per Form 10-Q	$16,700	$16,020	$16,249	$13,113
Reclassify acquired software amortization expense	–	(198)	(199)	(198)
Adjusted gross profit	$16,700	$15,822	$16,050	$12,915

[B] As a result of adopting SFAS No. 123R on January 1, 2006, our earnings before income taxes and net earnings for 2006 were $2.0 million and $1.6 million lower, respectively, than if we had continued to account for share-based compensation under APB No. 25. Basic and diluted earnings per share for 2006 would have been $0.04 higher, had we continued to account for share-based compensation under APB No. 25.

[C] We made significant organizational changes in the second quarter of 2005 to areas of our business that were not performing to our expectations. In connection with the reorganization we recorded a restructuring charge of $1.3 million.

CORPORATE OFFICERS

John M. Yeaman
Chairman of the Board

John S. Marr, Jr.
President and Chief Executive Officer

Dustin R. Womble
Executive Vice President

Brian K. Miller
Senior Vice President
Chief Financial Officer and Treasurer

H. Lynn Moore, Jr.
Vice President
General Counsel and Secretary

Rick L. Hoff
Chief Technology Officer

W. Michael Smith
Vice President
Chief Accounting Officer

Terri L. Alford
Controller

BOARD OF DIRECTORS

John M. Yeaman [1]
Chairman of the Board
Tyler Technologies, Inc.

John S. Marr, Jr. [1]
President and Chief Executive Officer
Tyler Technologies, Inc.

Donald R. Brattain [2,3]
President
Brattain and Associates, LLC

J. Luther King, Jr. [2,4]
Chief Executive Officer
Luther King Capital Management

G. Stuart Reeves [2,3,4]
Retired Executive Vice President
Electronic Data Systems Corporation

Michael D. Richards [3,4]
Chairman and Chief Executive Officer
Reunion Title Company

Dustin R. Womble [1]
Executive Vice President
Tyler Technologies, Inc.

1 Executive Committee
2 Audit Committee
3 Nominating and Governance Committee
4 Compensation Committee

CORPORATE HEADQUARTERS

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INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Ernst & Young LLP
Dallas, Texas

ANNUAL MEETING OF STOCKHOLDERS

Our Annual Meeting will be held on Thursday, May 17, 2007, at 9:00 a.m. Central time at: The Park City Club, 5956 Sherry Lane, Suite 1700, Dallas, Texas 75225.

CERTIFICATIONS

We submitted an unqualified Annual CEO Certification to the New York Stock Exchange (NYSE) as required by the NYSE Listed Company rules. We also filed with the Securities and Exchange Commission the Chief Executive Officer and Chief Financial Officer certifications required under Section 302 of the Sarbanes-Oxley Act as exhibits to our Annual Report on Form 10-K.

INVESTOR INFORMATION

Our Annual Report on Form 10-K is available on the Company's Web site at www.tylertech.com. A copy of the Form 10-K or other information may also be obtained by contacting the Investor Relations Department at corporate headquarters.

INVESTOR RELATIONS

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info@tylertech.com

COMMON STOCK

Listed on the New York Stock Exchange under the symbol "TYL"

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LISTED
NYSE

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tyler
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