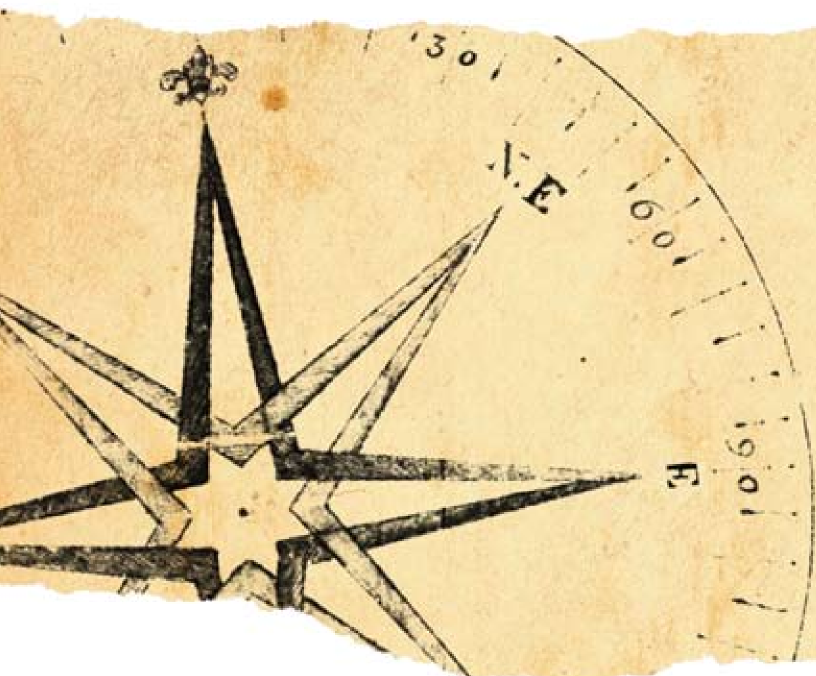
By Design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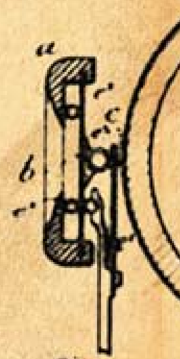
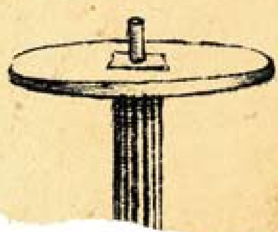
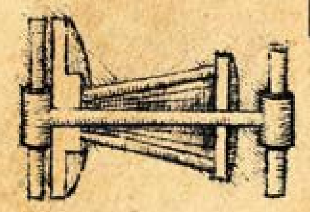
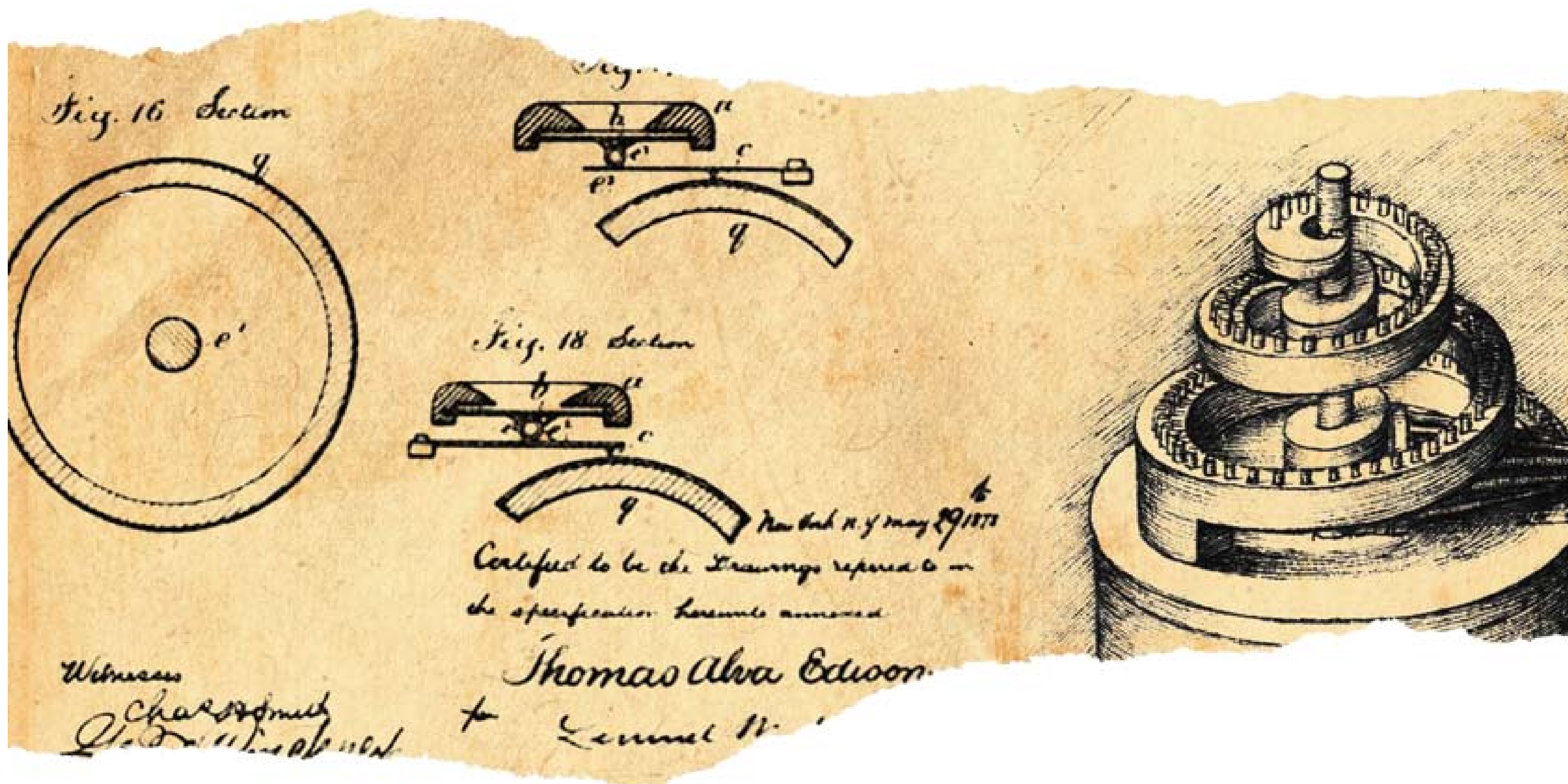






Throughout time, great inventions and discoveries have been born out of the diligent, focused efforts of some of the best minds. Engaging in countless hours of methodical planning, inventors like Leonardo da Vinci, Galileo and Thomas Edison have produced some of the world's most astounding designs. Like these innovators, Tyler Technologies is revolutionizing how local governments operate—delivering a broad portfolio of software solutions to streamline their many complex business functions. Posting another record year in 2008, Tyler Technologies proves once again that our success is no accident. It's by design.



To Our Shareholders

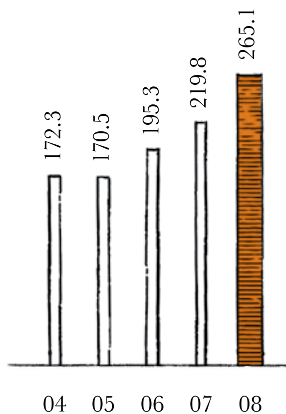
Since Tyler entered the public sector information management business, we have carefully designed and executed a strategy that provides reliable, consistent growth by delivering the innovative software solutions local governments need to manage their business processes. Year after year, Tyler demonstrates that our design works for our shareholders, employees and customers. Despite an unpredictable economic climate, Tyler Technologies surpassed its record-setting year in 2007 to post very strong results again in 2008.

Exceeding Expectations

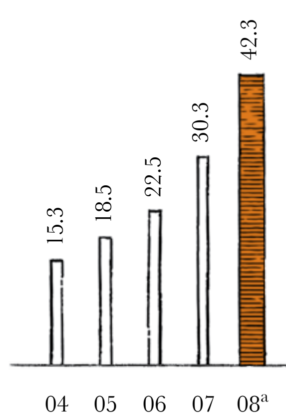
By virtually every measure, Tyler Technologies outperformed our own internal targets and market expectations for 2008. For the year, Tyler's revenues grew 21 percent to $265 million, with software-related revenues up 25 percent. License revenue growth of 18 percent was very solid, even as our software-as-a-service (SaaS) model continued to gain traction, resulting in a 38 percent increase in subscription revenues.

Tyler built momentum in the local government marketplace in 2008, and our brand awareness and competitive position are now stronger than ever.

Total Annual Revenues
IN MILLIONS

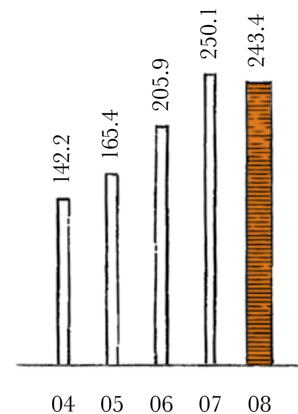


Free Cash Flow
IN MILLIONS



(a) excludes capital expenditures for office facilities of $16 million in 2008

Backlog
IN MILLIONS



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

John M. Yeaman
Chairman of the Board

For the year, our gross margin improved by 300 basis points and Tyler posted non-GAAP operating income for 2008 of $37.1 million, up 39 percent over the previous year. Non-GAAP earnings per share rose 45 percent to 61 cents. The fourth quarter of 2008 marked our 31st consecutive profitable quarter. GAAP operating income, including the non-cash charge for a legal settlement related to warrants, was $28.1 million. GAAP earnings per share was 38 cents.

Once again, free cash flow exceeded earnings. Cash provided by operations in 2008 reached $48 million, and free cash flow, excluding office facility investments, hit $42.3 million—an increase of 40 percent over 2007.

Over the years, we have built a foundation of more than 8,000 customers and we enjoy an exceptionally high customer retention rate. These relationships provide us a steady stream of recurring revenues through maintenance and subscription agreements, which, together with services for existing customers, accounted for over half our revenue in 2008.

Without question, our performance in 2008 was encouraging—but equally important, we maintained our long-term record of sustainable growth. Tyler's software-related revenues have a compound annual growth rate (CAGR) of 17 percent since 2001. Free cash flow, excluding capital expenditures for office facilities, has a CAGR of 43 percent over the same period, and non-GAAP earnings per share has grown at a compounded rate of 95 percent over the last seven years.

Stronger Than Ever

Tyler built momentum in the local government marketplace in 2008, and our brand awareness and competitive position are now stronger than ever. We continue to enjoy success thanks to the growth strategy that we have carefully designed and consistently executed over the years. We believe this strategy not only provides the type of steady growth we seek, but it also serves all of our constituents well. We are specifically focused on four key areas of growth: expanding geographically, securing larger opportunities, broadening our product offerings, and expanding existing customer relationships.

For the second consecutive year, Tyler was named one of "America's 200 Best Small Companies" by* Forbes *magazine.

Tyler is unique in that we serve only the public sector, but with an unmatched breadth of products and services. As a vertical software company, this enables us to focus all of our resources on delivering the software solutions and services that help states, cities, counties, schools and other agencies streamline the many facets of their operations.

While Tyler's technology solutions are best in class, we believe our employee team is what truly sets us apart. Our more than 2,000 employees demonstrate a high level of technical knowledge, as well as incredible domain expertise in the many unique aspects of local government operations. This enables us to extend an unparalleled level of innovation and service to our customers.

A Solid Investment

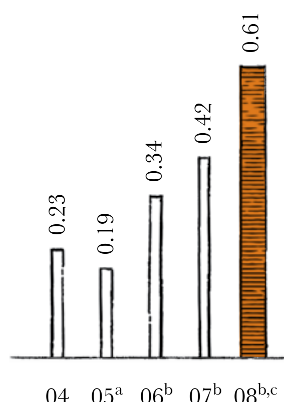
At Tyler, we know that building a company that works for shareholders, employees, and customers is just the beginning. That's why we are always looking for new ways to deliver the best return on investment, create the best work environment, and develop and support the best products possible.

Although Tyler's common stock price—like that of most companies—declined significantly from our 2008 high achieved in July, our stock performed better than most, ending the year down 7 percent. We believe that Tyler has a number of characteristics that make it an attractive investment—including consistent above-market growth, a broad and relatively stable market, strong cash flow, a high proportion of recurring revenues, and a very solid balance sheet. For the second consecutive year, Tyler was named one of "America's 200 Best Small Companies" by *Forbes* magazine.

Reflecting our confidence in the company's long-term prospects, in 2008 we invested $59 million of our cash to repurchase 4.3 million shares of stock, under our ongoing repurchase program that has been in place since 2002. From 2002 through 2008, we

Diluted Annual EPS

IN DOLLARS



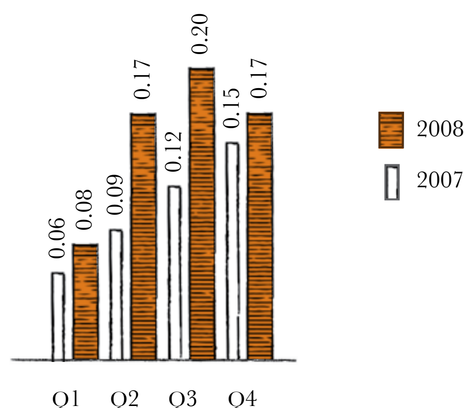
(a) includes restructuring charge of $0.02

(b) includes non-cash stock compensation expense of $0.04 in 2006, $0.05 in 2007 and $0.08 in 2008

(c) 2008 EPS is non-GAAP and excludes non-cash legal settlement charge related to warrants of $0.23

2007-2008 Quarterly EPS[a]

IN DOLLARS



(a) 2008 EPS is non-GAAP and excludes non-cash legal settlement charge related to warrants of $0.16 in Q2, $0.04 in Q3 and $0.03 in Q4

repurchased approximately 18 million shares of our common stock at an average cost of about $8 per share, for a total of nearly $144 million.

Although Tyler's common stock price—like that of most companies—declined significantly from our 2008 high achieved in July, our stock performed better than most, ending the year down just 7 percent.

We also used $24 million of cash to complete three acquisitions during 2008, each of which expanded our offerings for the K-12 schools market. We continue to look for attractive acquisitions that can supplement our growth by broadening our product offerings and customer base. We maintain a disciplined approach to acquisitions, particularly with respect to valuations, as we identify quality companies that fit well with Tyler's existing operations. Finally, in order to support our current facility requirements and planned needs in areas where we have significant growing workforces, we purchased an office building in Yarmouth, Maine, and began construction of a facility in Lubbock, Texas. When the building in Lubbock is completed in 2009, we will have a total of approximately $26 million invested in these assets, which we may leverage to free up cash for other uses.

While Tyler enjoys a strong market position today, we know that our long-term success requires a significant commitment on our part to ensure our solutions remain at the forefront competitively and meet the ever-changing needs of the public sector.

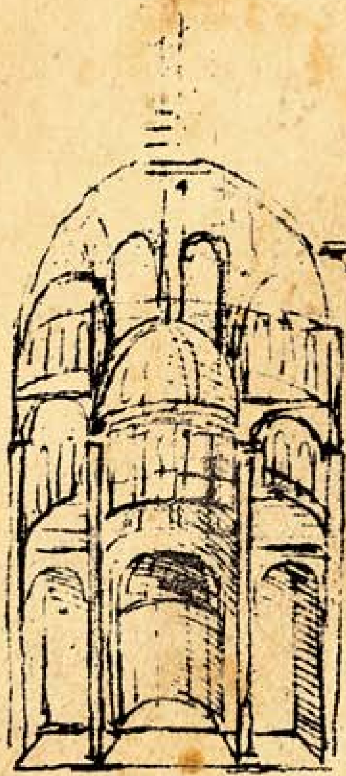
In 2008, we added more than 300 new employees, primarily in development, implementation, and support. Never in our history have we had so many resources committed to improving our current offerings, while at the same time investing in new products for the future, including our joint development of Microsoft Dynamics AX for the public sector.

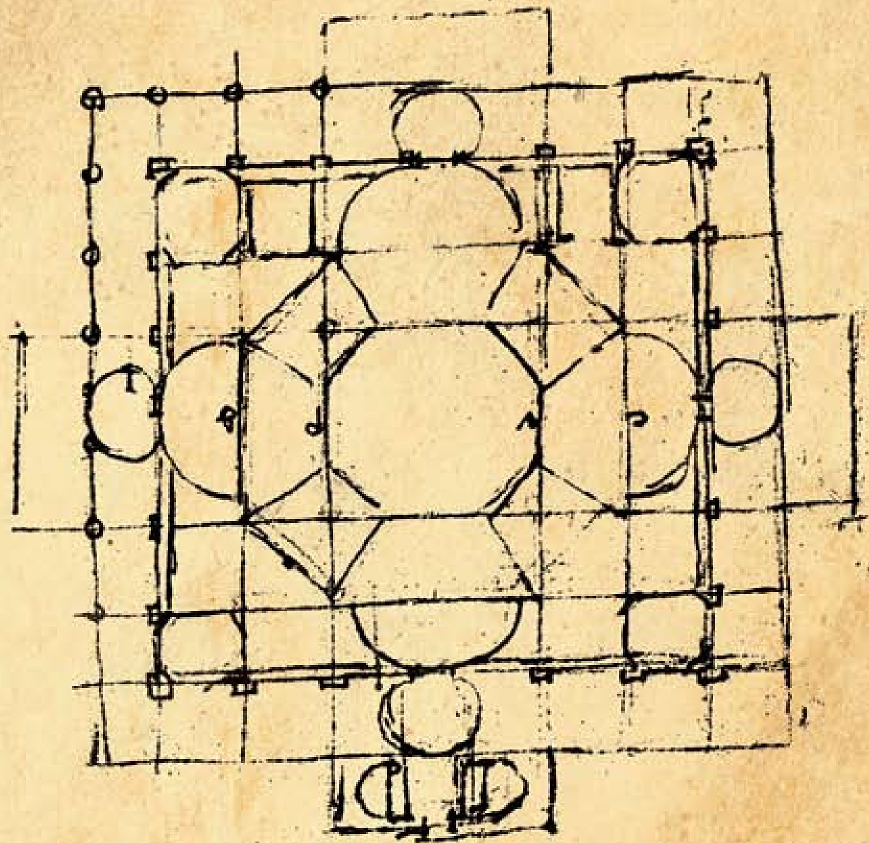
Looking Ahead

Despite the tough economic climate in 2008, Tyler notched a record-setting year—a testament, we believe, to our proven strategy, exceptional employee team, and market-leading portfolio of solutions. The broad economic conditions are clearly troubling. While Tyler has to this point performed well in this environment, there is certainly the possibility that these conditions will put some pressure on our business and affect short-term results.

We will continue to take a long-term approach to managing our business, and in the long run, we expect demand for our products to be strong and our execution to be sound. We are confident in our ability to extend the historical trends that we have established over the last several years, leveraging our top-line growth and expanding margins. Just as the best inventors blended the right mix of strategy, wisdom and determination, Tyler is ready to build on our rich history of success.

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





The Ideal City

Leonardo da Vinci sketched several plans for a more organized city with dwellings, castles, churches, gardens and canals.

With more than 8,000 customers and a portfolio of leading-edge software solutions, Tyler Technologies has crafted a proven blueprint for success.

The Ideal City

Over many years, Tyler Technologies has consistently proven that its methodical planning, sound growth strategy, and rich portfolio of solutions work for clients, employees and shareholders. With a clear vision, Tyler has established itself as a market leader—helping city, county, and state agencies of all sizes effectively manage the intricate network of services they deliver. In 2008, Tyler once again posted a record-setting year by virtually every measure.

Designed for Success

At Tyler Technologies, we understand that building a successful company requires methodical planning, consistent execution, and an unwavering commitment to clients, employees and shareholders. And in 1998, Tyler brought together under a single brand leading companies serving the local government market.

In the years since, Tyler has established a proven model for success. This starts with our clearly defined market segment—serving only the public sector. Given this focus, we know local governments' unique day-to-day business operations and how to help them keep pace with their constituents' changing demands.

While our focus may be narrow, our vision for what's possible is not. Tyler delivers a robust portfolio of software solutions that span the breadth and depth of the mission-critical services that government entities must address every day—including financial management, education, courts and justice, pension, public safety, tax and appraisal, citizen services and public records. In fact, no other company offers the same breadth of solutions for the public sector.

Today, Tyler has installations in all 50 states, Puerto Rico, the U.S. Virgin Islands, Canada, and the United Kingdom. Yet despite our growth over recent years, we still approach each client with the same level of attentive service and focused commitment. That's one reason why we've consistently maintained a customer retention rate of 98 percent or greater.

Designed to Endure

When Tyler first entered the public sector software market, the competitive landscape was even more fragmented than it is today. Now, there are fewer competitors serving our market—and good companies are always vying for market share with us. That means we must focus intently on maintaining a competitive edge.

For Tyler, this means providing the robust solutions that local governments need. It also means ensuring we have the best possible team in place to create and deliver these solutions and services—and support and enhance them long past implementation. And Tyler's team brings the right balance of domain experience, technology and innovation to ensure clients are satisfied from start to finish. While many companies faced the challenging task of reducing their workforce in 2008, Tyler's strong cash flow and above-market growth provided us the opportunity to continue to expand our teams.

Unlike organizations in the private sector, it's not uncommon for local governments to keep their information technology infrastructure in place for 10 years or more. And in some cases, they run a potpourri of software and hardware solutions that are no longer viable, including systems developed in-house years ago or software from vendors that are no longer in business or that haven't invested in new technology. We believe that these in-house systems and systems from vendors who do not have a competitive offering in the market today make up the majority of systems currently installed broadly across local governments.

Because local governments are heavily dependent on their IT systems to deliver mission-critical services over many years, they largely view technology as a necessary investment—rather than a discretionary purchase. Yet given how quickly technology evolves and the complexity of local governments' business operations, it's imperative that when governments purchase new systems, their investment delivers the best possible return now—and over the long term.

At Tyler, we know that no matter the size of a government agency or school, every dollar allocated must be used wisely. And that's why we are always looking for ways to enhance our existing software portfolio—giving customers access to improved technologies, as well as new features and functionality.

Measures of Success

Although 2008 was a challenging year for the United States economy, most communities throughout the nation continue to experience growth. In fact, local governments' annual spending on software and external technology services is currently estimated at approximately $13.8 billion, growing at approximately 5 percent annually over the next three years.

With this growth, it is incumbent upon local authorities and agencies to have the right systems in place to respond accordingly. Whether assessing property taxes or routing school buses, every facet of local government operation demands a high level of efficacy and efficiency.

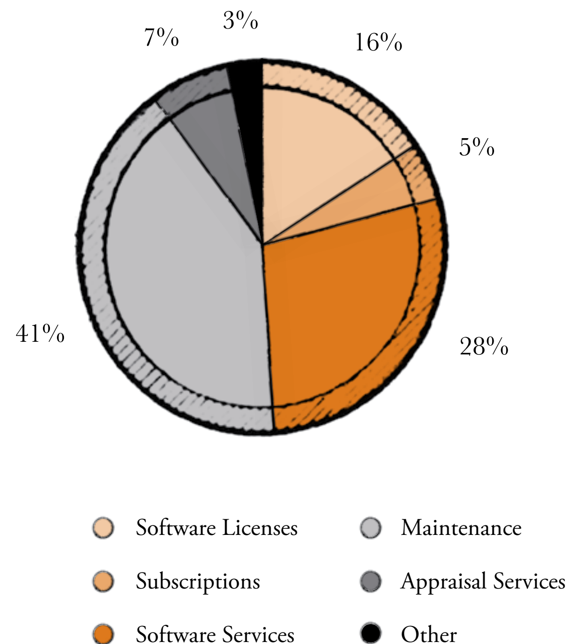
Given our record-setting performance in 2008 and our exceptionally high customer retention rate, it's clear Tyler's solutions deliver. In 2008, Tyler once again posted organic growth greater than two times the overall market growth rate, which was supplemented by targeted acquisitions. Our total revenues grew 21 percent in 2008, with 14 percent organic growth and 7 percent from acquisitions. Our recurring revenues from maintenance and subscriptions—which increased by 27 percent—continue to add the type of reliable revenue base we need to ensure our growth is sustainable over time.

Charting New Growth

While some companies are quick to change strategies, Tyler has taken a disciplined approach to our growth. With approximately 3,100 counties, 14,200 school districts, 36,000 cities and towns, and over 35,000 other local government agencies in the United States, Tyler has ample opportunity to drive new growth.

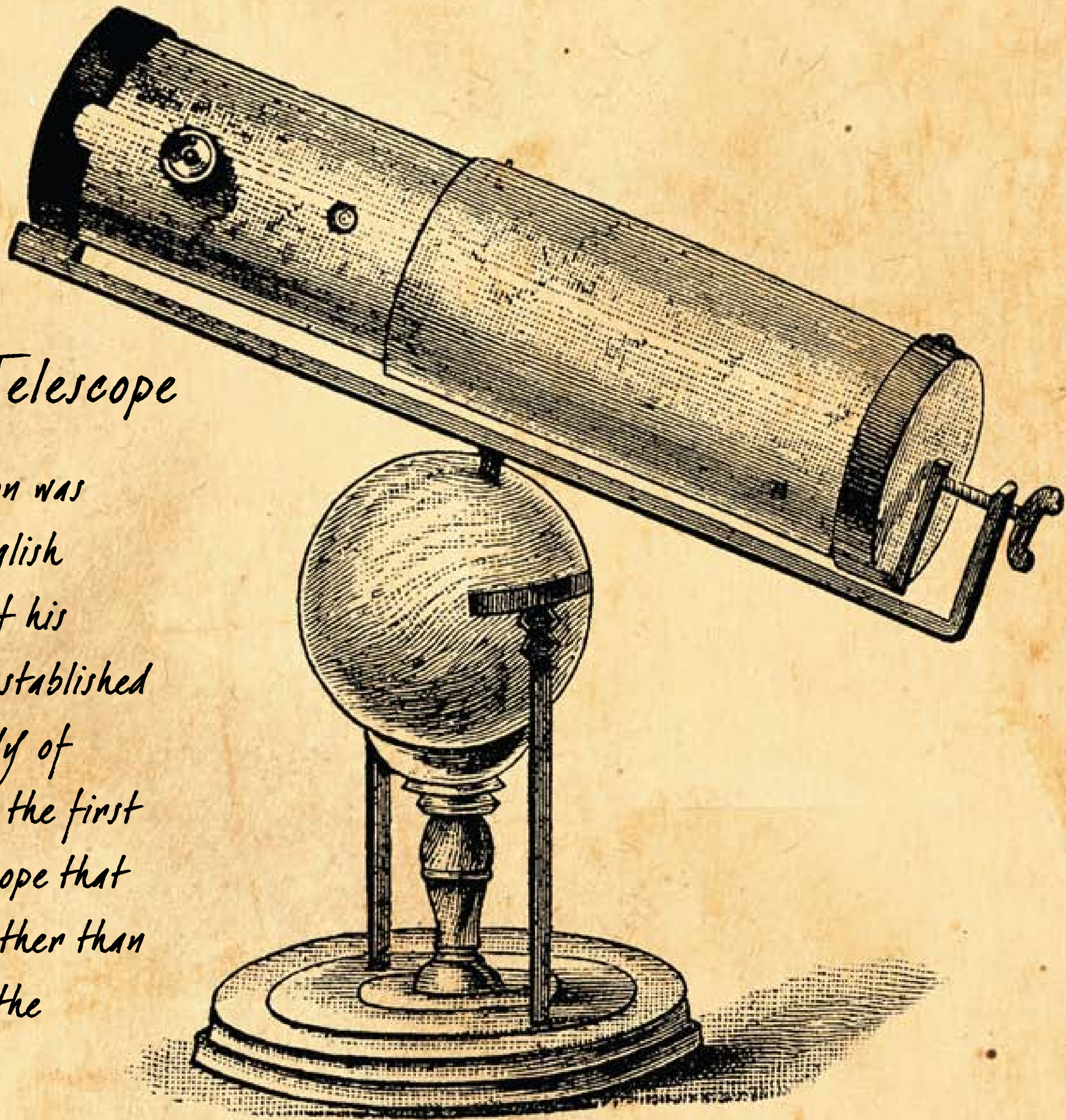
And as we have in years past, we are leveraging new opportunities by focusing specifically on four key growth drivers: taking our products into new geographic areas, expanding our product offerings, securing larger contracts, and cross-selling our portfolio of solutions to existing clients.

Revenue Mix

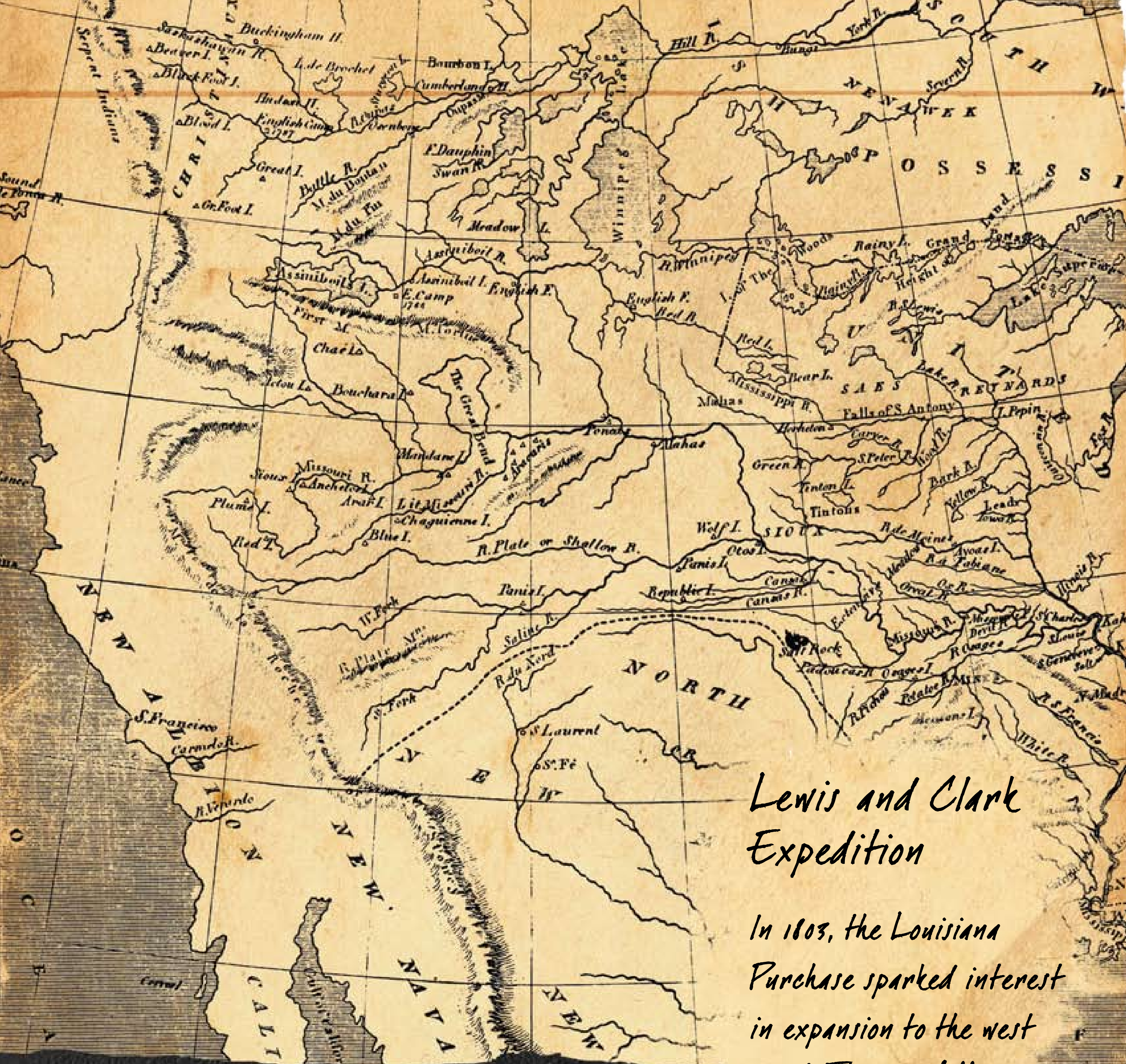


Reflecting Telescope

Sir Isaac Newton was the greatest English mathematician of his generation. He established the modern study of optics and built the first reflecting telescope that used mirrors, rather than lenses, to bring the light to a focus.



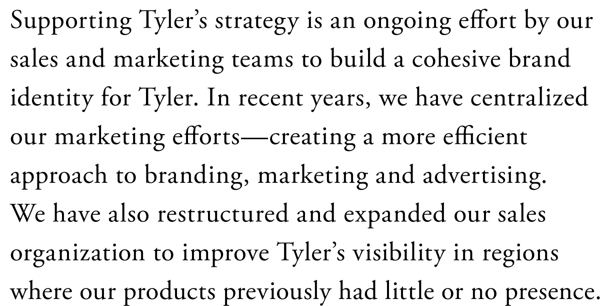
Tyler Technologies is uniquely focused on helping governments at the state, county and local level.



Lewis and Clark Expedition

In 1803, the Louisiana Purchase sparked interest in expansion to the west coast. Thomas Jefferson dispatched Lewis and Clark to find a water route across North America and explore the uncharted West.

Year after year, Tyler Technologies has expanded its geographic reach and secured larger opportunities to become a clear leader in the public sector software market.



Supporting Tyler's strategy is an ongoing effort by our sales and marketing teams to build a cohesive brand identity for Tyler. In recent years, we have centralized our marketing efforts—creating a more efficient approach to branding, marketing and advertising. We have also restructured and expanded our sales organization to improve Tyler's visibility in regions where our products previously had little or no presence.

Extending Our Reach

Thanks to these efforts, today virtually all of our software solutions are marketed nationwide. And in 2008, Tyler continued to extend our reach into new areas—illustrated by the fact that in any given quarter, Tyler may sign deals in 20 or more different states.

For example, Tyler's municipal court product also expanded into several new states, including moving into Ohio and signing a deal with Licking County, a special jurisdiction court.

Tyler also gained additional presence in Ohio in the city of Wyoming, which required an income tax module we did not support. There, we collaborated with the city of Wyoming and five other cities to design and develop the module they needed. Now that we have moved into these new markets, we anticipate our presence will continue to expand in the years ahead.

Securing Larger Deals

At Tyler, we understand that no matter a government's size, each of our clients wants to ensure the technology investments they make produce a solid return—while also providing a high degree of customization and scalability. We know that for many customers this means having access to highly functional solutions that take into account their unique needs in terms of budget, implementation schedule, and service customization.

Historically, Tyler focused primarily on serving the nation's many small and mid-sized governments. In recent years, however, we have also gained market share in larger markets, which create considerable revenue and margin expansion potential. Central to our ability to serve larger governments and school districts is the focus of all our resources on the specific needs of the public sector—enabling us to make key investments in scalable solutions incorporating leading-edge technology and best-of-class functionality. And it's this commitment to delivering the most innovative solutions possible for our market that gives us a competitive edge.

In 2008, we continued to secure larger deals to gain market share. With our financial management solutions, for example, Tyler won several multi-million dollar contracts, including a $4.9 million deal with the Northside Independent School District in San Antonio, Texas. And with our student transportation management solution, we signed a contract with the San Diego Unified School District, the nation's eighth largest urban district.

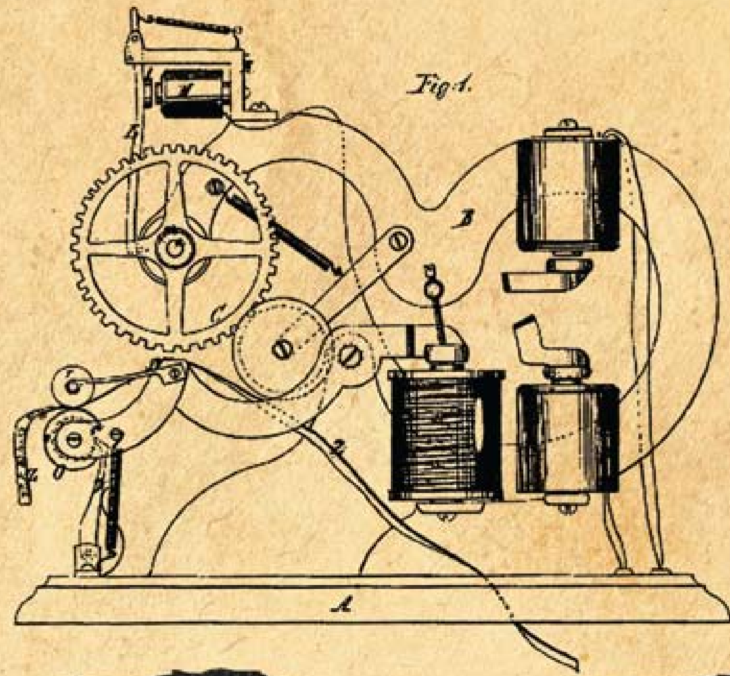
In 2008, we added new customers in key markets for our Odyssey courts and justice solution, including two as part of the license agreement we signed in 2006 with the Texas Conference of Urban Counties—a consortium of the 34 largest counties in the state. We also added our fifth statewide contract for Odyssey, a $6.4 million deal with the state of New Mexico.

Tyler also entered into significant agreements for our municipal court solution, including a $2.5 million contract with the city of Arlington, Texas, as well as major contracts with Birmingham, Alabama, and St. Louis County, Missouri. And Tyler built upon its more than 23-year relationship with Bucks County, Pennsylvania, by securing a $2.4 million deal for our property tax software.

Based on our extensive experience in serving the public sector and our steady performance in 2008, we believe Tyler is navigating the right course for success well into the future.

Ticker Tape Machine

Thomas Edison provided the first mechanical means of conveying stock price quotes over a long distance across telegraph wiring. The increase in speed provided by the ticker allowed for faster and more efficient sales.



Tyler Technologies' broad solutions portfolio helps local governments streamline their mission-critical business operations, while effectively maximizing the value of their technology investments.

Maximizing Results

Now more than ever, it's imperative that public sector agencies act judiciously with their resources to ensure citizens have easy access to a full range of services. From managing court cases and providing easy ways to pay utility bills to ensuring school districts can safeguard students' information, Tyler's software solutions help governments maximize the value they provide to constituents.

And in turn, because our solutions work for our customers, Tyler is gaining greater market visibility both in areas where we have a significant presence and in penetrating new markets. Thus, we are creating even greater returns for our shareholders, and in 2008, we continued exploring ways to maximize these results.

Enhancing Our Products

With technology in a constant state of evolution, Tyler understands that creating the best return on our customers' investment heavily depends on our ability to provide value over the long term. That's why we are keenly focused on making constant improvements to Tyler's existing offerings, providing customers with product updates incorporating new features, functionalities and technologies. We actively seek the best talent to help us develop, implement and support our solutions, and we added more than 300 new employees to our team in 2008.

Over the course of the last year, we also invested further in adding new products and clients through strategic acquisitions. We added several new solutions specifically for the education market, including the

acquisition of St. Louis-based School Information Systems, which develops and sells a full suite of student information and financial management systems for K-12 schools. Early in 2008, we completed the acquisition of VersaTrans Solutions which creates and supports school transportation solutions including bus routing, fleet management and trip planning. Additionally, we purchased Schoolmaster, a student information system used in more than 1,900 schools in 40 states, with a particularly strong presence in the western United States.

In addition to expanding our offerings through acquisition, in 2008 Tyler continued to invest in developing new products, including a new business management solution we're jointly developing with Microsoft. This solution, Microsoft Dynamics AX for the public sector is slated for release in late 2010 and will bring about opportunities to expand into new markets, including federal and state agencies and international governments.

As we look ahead, we will continue making the necessary investments to enhance and expand Tyler's product family and improve our competitive position, leveraging our strong free cash flow to bolster our product offerings through acquisition and internal development.

Increasing Access to Solutions

Given the complexity and unique needs of each government entity, Tyler is making it even easier for local governments to implement the solutions they need—without having to dedicate in-house personnel or equipment to manage the software. Our software-as-a-service (SaaS) model gives clients seamless access to Tyler's solutions on a subscription basis. Tyler handles all the back-end aspects of managing the software, freeing governments up to focus on other priorities.

In 2008, we saw continued traction in our SaaS model. Although comprising only 5 percent of our total revenues, subscriptions represented Tyler's fastest-growing revenue stream, increasing at 38 percent. Based on customer response thus far, this model is proving to be effective for government agencies of all sizes.

We now have 123 hosted clients with a subscription renewal rate of 100 percent since we signed our first SaaS customer seven years ago. In addition, 26 existing customers converted to our SaaS model in 2008.

New SaaS clients for our financial management solutions in 2008 include the Town of Westport, Connecticut, and the Recovery School District in New Orleans. Additionally, we signed our first SaaS customers for appraisal and tax solutions with Logan County, Colorado, and Henry County, Indiana.

Leveraging Our Customer Base

At Tyler, we don't just deliver dynamic, feature-rich solutions. We ensure the best possible experience for each of our customers from start to finish. From development and training to consulting and post-implementation support, Tyler provides turnkey solutions for our customers. This helps us better render solutions that meet our customers' exact specifications, with every resource allocated to the public sector.

Tyler enjoys an exceptionally high customer retention rate, which gives us a stable base of recurring revenue through maintenance and support renewals, as well as additional services like consulting and training for existing customers. Because of our high level of commitment and responsiveness, we're considered a trusted business partner to our customers. That means when the time comes to invest in new technology, many of our customers turn to us to provide additional solutions from our portfolio. This provides us a prime long-term opportunity to leverage our base of 8,000-plus customers by cross-selling our portfolio of software solutions.

In 2008, we gained new business by selling into our existing customer base, such as with Gregg County, Texas. The county was one of the original customers of our courts and justice solution and in 2008 added the Tyler's public safety product. Likewise, we had an existing relationship with St. Louis County, Missouri, for our property tax solution, and in 2008, we signed a $4.6 million multi-suite agreement adding our

financial management, municipal court, and enterprise content manager solutions to their product lineup.

We also saw a number of other clients that signed multi-suite contracts in 2008, implementing two or more Tyler products in an integrated solution. For example, Sandoval County, New Mexico, signed a $1.1 million contract to implement our financial management and human resource solution, as well as our tax assessment and appraisal solution.

Navigating the Future

Supporting each of their complex business operations can be challenging and resource intensive for local governments. With decades of experience in the public sector and a robust lineup of solutions, we are solely focused on helping local governments seamlessly manage the wide range of challenges they must tend to every day.

Based on our strong performance in 2008, we believe Tyler is in a prime competitive position and will emerge from the current economic cycle stronger than ever. In many categories, including revenue, operating income, and operating cash flow, 2008 was our best year ever. While we are no doubt pleased to report our strong financial results, the real indicator of our success is the value we offer every day for our shareholders, our employees, and our customers.

On the Right Path

In 2008, Tyler diligently sought new opportunities that would spur new revenue generation, market visibility, and product expansion. Unlike some competitors that have announced staffing reductions and cutbacks in discretionary spending on research and development, we have the ability to make key investments that will benefit us—and our clients—for years to come.

At Tyler, we know that while we have enjoyed a rich history of success, our future performance relies on our ability to create and deliver innovative solutions. And as in years past, in 2008, we continued adding new enhancements to our existing product portfolio, as well as augmented our offerings through acquisition and new product development. We also capitalized on our satisfied base of customers to create new opportunities to cross-sell our portfolio of software solutions—and secured new deals in key markets to further expand our presence.

Looking Forward

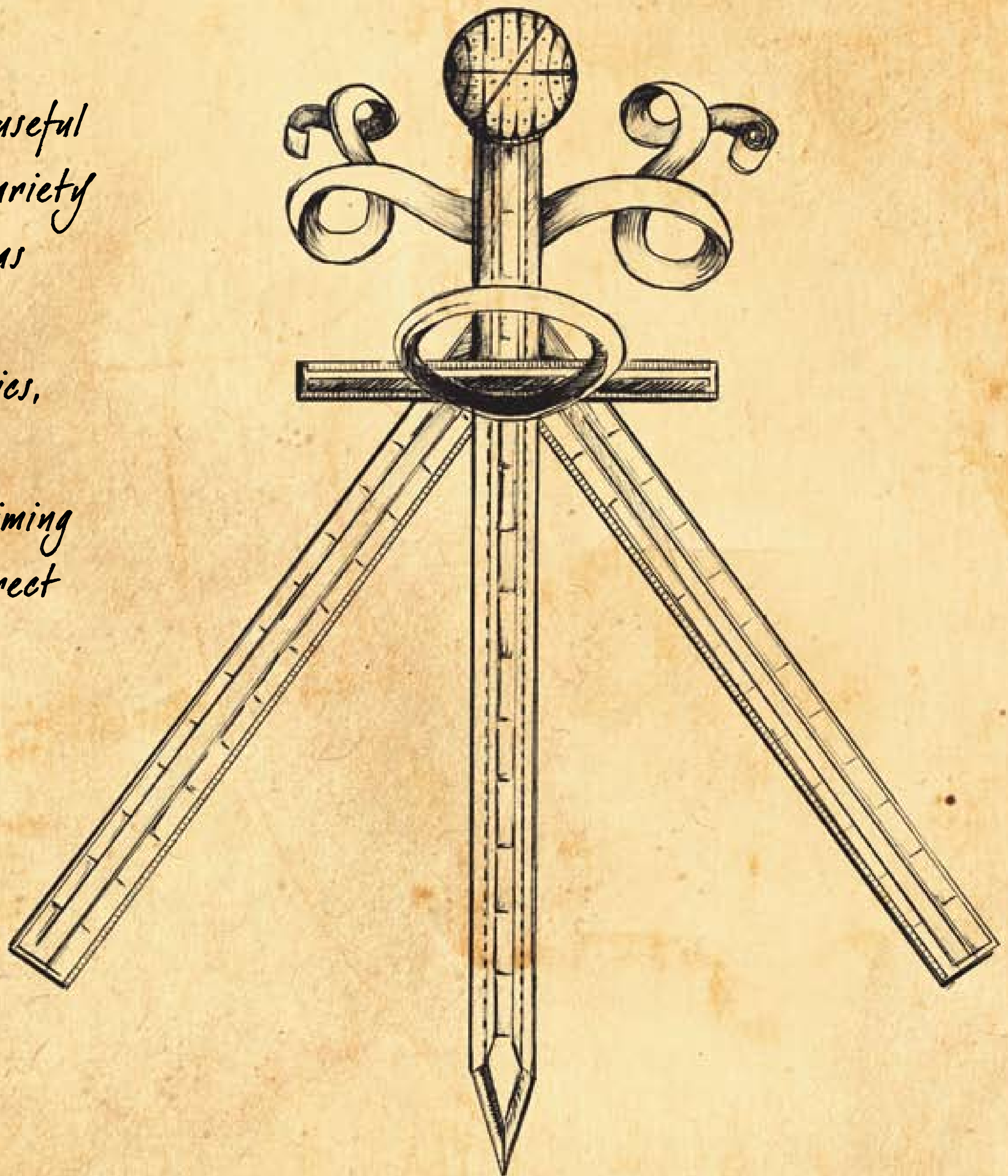
In 2009, we plan to carry this momentum forward and continue pursuing opportunities for growth. We believe we are well positioned within the marketplace to grow our distribution channels and expand our product portfolio. We anticipate our subscription-based model will continue to create growth potential over the long term as the market gradually moves toward greater adoption of SaaS offerings. We believe it's a great choice for customers not wanting to make upfront investments in technology or facing staffing challenges.

Over the years, Tyler has established a strong leadership position within the public sector software market. We have worked to create—and consistently execute—the right growth strategy to deliver the right return for our customers, employees, and shareholders. Quite simply, like history's most intricately designed inventions, Tyler's design works. And we're proving it every day.

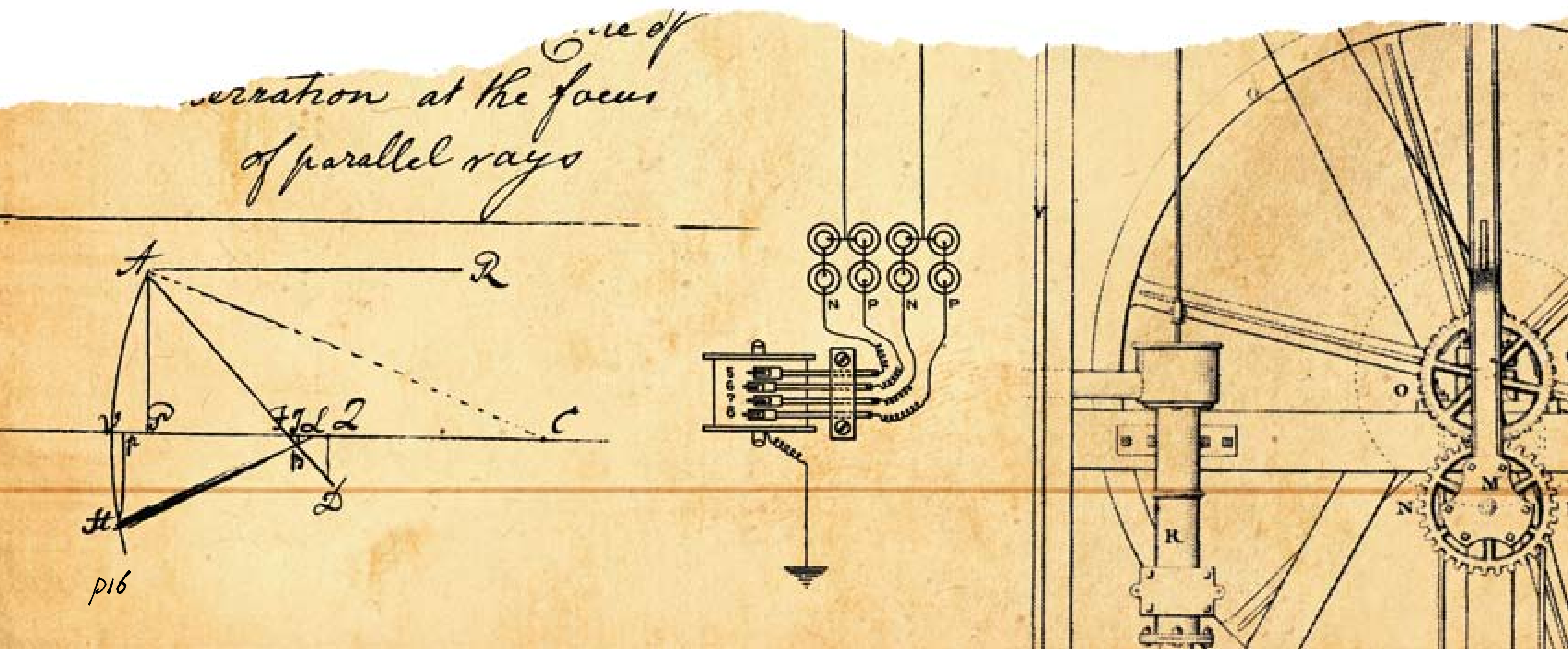
Building on Tyler's strong performance in 2008, we are moving in the right direction to chart new growth in the years ahead.

Compass

Galileo's compass is useful for an astonishing variety of calculations such as estimating altitudes, surveying topographies, laying out military fortifications and aiming a cannon at the correct angle to achieve a target distance.



Tyler Technologies' success in 2008 is the result of careful planning, consistent execution, and an unwavering commitment to delivering the best software solutions available for the public sector. In 2008, Tyler Technologies' 21 percent revenue increase surpassed our record-setting year in 2007 and once again outpaced the overall market growth rate. While our non-GAAP operating income rose by 39 percent, we also recorded an increase of 45 percent in non-GAAP EPS, and free cash flow expansion of 40 percent (excluding capital expenditures for office facilities). The following financial statements highlight in detail these results.



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

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

		High	Low
2007:	First Quarter	$14.93	$12.03
	Second Quarter	13.28	11.70
	Third Quarter	15.74	11.39
	Fourth Quarter	16.20	12.81
2008:	First Quarter	$14.70	$12.29
	Second Quarter	15.97	13.33
	Third Quarter	18.47	13.29
	Fourth Quarter	15.17	9.79

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

During 2008, we purchased approximately 4.3 million shares of our common stock for an aggregate purchase price of $59.0 million. The repurchase program, which was approved by our board of directors, was announced in October 2002, and was amended in April and July 2003, October 2004, October 2005, May 2007, May 2008 and October 2008. Our board of directors authorized the repurchase of an additional 2.0 million shares on both May 15, 2008 and October 23, 2008. As of December 31, 2008, we had remaining authorization to repurchase up to 1.5 million additional shares of our common stock. There is no expiration date specified for the authorization and we intend to repurchase stock under the plan from time to time. Our bank credit agreement contains restrictions on the amount of common stock we may purchase.

SELECTED FINANCIAL DATA

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

(1) Effective January 1, 2006, we adopted the fair value recognition provisions of Statement of Financial Accounting Standards No. 123R, "Share-Based Payment" using the modified-prospective method. In 2008, 2007 and 2006, respectively, cost of revenues included $364,000, $227,000 and $147,000 share-based compensation expense. Selling, general and administrative expenses in 2008, 2007 and 2006, respectively, included $3.5 million, $2.1 million and $1.8 million share-based compensation expense. In accordance with the standard, results of operations for the years prior to 2006 are reported under the previous accounting standard and no expense was recorded.

(2) On June 27, 2008, we settled outstanding litigation related to two Stock Purchase Warrants (the "Warrants") owned by Bank of America, N. A. ("BANA"). As disclosed in prior SEC filings, the Warrants entitled BANA to acquire 1.6 million shares of Tyler common stock at an exercise price of $2.50 per share. Following court-ordered mediation, in July 2008, BANA paid us $2.0 million and we issued to BANA 801,883 restricted shares of Tyler common stock. Accordingly, we recorded a non-cash legal settlement related to warrants charge of $9.0 million, which was not tax deductible.

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 this Annual Report and other documents we file from time to time with the SEC.

When used in this Annual Report, the words "believes," "plans," "estimates," "expects," "anticipates," "intends," "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

General

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

Our products are generally grouped into four major areas:

- Financial Management and Education;
- Courts and Justice;
- Property Appraisal and Tax; and
- Public Records and Content Management.

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

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

- **Cost of Revenues and Gross Margins –** Our primary cost component is personnel expenses in connection with providing software implementation, subscription-based services, maintenance and support, and appraisal services to our customers. We can improve gross margins by controlling headcount and related costs and by expanding our revenue base, especially from those products and services that produce incremental revenue with minimal incremental cost, such as software licenses, subscription-based services, and maintenance and support. Our appraisal projects are seasonal in nature, and we often employ appraisal personnel on a short-term basis to coincide with the life of a project. As of December 31, 2008, our total full-time equivalent employee count increased to 1,940 from 1,627 at December 31, 2007. The majority of these additions were to our implementation and support staff, including additions to our capacity to deliver our backlog. Our implementation and support staff at December 31, 2008 includes 102 full-time equivalent employees added as a result of three acquisitions completed in 2008.

- **Selling, General and Administrative ("SG&A") Expenses –** The primary components of SG&A expense are administrative and sales personnel salaries and commissions, marketing expense, rent and professional fees. Sales commissions generally fluctuate with revenues but other administrative expenses tend to grow at a slower rate than revenues.
- **Liquidity and Cash Flows –** The primary driver of our cash flows is net income. Uses of cash include acquisitions, capital investments in property and equipment and software development and the discretionary purchases of treasury stock. In 2008, we purchased 4.3 million shares of our common stock at an aggregate purchase price of $59.0 million. Almost half of our treasury stock purchases occurred in the fourth quarter of 2008. During 2008 we also used cash of $23.9 million to acquire three companies and invested $20.1 million in property and equipment. Our investment in property and equipment included $16.0 million for land, office buildings and a related tenant lease. Our working capital needs are fairly stable throughout the year with the significant components of cash outflows being payment of personnel expenses offset by cash inflows representing collection of accounts receivable and cash receipts from customers in advance of revenue being earned.
- **Balance Sheet –** Cash, accounts receivable and days sales outstanding and deferred revenue balances are important indicators of our business.

Acquisitions

We completed the acquisitions of School Information Systems, Inc., VersaTrans Solutions Inc. and certain assets of Olympia Computing Company, Inc. d/b/a Schoolmaster to expand our presence in the education market. The combined purchase price, excluding cash acquired and including transaction costs, was approximately $23.9 million in cash and approximately 196,000 shares of Tyler common stock valued at $2.9 million. In connection with these transactions we acquired total tangible assets of approximately $3.5 million and assumed total liabilities of approximately $8.2 million.

Outlook

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

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

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

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

Revenue Recognition. We recognize revenues in accordance with the provisions of Statement of Position ("SOP") 97-2, "Software Revenue Recognition," as amended by SOP 98-4 and SOP 98-9, as well as Technical Practice Aids issued from time to time by the

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

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

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

For subscription-based services such as application service provider arrangements and other hosting arrangements, we evaluate whether each of the elements in these arrangements represents a separate unit of accounting, as defined by EITF 00-21, using all applicable facts and circumstances, including whether (i) we sell or could readily sell the element unaccompanied by the other elements, (ii) the element has stand-alone value to the customer, (iii) there is objective reliable evidence of the fair value of the undelivered item, and (iv) there is a general right of return. We consider the applicability of EITF No. 00-03, "Application of SOP 97-2 to Arrangements That Include the Right to Use Software Stored on Another Entity's Hardware" on a contract-by-contract basis. In hosted term-based agreements, where the customer does not have the contractual right to take possession of the software, hosting fees are recognized on a monthly basis over the term of the contract commencing when the customer has access to the software. For professional services associated with hosting arrangements that we determine do not have stand-alone value to the

customer, we recognize the services revenue ratably over the remaining contractual period once hosting has gone live and we may begin billing for the hosting services. We record amounts that have been invoiced in accounts receivable and in deferred revenue or revenues, depending on whether the revenue recognition criteria have been met.

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

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

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

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

Share-Based Compensation. We have a stock option plan that provides for the grant of stock options to key employees, directors and non-employee consultants. We estimate the fair value of share-based awards on the date of grant using the Black-Scholes option valuation model. Share-based compensation expense includes the estimated effects of forfeitures, which will be adjusted over the requisite service period to the extent actual forfeitures differ, or are expected to differ from such estimates. Changes in estimated

forfeitures are recognized in the period of change and will also impact the amount of expense to be recognized in future periods. Forfeiture rate assumptions are derived from historical data. We estimate stock price volatility at the date of grant based on the historical volatility of our common stock. Estimated option life is determined using the "simplified method" in accordance with Staff Accounting Bulletin No. 110. Determining the appropriate fair-value model and calculating the fair value of share-based awards at the grant date requires considerable judgment, including estimating stock price volatility, expected option life and forfeiture rates.

ANALYSIS OF RESULTS OF OPERATIONS AND OTHER

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

2008 Compared to 2007

Revenues

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

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

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

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

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

Changes in software license revenues consist of the following components:

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

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

Subscriptions. Subscription-based services revenue primarily consists of revenues derived from application service provider ("ASP") arrangements and other hosted service offerings, software subscriptions and disaster recovery services. ASP and other software subscriptions agreements are typically for periods of three to six years and automatically renew unless either party cancels the agreement. Disaster recovery and miscellaneous other hosted service agreements are typically renewable annually. New ASP customers and existing customers converting to ASP arrangements provided the majority of the subscription revenue increase with the remaining increase due to new disaster recovery customers and slightly higher rates for disaster recovery services.

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

- Software services revenue related to financial management and education solutions, which comprises approximately half of our software services revenue in the years presented, increased substantially compared to 2007. This increase was driven in part by increased capacity to deliver backlog following additions to our implementation and support staff since 2007 and due to larger and more complex contracts, which include more programming and project management services. In addition, we acquired a student transportation management solution in January 2008 which contributed approximately $3.9 million to software service revenues in 2008. Excluding the impact of acquisitions, we have added approximately 95 full-time equivalent employees to our financial management and education implementation and training staff since 2007.
- Software services revenue related to our courts and justice solutions experienced strong increases compared to 2007, reflecting increased capacity to deliver backlog following additions to our implementation and support staff since mid-2007. In addition, increased contract volume for municipal courts software solutions and public safety software solutions also generated higher related services revenue. We have added approximately 12 full-time equivalent employees to our courts and justice implementation and training staff since 2007.

Maintenance. We provide maintenance and support services for our software products and third party software. Maintenance revenues increased 26% in 2008 compared to 2007. Maintenance and support services grew 16% in 2008, excluding the impact of acquisitions completed in the prior twelve months. This increase was due to growth in our installed customer base and slightly higher maintenance rates on most of our product lines.

Appraisal services. Appraisal services revenue declined 10% in 2008 compared to 2007. The appraisal services business is driven in part by revaluation cycles in various states. In late 2007, we substantially completed several projects related to the Ohio revaluation cycle, which occurs every six years, as well as a few other large contracts. Appraisal revenues for the first six months of 2008 were down 23% compared to the first six months of 2007. In mid-2008 we began a complete reappraisal of real property in Orleans Parish, Louisiana. This contract is valued at approximately $12.0 million and consists of two separate phases expected to be complete by late 2010. As a result of this contract and an overall increase in contract volume, appraisal revenues for the last six months of 2008 increased 4% over the last six months of 2007. In 2009, we expect appraisal revenue to increase over 2008 by a modest amount.

Cost of Revenues and Gross Margins

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

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

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

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

Software license. Approximately one-half of our cost of software license revenues is amortization expense for capitalized development costs on certain software products, with third party software costs making up the balance. Once a product is released, we begin to amortize, over the estimated useful life of the product, any capitalized costs associated with its development. Amortization expense is determined on a product-by-product basis at an annual rate not less than straight-line basis over the product's estimated life, which is generally five years. Development costs consist mainly of personnel costs, such as salary and benefits paid to our developers, and rent for related office space.

In 2008, our software license gross margin percentage rose compared to the prior year mainly due to strong license fee revenue increases. Because approximately one-half of our cost of software license revenues is comprised of amortization of capitalized development costs, increased license fee revenues inherently result in higher gross margins.

Software services, maintenance and subscription-based services. Cost of software services, maintenance and subscriptions primarily consists of personnel costs related to installation of our software, conversion of customer data, training customer personnel and support activities and various other services such as ASP and disaster recovery. In 2008, the software services, maintenance and subscriptions gross margin increased compared to the prior year partly because maintenance and various other services such as ASP and disaster recovery costs typically grow at a slower rate than related revenues due to leverage in the utilization of our support and maintenance staff and economies of scale. We have increased our implementation and support staff by 215 full-time equivalent employees since 2007 in order to expand our capacity to implement our contract backlog. This increase includes 102 full-time equivalent employees related to acquisitions completed since 2007.

Appraisal services. A high proportion of the costs of appraisal services revenue are variable, as we often hire temporary employees to assist in appraisal projects whose term of employment generally ends with the projects' completion. Our appraisal gross margin for 2008 is higher than the prior year due to cost savings associated with a significant complex reappraisal project.

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

Selling, General and Administrative Expenses

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

($ in thousands)	2008	% of Revenues	2007	% of Revenues	Change $	Change %
Selling, general and administrative expenses	$62,923	24%	$51,724	24%	$11,199	22%

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

Research and Development Expense

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

($ in thousands)	2008	% of Revenues	2007	% of Revenues	Change $	Change %
Research and development expense	$7,286	3%	$4,443	2%	$2,843	64%

Research and development expense mainly consist of costs associated with the Microsoft Dynamics AX project, in addition to costs associated with other new product development efforts. In January 2007, we entered into a strategic alliance with Microsoft Corporation to jointly develop core public sector functionality for Microsoft Dynamics AX to address the accounting needs of public sector organizations worldwide. Research and development costs increased over the prior year because the Microsoft Dynamics AX development effort was not fully staffed until mid-2007. In 2008 and 2007, we offset our research and development expense by $1.8 million and $1.6 million, respectively, which were the amounts earned under the terms of our research and development agreement with Microsoft. We amended this agreement in September 2008 to define the scope of reimbursable development through the balance of the project and now expect to offset research and development expense by approximately $850,000 each quarter through the end of 2010. The actual amount and timing of future research and development costs and related reimbursements and whether they are capitalized or expensed may vary.

Non-Cash Legal Settlement Related to Warrants

On June 27, 2008, we settled outstanding litigation related to the Warrants owned by BANA. As disclosed in prior SEC filings, the Warrants entitled BANA to acquire 1.6 million shares of Tyler common stock at an exercise price of $2.50 per share. Following court-ordered mediation, in July 2008, BANA paid us $2.0 million and we issued to BANA 801,883 restricted shares of Tyler common stock. Accordingly, we recorded a non-cash legal settlement related to warrants charge of $9.0 million, which is not tax deductible.

Amortization of Customer and Trade Name Intangibles

Acquisition intangibles are comprised of the excess of the purchase price over the fair value of net tangible assets acquired that is allocated to acquired software and customer and trade name intangibles. The remaining excess purchase price is allocated to goodwill that is not subject to amortization. Amortization expense related to acquired software is included with cost of revenues, while amortization expense of customer and trade name intangibles is recorded as a non-operating expense. The estimated useful lives of both customer and trade name intangibles are 5 to 25 years. The following table sets forth a comparison of amortization of customer and trade name intangibles for the following years ended December 31:

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

In 2008, we completed three acquisitions, which increased amortizable customer and trade name intangibles by $12.3 million. This amount will be amortized over approximately 11 years.

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

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

Other

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

Income Tax Provision

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

			Change	
($ in thousands)	2008	2007	$	%
Income tax provision	$14,414	$11,079	$3,335	30%
Effective income tax rate	49.2%	38.8%		

Our effective income tax rate increased approximately twelve points compared to the prior year due to a non-cash legal settlement related to warrants charge of $9.0 million, which was not deductible. The effective income tax rates were different from the statutory United States federal income tax rate of 35% primarily due to non-cash legal settlement related to warrants charge which was not deductible, as well as state income taxes, non-deductible share-based compensation expense, the qualified manufacturing activities deduction, and non-deductible meals and entertainment costs.

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

2007 Compared to 2006

Revenues

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

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

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

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

Changes in software license revenues consist of the following components:

- Software license revenue related to our financial management and education solutions for 2007 decreased 8% compared to the prior year. Over half the decline was due to product mix in 2007 that required less third party software. A portion of the remaining decline was mainly due to a number of customers in 2007 choosing our subscription-based options, rather than purchasing the software under a traditional perpetual software license arrangement. Although these customers represented a relatively small percentage of new customers, the size of those contracts was larger than in the prior year. Subscription-based arrangements result in lower software license revenues in the initial year as compared to traditional perpetual software license arrangement but generate higher overall subscription-based services revenue over the term of the contract.
- Software license revenue related to our courts and justice software solutions increased 26% for 2007 compared to the prior year. In the fourth quarter of 2007 we recorded software license revenue of approximately $1.3 million from a contract which had been deferred in accordance with the terms of the contract.
- Appraisal and tax and other software license declined 21% in 2007 compared to the prior year primarily due to the deferral of software license revenue on a customer arrangement pending establishment of a revised timeline for the completion of certain development and implementation services.

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

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

- Software services revenue related to financial management and education solutions, which comprises approximately half of our software services revenue in the years presented, experienced modest increases in 2007 compared to the prior year due to increased contract volume and additions to implementation and training staff which enabled us to deliver our backlog at a faster rate. Excluding the impact of acquisitions we added approximately 40 people to our financial management and education implementation and training staff during 2007.
- Software services revenue related to our courts and justice solutions experienced substantial increases in 2007 compared to the prior year, reflecting increased contract volume. We had approximately 34 active Odyssey contracts in 2007 compared to approximately 25 active Odyssey contracts in 2006, primarily due to continued expansion in Texas and Florida and a new contract with Indiana. We added approximately 50 people to our courts and justice implementation and training staff during 2007.
- Software services revenue related to appraisal and tax and other solutions, which comprise approximately 25% of our software services revenue in the periods presented, had moderate increases for 2007 compared to 2006. The majority of the increase is related to one large appraisal and tax software implementation, which was substantially completed by December 31, 2007.

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

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

Cost of Revenues and Gross Margins

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

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

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

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

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

Software services, maintenance and subscription-based services. In 2007, the software services, maintenance and subscription gross margin percentage increased 1.6% over the prior year because maintenance and various other services such as ASP and disaster recovery costs typically grow at a slower rate than related revenues due to leverage in the utilization of our support and maintenance staff and economies of scale. We increased our implementation and support staff by 162 full-time equivalent employees since December 31, 2006. This increase includes 73 additional employees related to acquisitions completed in 2007. The remaining additions were to increase our capacity to train and deliver our contract backlog, particularly for our courts and justice solutions.

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

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

Selling, General and Administrative Expenses

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

($ in thousands)	2007	% of Revenues	2006	% of Revenues	Change $	Change %
Selling, general and administrative expenses	$51,724	24%	$48,389	25%	$3,335	7%

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

Research and Development Expense

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

($ in thousands)	2007	% of Revenues	2006	% of Revenues	Change $	Change %
Research and development expense	$4,443	2%	$3,322	2%	$1,121	34%

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

Other

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

Income Tax Provision

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

($ in thousands)	2007	2006	Change $	Change %
Income tax provision	$11,079	$8,493	$2,586	30%
Effective income tax rate	38.8%	37.2%		

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

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

FINANCIAL CONDITION AND LIQUIDITY

As of December 31, 2008, we had cash and cash equivalents (including restricted cash equivalents) of $6.8 million and current and non-current investments of $4.6 million, compared to cash and cash equivalents (including restricted cash equivalents) of $14.1 million and short-term investments of $41.6 million at December 31, 2007. As of December 31, 2008, we had outstanding borrowings of $8.0 million and outstanding letters of credit totaling $5.1 million to secure surety bonds required by some of our customer contracts.

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

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

Net cash provided by operating activities continues to be our primary source of funds to finance operating needs and capital expenditures. Other capital resources include cash on hand, public and private issuances of debt and equity securities, and bank borrowings. The capital and credit markets have become more volatile and tight as a result of adverse conditions that have caused the failure and near failure of a number of large financial services companies. It is possible that our ability to access the capital and credit markets may be limited by these or other factors. Notwithstanding the foregoing, at this time, we believe that cash provided by operating activities, cash on hand and our revolving credit agreement are sufficient to fund our working capital requirements, capital expenditures, income tax obligations, and share repurchases for the foreseeable future.

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

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

All of our non-current ARS are reflected at estimated fair value in the balance sheet at December 31, 2008. In prior periods, due to the auction process which took place every 28 to 35 days for most ARS, quoted market prices were readily available, which would have qualified as Level 1 under Statement of Financial Accounting Standards No. 157, "Fair Value Measurements." However, due to recent events in credit markets beginning during the first quarter of 2008, the auction events for most of these securities failed. Therefore, quoted prices in active markets are no longer available and we determined the estimated fair values of these securities as of December 31, 2008, utilizing a discounted trinomial model.

In association with this estimate of fair value, we have recorded an after tax temporary unrealized loss on our non-current ARS of $387,000, net of related tax effects of $209,000 in 2008, which is included in accumulated other comprehensive loss on our balance sheet. As of December 31, 2008, we have continued to earn and collect interest on all of our ARS. We believe that this temporary decline in fair value is due entirely to liquidity issues, because the underlying assets of these securities are supported by municipal and state agencies and do not include mortgage-backed securities, have redemption features which call for redemption at 100% of par value and have a current credit rating of A or AAA. The ratings on the ARS take into account credit support through insurance policies guaranteeing each of the bonds' payment of principal and accrued interest, if it becomes necessary. In addition, we do not plan to sell any of the ARS prior to maturity at an amount below the original purchase value and, at this time, do not deem it probable that we will receive less than 100% of the principal and accrued interest. Based on our cash and cash equivalents balance of $6.8 million, expected operating cash flows and the liquidation of $775,000 of ARS subsequent to the period ending December 31, 2008, we do not believe a lack of liquidity associated with our ARS will adversely affect our ability to conduct business, and believe we have the ability to hold the securities throughout the currently estimated recovery period. We have classified these securities as non-current because we believe the market for these securities may take in excess of twelve months to fully recover. We will continue to evaluate any changes in the market value of our non-current ARS and in the future, depending upon existing market conditions, we may be required to record an other-than-temporary decline in market value.

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

Investing activities used cash of $9.6 million in 2008 compared to $34.3 million in 2007. In 2008, we liquidated $36.4 million of ARS investments for cash at par, and we completed the acquisitions of School Information Systems, Inc., VersaTrans Solutions Inc. and certain assets of Olympia Computing Company, Inc. d/b/a Schoolmaster to expand our presence in the education market. The combined purchase price, excluding cash acquired and including transaction costs, was approximately $23.9 million in cash and approximately 196,000 shares of Tyler common stock valued at $2.9 million. In connection with plans to consolidate workforces and support planned long-term growth, we paid $3.3 million, which included $2.1 million for land, for an office development in Lubbock, Texas. We also paid $12.7 million for an office building, land, and a related tenant lease in Yarmouth, Maine. Capital expenditures and acquisitions were funded from cash generated from operations.

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

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

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

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

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

On October 20, 2008, we entered into a revolving bank credit agreement (the "Credit Facility") and a related pledge and security agreement. The Credit Facility matures October 19, 2009 and provides for total borrowings of up to $25.0 million and a $6.0 million Letter of Credit facility under which the bank will issue cash collateralized letters of credit. Borrowings under the Credit Facility bear interest at a rate of either LIBOR plus 1% or prime rate minus 1.5%. As of December 31, 2008, our effective interest rate was 1.47% under the Credit Facility. The effective average interest rate for borrowings during the period October 20 through December 31, 2008 was 2.1%. The Credit Facility is secured by substantially all of our personal property. The Credit Facility requires us to maintain certain financial ratios and other financial conditions and prohibits us from making certain investments, advances, cash dividends or loans, restricts the amount of our common stock we may purchase and the limits incurrence of additional

indebtedness and liens. We expect borrowings to fund discretionary purchases of our common stock or fund acquisitions and these covenants are not expected to impact our financial condition or operating performance. As of December 31, 2008, we were in compliance with those covenants.

As of December 31, 2008, we had outstanding borrowings of $8.0 million and unused available borrowing capacity of $17.0 million under the Credit Facility. In addition, as of December 31, 2008, our bank had issued outstanding letters of credit totaling $5.1 million to secure surety bonds required by some of our customer contracts. These letters of credit have been collateralized by restricted cash balances invested in a certificate of deposit. These letters of credit expire through mid-2009.

Excluding acquisitions, we anticipate that 2009 capital spending will be between $14.0 million and $16.0 million. Approximately $11.0 million of these expenditures will be incurred to complete the construction of an office development in Lubbock, Texas. The remainder of our 2009 expenditures are primarily related to computer equipment and software for infrastructure expansions. We currently do not expect to capitalize significant amounts related to software development in 2009, but the actual amount and timing of those costs, and whether they are capitalized or expensed may result in additional capitalized software development. Capital spending in 2009 is expected to be funded from existing cash balances and cash flows from operations.

From time to time we engage in discussions with potential acquisition candidates. In order to pursue such opportunities, which could require significant commitments of capital, we may be required to incur debt or to issue additional potentially dilutive securities in the future. No assurance can be given as to our future acquisition opportunities and how such opportunities will be financed.

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

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

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

CAPITALIZATION

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

NEW ACCOUNTING PRONOUNCEMENTS

In December 2007, the Financial Accounting Standards Board issued SFAS No. 141R "Business Combinations." SFAS No. 141R changes the accounting for business combinations including the measurement of acquirer shares issued in consideration for a business combination, the recognition of contingent consideration, the accounting for pre-acquisition gain and loss contingencies, the recognition of capitalized in-process research and development, the accounting for acquisition-related restructuring cost accruals, the treatment of acquisition related transaction costs and the recognition of changes in the acquirer's income tax valuation allowance. SFAS No. 141R is effective for fiscal years beginning after December 15, 2008, with early adoption prohibited. The adoption of SFAS No. 141R is not expected to have a material impact on our financial statements or related disclosures.

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

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk represents the risk of loss that may affect us due to adverse changes in financial market prices and interest rates. Our short-term and non-current investments available-for-sale consist of ARS which are collateralized debt obligations supported by municipal and state agencies and do not include mortgage-backed securities. Short-term investments available-for-sale consist of ARS which were sold at par during the period January 1, 2009 through February 20, 2009.

All of our non-current ARS are reflected at estimated fair value in the balance sheet at December 31, 2008. In prior periods, due to the auction process which took place every 28 to 35 days for most ARS, quoted market prices were readily available, which would have qualified as Level 1 under Statement of Financial Accounting Standards No. 157, "Fair Value Measurements." However, due to recent events in credit markets beginning during the first quarter of 2008, the auction events for most of these securities failed. Therefore, quoted prices in active markets are no longer available and we determined the estimated fair values of these securities as of December 31, 2008, utilizing a discounted trinomial model.

In association with this estimate of fair value, we have recorded an after tax temporary unrealized loss on our non-current ARS of $387,000, net of related tax effects of $209,000 in 2008, which is included in accumulated other comprehensive loss on our balance sheet. As of December 31, 2008, we have continued to earn and collect interest on all of our ARS. We believe that this temporary decline in fair value is due entirely to liquidity issues, because the underlying assets of these securities are supported by municipal and state agencies and do not include mortgage-backed securities, have redemption features which call for redemption at 100% of par value and have a current credit rating of A or AAA. The ratings on the ARS take into account credit support through insurance policies guaranteeing each of the bonds' payment of principal and accrued interest, if it becomes necessary. In addition, we do not plan to sell any of the ARS prior to maturity at an amount below the original purchase value and, at this time, do not deem it probable that we will receive less than 100% of the principal and accrued interest. Based on our cash and cash equivalents balance of $6.8 million, expected operating cash flows and the liquidation of $775,000 of ARS subsequent to the period ending December 31, 2008, we do not believe a lack of liquidity associated with our ARS will adversely affect our ability to conduct business, and believe we have the ability to hold the securities throughout the currently estimated recovery period. We have classified these securities as non-current because we believe the market for these securities may take in excess of twelve months to fully recover. We will continue to evaluate any changes in the market value of our non-current ARS and in the future, depending upon existing market conditions, we may be required to record an other-than-temporary decline in market value.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders

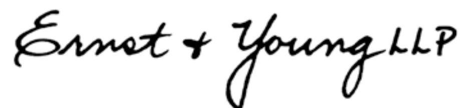
Tyler Technologies, Inc.

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

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

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

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



Dallas, Texas
February 25, 2009

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders

Tyler Technologies, Inc.

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

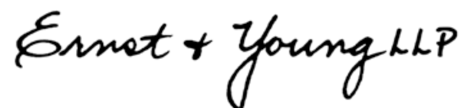
We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material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

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

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

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

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



Dallas, Texas
February 25, 2009

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

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

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

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

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

Management's assessment of the effectiveness of internal control over financial reporting as of December 31, 2008 has been audited by Ernst & Young, LLP, the independent registered public accounting firm who also audited Tyler's financial statements. Ernst & Young's attestation report on management's assessment of Tyler's internal control over financial reporting appears on page 36 hereof.

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

Statements of Operations

For the years ended December 31	2008	2007	2006
In thousands, except per share amounts			
Revenues:			
Software licenses	$ 41,490	$ 35,063	$ 37,247
Subscriptions	14,374	10,406	7,298
Software services	74,997	60,283	50,861
Maintenance	107,458	85,411	73,413
Appraisal services	19,098	21,318	19,755
Hardware and other	7,684	7,315	6,729
Total revenues	265,101	219,796	195,303
Cost of revenues:			
Software licenses	9,224	7,953	9,968
Acquired software	1,799	2,279	1,360
Software services, maintenance and subscriptions	126,247	104,993	90,601
Appraisal services	12,251	14,467	13,563
Hardware and other	5,793	5,679	5,007
Total cost of revenues	155,314	135,371	120,499
Gross profit	109,787	84,425	74,804
Selling, general and administrative expenses	62,923	51,724	48,389
Research and development expense	7,286	4,443	3,322
Amortization of customer and trade name intangibles	2,438	1,478	1,318
Non-cash legal settlement related to warrants	9,045	–	–
Operating income	28,095	26,780	21,775
Other income, net	1,181	1,800	1,080
Income before income taxes	29,276	28,580	22,855
Income tax provision	14,414	11,079	8,493
Net income	$ 14,862	$ 17,501	$ 14,362
Earnings per common share:			
Basic	$ 0.39	$ 0.45	$ 0.37
Diluted	$ 0.38	$ 0.42	$ 0.34
Basic weighted average common shares outstanding	37,714	38,735	38,817
Diluted weighted average common shares outstanding	39,184	41,352	41,868

See accompanying notes.

Balance Sheets

December 31	2008	2007
In thousands, except share and per share amounts		
ASSETS		
Current assets:		
Cash and cash equivalents	$ 1,762	$ 9,642
Restricted cash equivalents	5,082	4,462
Short-term investments available-for-sale	775	41,590
Accounts receivable (less allowance for losses of $2,115 in 2008 and $1,851 in 2007)	76,989	63,965
Prepaid expenses	8,602	7,726
Other current assets	1,444	1,324
Deferred income taxes	2,570	2,355
Total current assets	97,224	131,064
Accounts receivable, long-term portion	197	398
Property and equipment, net	26,522	9,826
Non-current investments available-for-sale	3,779	–
Other assets:		
Goodwill	88,791	71,677
Customer related intangibles, net	27,438	17,706
Software, net	5,112	9,588
Other intangibles, net	2,471	1,074
Sundry	227	175
	$251,761	$241,508
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 2,617	$ 3,323
Accrued liabilities	22,913	18,905
Short-term obligation	8,000	–
Deferred revenue	95,773	73,714
Income taxes payable	166	632
Total current liabilities	129,469	96,574
Deferred income taxes	8,030	7,723
Commitments and contingencies		
Shareholders' equity:		
Preferred stock, $10.00 par value; 1,000,000 shares authorized, none issued	–	–
Common stock, $0.01 par value; 100,000,000 shares authorized; 48,147,969 shares issued in 2008 and 2007	481	481
Additional paid-in capital	151,245	149,568
Accumulated other comprehensive loss, net of tax	(387)	–
Retained earnings	50,494	35,632
Treasury stock, at cost; 12,333,549 and 9,528,467 shares in 2008 and 2007, respectively	(87,571)	(48,470)
Total shareholders' equity	114,262	137,211
	$251,761	$241,508

See accompanying notes.

Statements of Shareholders' Equity

For the years ended December 31, 2008, 2007 and 2006

	Common Stock		Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Treasury Stock		Total Shareholders' Equity
In thousands	Shares	Amount				Shares	Amount	
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
Comprehensive income:								
Net income	–	–	–	–	17,501	–	–	17,501
Unrealized gain on investment securities, net of tax	–	–	–	10	–	–	–	10
Total comprehensive income								17,511
Issuance of shares pursuant to stock compensation plan	–	–	(7,339)	–	–	878	10,928	3,589
Stock compensation	–	–	2,365	–	–	–	–	2,365
Treasury stock purchases	–	–	–	–	–	(1,250)	(16,163)	(16,163)
Issuance of shares pursuant to Employee Stock Purchase Plan	–	–	(2)	–	–	100	1,119	1,117
Federal income tax benefit related to exercise of stock options	–	–	2,917	–	–	–	–	2,917
Balance at December 31, 2007	48,148	481	149,568	–	35,632	(9,528)	(48,470)	137,211
Comprehensive income:								
Net income	–	–	–	–	14,862	–	–	14,862
Unrealized loss on investment securities, net of tax	–	–	–	(387)	–	–	–	(387)
Total comprehensive income								14,475
Issuance of shares pursuant to stock compensation plan	–	–	(3,495)	–	–	379	5,310	1,815
Stock compensation	–	–	3,820	–	–	–	–	3,820
Treasury stock purchases	–	–	–	–	–	(4,283)	(58,984)	(58,984)
Issuance of shares pursuant to Employee Stock Purchase Plan	–	–	(186)	–	–	101	1,376	1,190
Federal income tax benefit related to exercise of stock options	–	–	822	–	–	–	–	822
Issuance of shares in connection with legal settlement	–	–	455	–	–	802	10,595	11,050
Issuance of shares for acquisitions	–	–	261	–	–	196	2,602	2,863
Balance at December 31, 2008	48,148	$481	$151,245	$(387)	$50,494	(12,333)	$(87,571)	$114,262

See accompanying notes.

Statements of Cash Flows

For the years ended December 31 In thousands	2008	2007	2006
Cash flows from operating activities:			
Net income	$ 14,862	$ 17,501	$ 14,362
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	12,611	11,211	10,102
Non-cash legal settlement related to warrants	9,045	–	–
Share-based compensation expense	3,820	2,365	1,960
Purchased in-process research and development charge	–	–	140
Non-cash interest and other charges	–	–	220
Provision for losses – accounts receivable	1,764	753	2,077
Excess tax benefit from exercises of share-based arrangements	(666)	(1,891)	(614)
Deferred income tax benefit	(2,151)	(1,598)	(2,520)
Changes in operating assets and liabilities, exclusive of effects of acquired companies:			
Accounts receivable	(11,853)	(1,575)	(10,400)
Income tax payable	827	3,919	536
Prepaid expenses and other current assets	(338)	(304)	(1,496)
Accounts payable	(870)	(1,955)	1,626
Accrued liabilities	3,420	(1,619)	972
Deferred revenue	17,331	7,304	9,839
Net cash provided by operating activities	47,802	34,111	26,804
Cash flows from investing activities:			
Proceeds from sales of investments	45,065	45,480	19,016
Purchases of investments	(8,625)	(67,545)	(26,825)
Cost of acquisitions, net of cash acquired	(23,868)	(9,005)	(12,237)
Additions to property and equipment	(20,143)	(3,678)	(4,088)
Investment in software development costs	–	(167)	(236)
Acquired lease	(1,387)	–	–
(Increase) decrease in restricted investments	(620)	500	38
Decrease in other	24	140	6
Net cash used by investing activities	(9,554)	(34,275)	(24,326)
Cash flows from financing activities:			
Purchase of treasury shares	(59,847)	(14,037)	(10,531)
Net borrowings on revolving credit facility	8,000	–	–
Contributions from employee stock purchase plan	1,233	1,151	1,002
Proceeds from exercise of stock options	1,815	3,589	2,916
Excess tax benefits from exercise of share-based arrangements	666	1,891	614
Warrant exercise in connection with legal settlement	2,005	–	–
Net cash used by financing activities	(46,128)	(7,406)	(5,999)
Net decrease in cash and cash equivalents	(7,880)	(7,570)	(3,521)
Cash and cash equivalents at beginning of year	9,642	17,212	20,733
Cash and cash equivalents at end of year	$ 1,762	$ 9,642	$ 17,212

See accompanying notes.

(Tables in thousands, except per share data)

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

DESCRIPTION OF BUSINESS

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

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

CASH AND CASH EQUIVALENTS

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

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

INVESTMENTS

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

REVENUE RECOGNITION

Software Arrangements:

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

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

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

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

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

Software Licenses

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

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

For arrangements that involve significant production, modification or customization of the software, or where software services are otherwise considered essential, we recognize revenue using contract accounting. We generally use the percentage-of-completion method to recognize revenue from these arrangements. We measure progress-to-completion primarily using labor hours incurred, or value added. The percentage-of-completion method generally results in the recognition of reasonably consistent profit margins over the life of a contract because we have the ability to produce reasonably dependable estimates of contract billings and contract costs. We use the level of profit margin that is most likely to occur on a contract. If the most likely profit margin cannot be precisely determined, the lowest probable level of profit in the range of estimates is used until the results can be estimated more precisely. These arrangements are often implemented over an extended time period and occasionally require us to revise total cost estimates. Amounts recognized in revenue are calculated using the progress-to-completion measurement after giving effect to any changes in our

cost estimates. Changes to total estimated contract costs, if any, are recorded in the period they are determined. Estimated losses on uncompleted contracts are recorded in the period in which we first determine that a loss is apparent.

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

Subscription-Based Services

Subscription-based services primarily consist of revenues derived from application service provider ("ASP") arrangements and other hosted service offerings, software subscriptions and disaster recovery services.

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

For ASP and other hosting arrangements, we evaluate whether each of the elements in these arrangements represents a separate unit of accounting, as defined by Emerging Issues Task Force ("EITF") No. 00-21, using all applicable facts and circumstances, including whether (i) we sell or could readily sell the element unaccompanied by the other elements, (ii) the element has stand-alone value to the customer, (iii) there is objective reliable evidence of the fair value of the undelivered item, and (iv) there is a general right of return. We consider the applicability of EITF No. 00-03, "Application of SOP 97-2 to Arrangements That Include the Right to Use Software Stored on Another Entity's Hardware" on a contract-by-contract basis. In hosted term-based agreements, where the customer does not have the contractual right to take possession of the software, hosting fees are recognized on a monthly basis over the term of the contract commencing when the customer has access to the software. For professional services associated with hosting arrangements that we determine do not have stand-alone value to the customer, we recognize the services revenue ratably over the remaining contractual period once hosting has gone live and we may begin billing for the hosting services. We record amounts that have been invoiced in accounts receivable and in deferred revenue or revenues, depending on whether the revenue recognition criteria have been met.

If we determine that the customer has the contractual right to take possession of our software at any time during the hosting period without significant penalty, and can feasibly maintain the software on the customer's hardware or enter into another arrangement with a third party to host the software, we recognize the license, professional services and hosting services revenues pursuant to SOP 97-2.

Software Services

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

Computer Hardware Equipment

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

Postcontract Customer Support

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

Allocation of Revenue in Statement of Operations

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

Appraisal Services:

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

Other:

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

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

USE OF ESTIMATES

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

PROPERTY AND EQUIPMENT, NET

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

RESEARCH AND DEVELOPMENT COSTS

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

INCOME TAXES

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

SHARE-BASED COMPENSATION

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

SEGMENT AND RELATED INFORMATION

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

GOODWILL AND OTHER INTANGIBLE ASSETS

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

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

appraisal services and appraisal software stand-alone business unit is organized in such a manner that both of its revenue sources are tightly integrated with each other and discrete financial information at the operating profit level does not exist for this business unit's respective revenue sources. There have been no significant impairments of goodwill or other intangibles.

IMPAIRMENT OF LONG-LIVED ASSETS

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

COSTS OF COMPUTER SOFTWARE

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

FAIR VALUE OF FINANCIAL INSTRUMENTS

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

CONCENTRATIONS OF CREDIT RISK AND UNBILLED RECEIVABLES

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

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

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

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

In connection with this activity, we have recorded unbilled receivables of $13.7 million and $11.2 million at December 31, 2008 and 2007, respectively. We also have recorded retention receivable of $1.5 million and $3.9 million at December 31, 2008 and 2007, respectively, and these retentions become payable upon the completion of the contract or completion of our field work and formal hearings. Unbilled receivables and retention receivables expected to be collected in excess of one year have been classified as accounts receivable, long-term portion in the accompanying balance sheets.

INDEMNIFICATION

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

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

NEW ACCOUNTING PRONOUNCEMENTS

In December 2007, the Financial Accounting Standards Board ("FASB") issued SFAS No. 141R "Business Combinations." SFAS No. 141R changes the accounting for business combinations including the measurement of acquirer shares issued in consideration for a business combination, the recognition of contingent consideration, the accounting for pre-acquisition gain and loss contingencies, the recognition of capitalized in-process research and development, the accounting for acquisition-related restructuring cost accruals, the treatment of acquisition related transaction costs and the recognition of changes in the acquirer's income tax valuation allowance. SFAS No. 141R is effective for fiscal years beginning after December 15, 2008, with early adoption prohibited. The adoption of SFAS No. 141R is not expected to have a material impact on our financial statements or related disclosures.

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

(2) ACQUISITIONS

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

In the first quarter of 2008, we completed the acquisitions of all of the capital stock of VersaTrans Solutions Inc. ("VersaTrans") and certain assets of Olympia Computing Company, Inc. d/b/a Schoolmaster ("Schoolmaster"). VersaTrans is a provider of student transportation management software solutions for school districts and school transportation providers across North America, including solutions for school bus routing and planning, redistricting, GPS fleet tracking, fleet maintenance and field trip planning. Schoolmaster provides a full suite of student information systems, which manage such functions as grading, attendance, scheduling, guidance, health, admissions and fund raising. The combined purchase price for these transactions excluding cash acquired and including transaction costs, was approximately $13.9 million in cash and approximately 126,000 shares of Tyler common stock valued at $1.7 million.

Our balance sheet as of December 31, 2008 reflects the allocation of the purchase price to the assets acquired and liabilities assumed based on their estimated fair values at the dates of acquisition. In connection with these three transactions we acquired total tangible assets of approximately $3.5 million and assumed total liabilities of approximately $8.2 million. We recorded goodwill of $17.1 million, $7.8 million of which is expected to be deductible for tax purposes, and other intangible assets of $14.3 million. The $14.3 million of intangible assets is attributable to acquired software, customer relationships and trade name that will be amortized over a weighted average period of approximately 10 years.

The operating results of these acquisitions are included in our results of operations since their respective dates of acquisition. We believe these acquisitions will complement our business model by expanding our presence in the education market and will give us additional opportunities to provide our customers with solutions tailored specifically for local governments.

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

(3) FAIR VALUE OF FINANCIAL INSTRUMENTS

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

SFAS No. 157 establishes a three-tier fair value hierarchy, which prioritize the inputs used in measuring fair value. These tiers include the following:

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

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

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

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

	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash and cash equivalents	$ 6,844	$6,844	$ –	$ –
Short–term investments available-for-sale	775	775	–	–
Non–current investments available-for-sale	3,779	–	–	3,779
	$11,398	$7,619	$ –	$ 3,779

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

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

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

In association with this estimate of fair value, we have recorded an after tax temporary unrealized loss on our non-current ARS of $387,000, net of related tax effects of $209,000 in 2008, which is included in accumulated other comprehensive loss on our balance sheet. As of December 31, 2008 we have continued to earn and collect interest on all of our ARS. We believe that this temporary decline in fair value is due entirely to liquidity issues, because the underlying assets of these securities are supported by municipal and state agencies and do not include mortgage-backed securities, have redemption features which call for redemption at 100% of par value and have a current credit rating of A or AAA. The ratings on the ARS take into account credit support through insurance

policies guaranteeing each of the bonds' payment of principal and accrued interest, if it becomes necessary. In addition, we do not plan to sell any of the ARS prior to maturity at an amount below the original purchase value and, at this time, do not deem it probable that we will receive less than 100% of the principal and accrued interest. Based on our cash and cash equivalents balance of $6.8 million, expected operating cash flows and the liquidation of $775,000 of ARS subsequent to the period ending December 31, 2008, we do not believe a lack of liquidity associated with our ARS will adversely affect our ability to conduct business, and believe we have the ability to hold the securities throughout the currently estimated recovery period. We have classified these securities as non-current because we believe the market for these securities may take in excess of twelve months to fully recover. We will continue to evaluate any changes in the market value of our non-current ARS and in the future, depending upon existing market conditions, we may be required to record an other-than-temporary decline in market value.

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

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

(4) PROPERTY AND EQUIPMENT, NET

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

	Useful Lives (years)	2008	2007
Land	–	$ 3,349	$ 179
Computer equipment and purchased software	3–5	19,553	18,502
Furniture and fixtures	5	5,103	4,625
Building and leasehold improvements	5–35	16,248	4,099
Transportation equipment	5	266	279
		44,519	27,684
Accumulated depreciation and amortization		(17,997)	(17,858)
Property and equipment, net		$ 26,522	$ 9,826

Depreciation expense was $3.5 million during 2008, $2.8 million during 2007, and $2.4 million during 2006.

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

(5) GOODWILL AND OTHER INTANGIBLE ASSETS

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

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

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

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

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

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

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

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

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

(6) ACCRUED LIABILITIES

Accrued liabilities consist of the following at December 31:

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

(7) SHORT-TERM OBLIGATION

On October 20, 2008, we entered into a revolving bank credit agreement (the "Credit Facility") and a related pledge and security agreement. The Credit Facility matures October 19, 2009 and provides for total borrowings of up to $25.0 million and a $6.0 million Letter of Credit facility under which the bank will issue cash collateralized letters of credit. Borrowings under the Credit Facility bear interest at a rate of either LIBOR plus 1% or prime rate minus 1.5%. As of December 31, 2008, our effective interest rate was 1.47% under the Credit Facility. The effective average interest rate for borrowings during the period October 20 through December 31, 2008 was 2.1%. The Credit Facility is secured by substantially all of our personal property. The Credit Facility requires us to maintain certain financial ratios and other financial conditions and prohibits us from making certain investments, advances, cash dividends or loans, restricts the amount of our common stock we may purchase and limits incurrence of additional indebtedness and liens. As of December 31, 2008, we were in compliance with those covenants.

As of December 31, 2008, we had outstanding borrowings of $8.0 million and unused available borrowing capacity of $17.0 million under the Credit Facility. In addition, as of December 31, 2008, our bank had issued outstanding letters of credit totaling $5.1 million to secure surety bonds required by some of our customer contracts. These letters of credit have been collateralized by restricted cash balances invested in a certificate of deposit and expire through mid-2009. The carrying amount of the Credit Facility approximates fair value due to the short-term nature of the instrument.

(8) INCOME TAX

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

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

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

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

In 2008, non-deductible business expenses include the impact of a non-cash legal settlement related to warrants charge of $9.0 million, which was not tax deductible. See Note 14 – "Commitments and Contingencies" for more information.

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

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

	2008	2007
Deferred income tax assets:		
Operating expenses not currently deductible	$ 1,466	$ 1,502
Employee benefit plans	2,528	1,687
Capital loss carryforward	221	–
Property and equipment	203	114
Total deferred income tax assets	4,418	3,303
Deferred income tax liabilities:		
Intangible assets	(9,697)	(8,504)
Other	(181)	(167)
Total deferred income tax liabilities	(9,878)	(8,671)
Net deferred income tax liabilities	$(5,460)	$(5,368)

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

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

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

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

(9) SHAREHOLDERS' EQUITY

The following table details activity in our common stock:

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

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

On June 27, 2008, we settled outstanding litigation related to two Stock Purchase Warrants owned by Bank of America, N. A. ("BANA"). In July 2008, as a result of this settlement, BANA paid us $2.0 million and we issued to BANA 801,883 restricted shares of Tyler common stock. See Note 14 – "Commitments and Contingencies" for further information.

(10) SHARE-BASED COMPENSATION

Share-Based Compensation Plan

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

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

Determining Fair Value Under SFAS No. 123R

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

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

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

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

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

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

The following weighted average assumptions were used for options granted:

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

Share-Based Compensation Under SFAS No. 123R

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

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

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
Outstanding at December 31, 2005	4,608	$ 4.99		
Granted	237	10.76		
Exercised	(623)	4.68		
Forfeited	(127)	6.42		
Expired	(8)	5.21		
Outstanding at December 31, 2006	4,087	5.32		
Granted	773	13.42		
Exercised	(878)	4.09		
Forfeited	(10)	8.29		
Outstanding at December 31, 2007	3,972	7.16		
Granted	1,750	14.38		
Exercised	(379)	4.79		
Forfeited	(34)	10.82		
Outstanding at December 31, 2008	5,309	9.69	7	$17,474
Exercisable at December 31, 2008	2,463	$ 5.71	5	$15,656

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

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

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

Employee Stock Purchase Plan

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

(11) EARNINGS PER SHARE

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

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

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

(12) LEASES

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

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

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

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

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

(13) EMPLOYEE BENEFIT PLANS

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

(14) COMMITMENTS AND CONTINGENCIES

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

On June 27, 2008, we settled outstanding litigation related to two Stock Purchase Warrants (the "Warrants") owned by Bank of America, N. A. ("BANA"). As disclosed in prior SEC filings, the Warrants entitled BANA to acquire 1.6 million shares of Tyler common stock at an exercise price of $2.50 per share. The Warrants expired on September 10, 2007. Prior to their expiration, BANA attempted to exercise the Warrants; however, the parties disputed whether or not BANA's exercise was effective. We filed suit for declaratory judgment seeking a court's determination on the matter, and BANA asserted numerous counterclaims against us, including breach of contract and misrepresentation.

Following court-ordered mediation, in July 2008, BANA paid us $2.0 million and we issued to BANA 801,883 restricted shares of Tyler common stock. Accordingly, as a result of the settlement, we recorded a non-cash legal settlement related to warrants charge of $9.0 million, which is not tax deductible.

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

(15) QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

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

	2008				2007			
Quarters ended	Dec. 31	Sept. 30	June 30 [1]	Mar. 31	Dec. 31	Sept. 30	June 30	Mar. 31
Revenues	$69,544	$68,637	$67,569	$59,351	$60,420	$54,932	$54,112	$50,332
Gross profit	28,945	29,950	29,089	21,803	24,436	21,630	20,337	18,022
Income before income taxes	9,845	12,335	2,026	5,070	10,128	8,369	6,160	3,923
Net income	5,131	6,359	246	3,126	6,190	5,160	3,750	2,401
Earnings per diluted share	0.14	0.16	0.01	0.08	0.15	0.12	0.09	0.06
Shares used in computing diluted earnings per share	37,604	40,019	39,633	39,527	40,358	41,395	41,448	42,066

[1] On June 27, 2008, we settled outstanding litigation related to Warrants owned by BANA. As disclosed in prior SEC filings, the Warrants entitled BANA to acquire 1.6 million shares of Tyler common stock at an exercise price of $2.50 per share. Following court-ordered mediation, in July 2008, BANA paid us $2.0 million and we issued to BANA 801,883 restricted shares of Tyler common stock. Accordingly, we recorded a non-cash legal settlement related to warrants charge of $9.0 million, which is not tax deductible, during the three months ended June 30, 2008.

PERFORMANCE GRAPH

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

Comparison of Cumulative Five Year Total Return

	2003	2004	2005	2006	2007	2008
Tyler	100	86.81	91.17	146.00	133.85	124.40
S&P 500 Index	100	110.88	116.33	134.70	142.10	89.53
S&P 600 Information Technology Index	100	106.65	106.39	116.42	127.25	75.88

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
Executive Vice President
Chief Financial Officer and Treasurer

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

Rick L. Hoff
Vice President
Chief Technology Officer

Robert J. Sansone
Vice President
Human Resources

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]
Executive Vice President
Republic Title of Texas, Inc.

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 14, 2009, at 9:30 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 website 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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Common Stock

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

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