

laws of  
**performance**



**The physical world is governed by basic laws of physics —**

the unwavering rules that equip us with valuable insights about how and why things happen as they do. At Tyler Technologies, we believe they can be applied equally to the business world. These are the laws of performance that empower us to navigate dynamic markets with strength, stability and confidence.

# to our shareholders

Business performance is measured in many ways. And by virtually every financial indicator, I'm pleased to report that 2011 was the strongest year yet for Tyler Technologies.

Total revenue reached \$309.4 million — a 7.2 percent increase over 2010 and a new high for Tyler. Recurring revenues drove our growth as we continued to expand our maintenance base, and our software as a service (SaaS) model continued to gain popularity, attracting new clients and prompting many existing clients to make the switch from traditional on-premise installations. Bookings showed strong growth in the second half of the year, pushing backlog to a record high of \$339.8 million. Cash flow grew as well, reaching our highest-ever level of \$44.2 million (\$50.8 million before real estate expenditures).

Tyler's earnings also grew in 2011, and we posted our 43rd consecutive profitable quarter in December. For the year, diluted earnings per share rose 17 percent to \$0.83. We created significant shareholder value with the repurchase of approximately 3 million shares of our common stock at an average price of \$23.90 per share. Our return on average equity for the year was 29.8 percent, compared to 20.8 percent in 2010.

In October, we completed our largest acquisition since 1999 — the \$23.8 million purchase of Windsor Management Group, which provides financial and human capital management solutions to the K–12 education market. With 800 school district clients in 31 states, this acquisition significantly broadens Tyler's geographic reach in K–12 schools, especially in Western states including Arizona, New Mexico and Colorado, where we did not have a sizable presence in the education market. Through Windsor's flagship product, Infinite Visions®, Tyler also gains meaningful recurring revenues.

## Milestones and Accolades

2011 marked the company's 45th year in business — and in October, our executive leadership team rang the New York Stock Exchange Closing Bell to mark the occasion. We believe Tyler's staying power is a testament to our ability to adapt to the changing needs of the public sector without sacrificing the fundamentals of our business — providing superior service to our clients, being a good steward of each client's investment in our products, delivering value to shareholders, maintaining a fiscally disciplined business, and investing in the future of our company, as well as that of our clients and employees.

Our company's 45th anniversary was only one of several milestones we reached in 2011. Once again, Tyler was included on the *Forbes* list of America's Best Small Companies. We've made the list in four of the last five years and currently rank 76th. Criteria included companies with revenues from \$5 million to \$1 billion, a share price no lower than \$5, a healthy return on equity, sustained sales and earnings growth, and solid stock performance in comparison to industry peers.

**Tyler posted record revenues, earnings and free cash flow in 2011, driven largely by strength in our recurring revenues. This marks 11 consecutive years of profitability for the company.**

With the release of Microsoft Dynamics® AX 2012 with public sector functionality, Tyler opens up a new stream of incremental revenue while improving our competitive advantage as we pursue a broader range of enterprise resource planning (ERP) system opportunities.

In addition, Tyler was included in the 2011 Software 500 ranking, published by *Software Magazine*. This is our fourth consecutive year on the list. Tyler ranked 155th, measured by 2010 software and services revenue. We're pleased to be included on these prestigious lists because they reinforce the value that our singular focus on the public sector brings to our company, clients and shareholders. By delivering perpetual upgrades and integrated solutions specifically designed for local governments and schools, Tyler continues to earn client loyalty and strengthen our position as a market leader and valued partner for the public sector.

### Rolling Out a New Solution with Microsoft

After more than four years of joint development, Microsoft Dynamics AX 2012 with public sector functionality was released in August.

The city of Redmond, Washington, was our pilot client, going live in July as an early adopter of Dynamics AX 2012, along with Tyler's payroll and cashiering systems. This implementation represents a successful collaboration not only with Tyler and Microsoft, but also with end users in Microsoft's home city of Redmond. These local government employees provided valuable feedback through Microsoft's Technology Adoption Program.

As a Microsoft partner, Tyler now sells Microsoft Dynamics AX 2012 along with our other financial solutions. We believe the product gives us an alternative offering that will strengthen our competitive position in certain opportunities and ultimately enable us to increase our market share. Microsoft Dynamics AX 2012 also opens up a new stream of revenue for Tyler with royalties on public sector sales by other Microsoft partners. The product will also be sold by other Microsoft partners around the world, including those in markets where Tyler doesn't currently compete, such as the federal government and international markets. Tyler receives royalties on both the license fee and the maintenance stream from all public sector sales of Microsoft Dynamics worldwide. While we are pleased with the progress of the Dynamics AX 2012 project, it's still very early in the sales cycle, and we don't expect to see meaningful contributions before 2013.

### Navigating the Economy

Despite difficult economic conditions and a challenging new business environment in the last two years, we've stayed true to our business strategy.

Perhaps more important than the growth in our revenues and earnings was maintaining our aggressive level of development spending in 2011, which has shown a meaningful return in terms of our strong competitive position and improved win rates against key competitors. In addition, we have a strong balance sheet and an expanding base of recurring revenues generating reliable cash flow.



*(left)* **John S. Marr Jr.**  
President and CEO

*(right)* **John M. Yeaman**  
Chairman of the Board

At Tyler, our deep domain expertise is a vital part of our value proposition. Despite the lower level of new business activity in the marketplace in the last two years, we maintained a relatively stable headcount. Although lower professional services staff utilization put pressure on margins, retaining highly experienced staff and continuing to invest in product development at a high level means that we're well positioned to support our growing backlog.

While the public sector software market is still far from robust, the market showed signs in the second half of 2011 that it is beginning to strengthen. We are confident that Tyler's strong competitive position will enable us to continue to gain market share as the economic environment returns to more normal conditions.

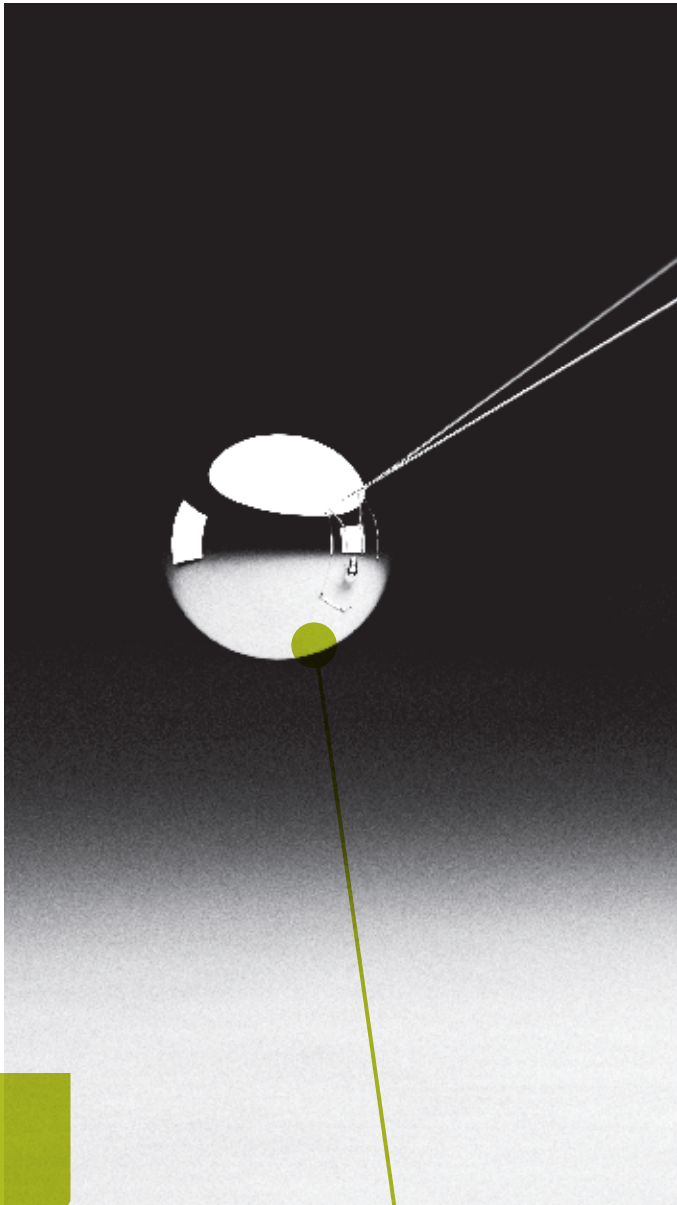
To all of our shareholders, employees and clients, thank you for your confidence in Tyler. Together, we are empowering people who serve the public — each and every day.

A handwritten signature in black ink, appearing to read "John S. Marr Jr.", written in a cursive style.

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

# tyler at a glance

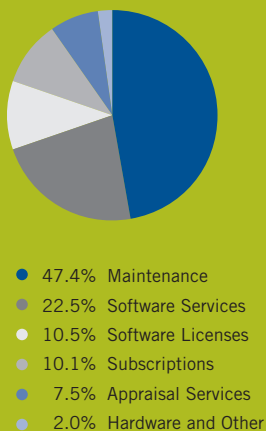
With more than 2,000 employees and more than 10,000 government and school clients across the United States, Canada and the Caribbean, Tyler Technologies is the largest software company in the nation with an exclusive focus on the public sector. We're more than software developers — we're training and support partners whose client relationships span decades. From appraisal services for an 800-acre island to a financial management system for a city with 1 million residents, Tyler's perpetual upgrades and comprehensive services empower our clients to serve the public with accuracy, accessibility and fiscal responsibility.



**Recurring Revenues**  
*in millions*

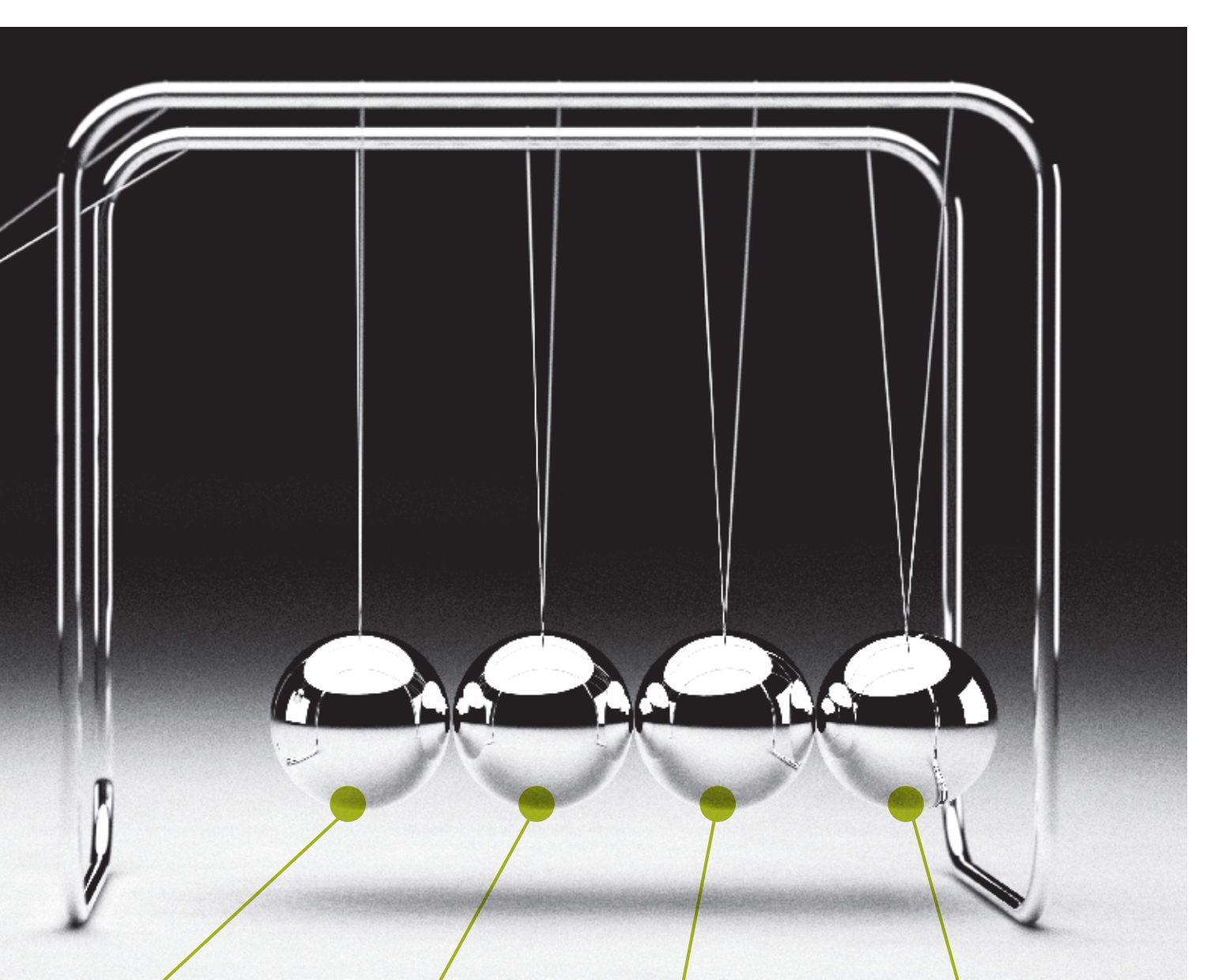


**Revenue Mix**



**ERP | FINANCIAL**

More than 4,000 agencies rely on Tyler's financial ERP solutions for efficient management of their core functions — managing \$116 billion in public sector funds annually, processing paychecks for more than 1 million public sector employees and facilitating more than 100 million utility billing transactions.



#### **COURTS & JUSTICE**

From paperless court case management to e-filing portals, Tyler's courts and justice products offer a broad range of functionality for courts, prosecutors, law enforcement, corrections and supervision staff. Eight states and more than 400 counties and 750 municipalities use our integrated solutions to streamline operations while enhancing service.

#### **APPRAISAL & TAX**

As a leading provider of appraisal and tax solutions, Tyler delivers the accurate market values and secure revenue collection technologies that empower 1,300 jurisdictions throughout the United States and Canada. Offerings include computer-assisted mass appraisal (CAMA) solutions, tax billing and collections software, and turnkey or targeted reassessment and revaluation services.

#### **SCHOOLS**

Tyler offers a full suite of solutions to help educators and administrators put students first — including student information, school financials, data warehouse and student transportation. In fact, Tyler School Solutions manage transportation for one out of every 10 U.S. schools, which means on any given day, 7 million students ride on school buses routed by Tyler software.

#### **LAND & VITAL RECORDS**

From land records and birth certificates to social service documents and enterprise-wide content management, Tyler's solutions manage the land, vital and official records for 19 million residents across the U.S. and store more than 380 million land and vital records. If printed, these records laid end-to-end would wrap around the Earth almost three times.



**FIRST LAW OF PERFORMANCE**

# an object in motion stays in motion

At Tyler, product development is the dynamic force that drives our evergreen service model. By anticipating client needs and delivering perpetual upgrades, our innovations continue to move the company and our public sector clients forward.



# Q&A:

**Despite ongoing budget pressures throughout the public sector, in 2011 Tyler Technologies posted our strongest financial performance yet. With this question and answer format, we hope to lend context to the many factors that shaped our performance.**

## How has the recession affected Tyler's new business?

For the past couple of years, sales cycles increased significantly as a result of weak economic conditions. As local governments experienced budget pressures, decision processes became more complex, with more people involved and greater spending justification required. In many cases, public sector organizations postponed the purchase of new software, opting to continue using outdated legacy systems longer than planned. This significantly lengthened many sales cycles and led to a pipeline of new business prospects that is at a historically high level.

## Although local government budget woes are well publicized, Tyler has continued to sign new clients. What drives new business in this weak economy?

The factors that create demand for Tyler products and services don't really change with the economy, even though our clients' budgetary constraints sometimes compel them to postpone the implementation of a new system. Our clients generally begin a process to replace older systems when they become unreliable, are no longer supported, are difficult to maintain with in-house resources or run on obsolete hardware. When the systems reach any of these points, the decision to replace them is somewhat non-discretionary, as mission-critical tasks like paying employees and running the courts and jails must continue without interruption. In addition, the implementation of a new system virtually always leads to improvements in efficiency and productivity, allowing governments to "do more with less," a common mantra in the public sector today.

## Is the public sector showing signs of recovery?

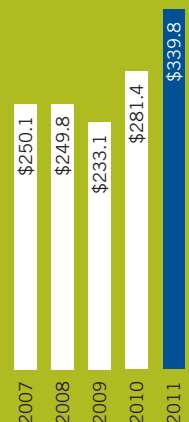
It's hard to generalize, because there are so many local entities — about 90,000 in the United States alone — and even neighboring towns can have very different budgetary situations. That said, a January 2012 report from the Nelson A. Rockefeller Institute of Government indicates that although state tax revenues have yet to return to peak levels, they have rebounded to pre-recession performance following seven consecutive quarters of growth. In general, it looks as though much of the public sector has seen the worst of the down market. In addition, while many prospects deferred purchases of new software due to budget pressures over the past several quarters, we believe that some of their needs have now reached more critical stages and can no longer be postponed.

Free Cash Flow<sup>(a)</sup>  
in millions



(a) excludes capital expenditures for real estate

Backlog  
in millions





## ERP | FINANCIAL

Munis Version 9.1, enhanced with Microsoft® Silverlight® functionality, is now in general release, with a significantly increased competitive position. Incode V.X continues to gain momentum with both deployed and SaaS clients.

In 2011, we added more than 80 new ERP clients, including Putnam County, New York (\$4.1 million); Ottawa County, Michigan (\$1.2 million); and Sussex County, Delaware (\$1.1 million). Our Incode financial solution played a vital role in a number of multi-solution agreements including contracts for the cities of Greenville and Georgetown, Texas, and Valencia County, New Mexico.

As 2011 progressed, we began to see the pace of activity in our sales pipeline pick up modestly — although it's important to note that it's still a longer process on average than we've seen in a normal market. The timing of new business awards also remains less predictable than normal, and as our average contract size increases, the timing of large contracts can cause significant fluctuations in bookings from quarter to quarter. For the year 2011, our bookings grew more than nine percent from the prior year. While we're optimistic that the market will continue its gradual return to more normal levels of business, we'd like to see more sustained new business growth before we consider it a trend.

### **Tyler signed a number of significant new contracts in 2011. What are some of the highlights?**

With significant investments in our products and technology, as well as in branding and marketing, we've continued to pursue large-scale opportunities — and in 2011, we gained considerable momentum on that front with the signing of our two biggest contracts in company history. The first was a \$31 million court system for the state of Oregon, which was approximately twice the size of our previous largest software deal. The second was a \$45 million court system for the state of Maryland, which replaces legacy systems and applications with a single integrated solution. Both will be multi-year implementations, which provide increased revenue visibility down the road.

Other notable wins included a \$3.4 million ERP contract with the Guam Department of Education; a Versatrans student transportation management contract with Ohio's Columbus City Schools, a client that already uses our Munis ERP system; and an agreement with Florida's Pasco County Schools totaling almost \$8 million — our largest ERP contract of the year.



**Recurring revenues accounted for the majority of Tyler's growth in 2011. Do you anticipate this trend continuing, and if so, how will that impact your business?**

Recurring revenues grew almost 12 percent in 2011 and comprised 57 percent of our total revenues for the year. In particular, our subscription revenues have grown more than 30 percent in each of the last two years. We have added more SaaS product offerings over the past three years, and the mix of new business has gradually increased. Even so, we expect the majority of our new business will continue to favor the perpetual license model for some time to come. Despite a weak new business market, maintenance revenues have grown steadily — a combination of maintenance revenues from new clients, as well as with annual price increases for existing clients and a low attrition rate.

Recurring revenues are important to our business in a number of ways. First of all, they offer a high level of predictability and consistency that helps to balance out the dynamic nature of new license and services revenues. Secondly, these services tie in perfectly with our evergreen model — providing updates and new releases to clients as part of their maintenance or subscription fee. Our extremely high renewal rates have contributed to solid performance even in a tough new business environment, and we believe this will be the case going forward as well.

**What were some of the key SaaS contracts you signed in 2011?**

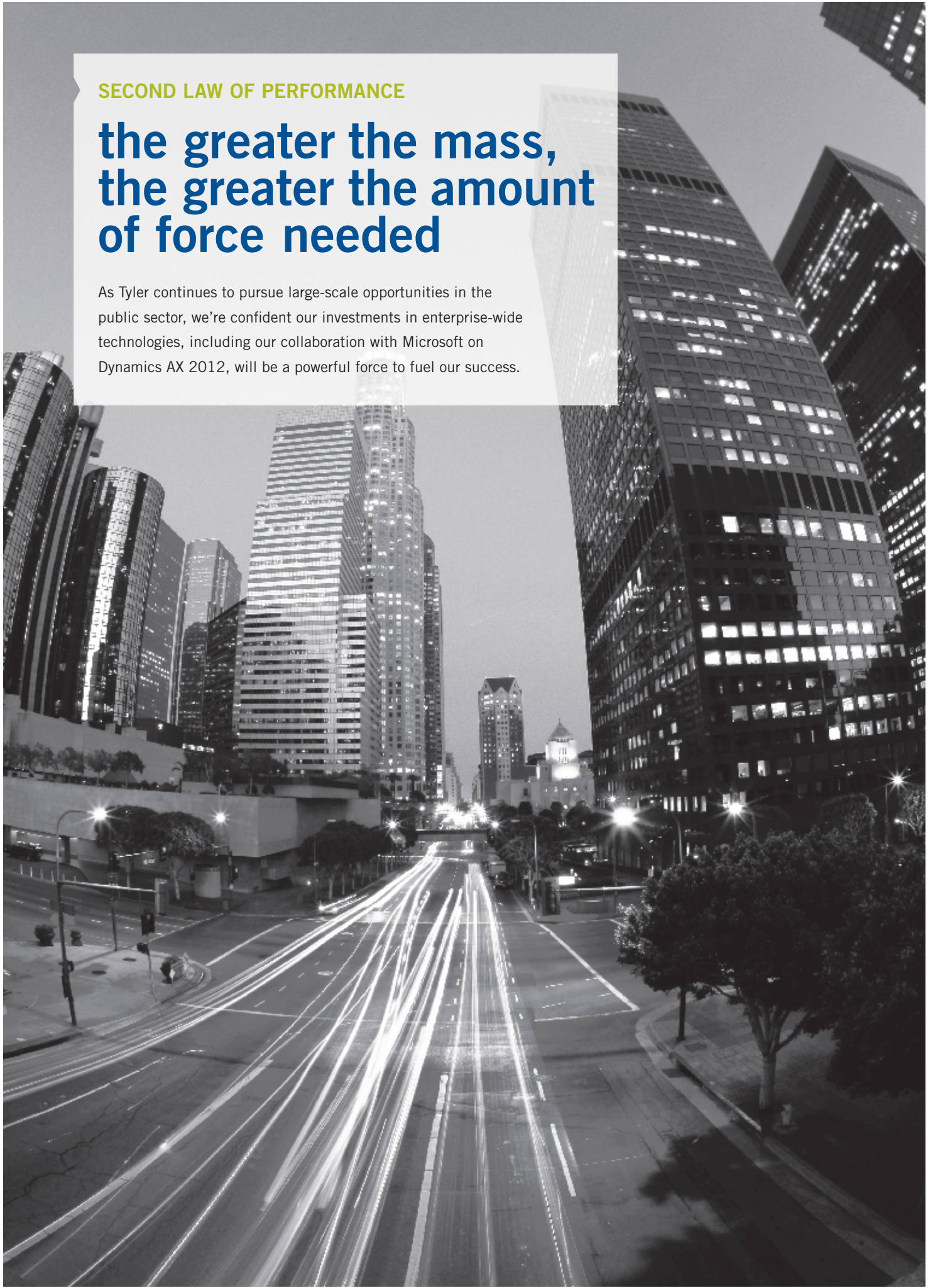
We signed a four-year appraisal and tax software contract in Loudoun County, Virginia, one of the state's largest counties. They've chosen our iasWorld® Online product to enhance their existing CAMA capabilities. Not only will Tyler's SaaS solution deliver the operational benefits of integrated access, but it will do so without the up-front capital expenditure of an on-premise implementation.

Going paperless not only saves natural resources and enhances operational efficiencies — it's also becoming a requirement in a growing number of jurisdictions.

## SECOND LAW OF PERFORMANCE

# the greater the mass, the greater the amount of force needed

As Tyler continues to pursue large-scale opportunities in the public sector, we're confident our investments in enterprise-wide technologies, including our collaboration with Microsoft on Dynamics AX 2012, will be a powerful force to fuel our success.



A number of new small and mid-sized clients like Matagorda County, Texas, are choosing our Odyssey Online courts and justice solution to help them do more with less. Clay County, Florida, an existing Odyssey client, transitioned its operations to our SaaS model as well.

In addition, a longtime Tyler Munis ERP client, the Kentucky Department of Education, is moving to the cloud from systems deployed on-premises at each school district in the state. We're converting an average of 10 Kentucky districts to SaaS every month, resulting in a meaningful increase in our recurring revenues. By the end of 2011, 173 of the state's 174 school districts had signed up for the cloud, and 64 had been converted. And finally, the city of Eugene, Oregon, became one of the first SaaS clients to adopt our Incode V.X municipal court system.

### **What does the migration toward a SaaS delivery model mean for your traditional offerings?**

Traditional on-premise implementations will remain an important part of our business, and we expect they will continue to make up the majority of our new business for the foreseeable future. After all, clients who have functional infrastructures already in place are compelled to make the most of those assets, and Tyler will continue to provide perpetual upgrades and ongoing maintenance for those systems. Should those clients eventually choose to adopt our SaaS model, we'll be here to help them make a seamless transition. All of our major products are offered either as a traditional model or as a SaaS model, so our company is a bit of a hybrid. With both models, however, we're growing recurring revenues — whether through maintenance agreements or SaaS subscriptions.

### **How is the popularity of the SaaS model affecting revenues for new licenses?**

With SaaS contracts, license and service revenues aren't generally recognized up front; instead, they're bundled into the contract and recognized over the terms of the agreements, which typically range from three to seven years. While the increase in new SaaS clients dampened new license revenue recognized in 2011, subscription backlog grew 35 percent in 2011.

### **How did transaction-based revenues figure into the financial picture for 2011?**

We're especially pleased with the growth in the transaction-based revenues included in our subscriptions line. Our Odyssey File & Serve e-filing engine that we acquired with Wiznet in 2010, allows attorneys to file briefs, motions, lawsuits and other legal documents electronically, and then flow seamlessly through our court case management system. Many of our new File & Serve implementations are being done on a revenue-sharing basis, which means there are low or no up-front costs for the client. Under this model, even clients with budget pressures have the flexibility to implement the system and achieve the efficiencies associated with going paperless. In turn, Tyler receives all or a part of the filing fees charged to users, resulting in high-margin recurring revenues based on these transactions.

## **COURTS & JUSTICE**

With a market-leading position in courts technology, Tyler signed its two largest contracts to date — a \$45 million Odyssey® case management system for the state of Maryland, and a \$31 million system for the state of Oregon. These multi-year implementations will enable those states to streamline court processes, reduce costs related to handling and storing paper, and provide 24/7 access to court documents.

Minnesota purchased a statewide license for our SessionWorks Judge Edition, a powerful touch-screen application used by trial judges to access case information while court is in session. Additionally, New Mexico expanded its e-filing (Odyssey File & Serve) agreement statewide.

**2011 Quarterly Earnings Per Share**  
in dollars



**Annual Earnings Per Share**  
in dollars



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



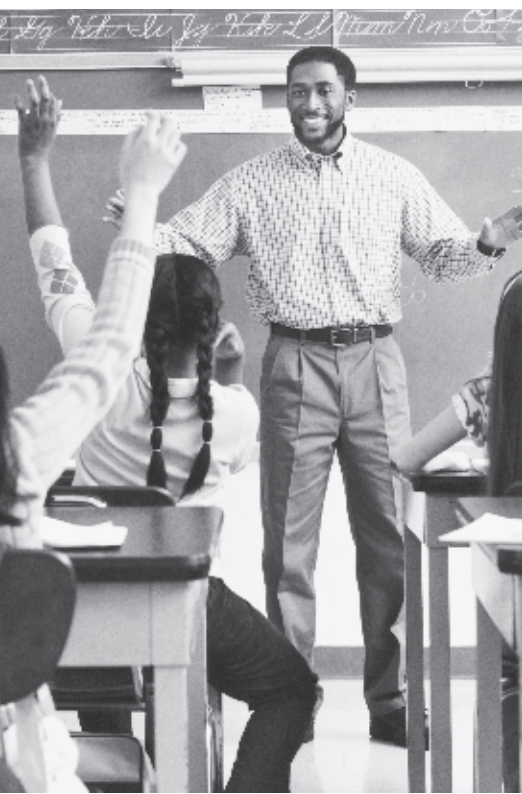
In addition, we have established a growing revenue stream from online payment processing for transactions such as utility bills and traffic tickets. For these clients, we host the payment portals and process the transactions, earning revenues from convenience fees and hosting fees. Together, online payments and e-filing contributed \$6.7 million in revenues in 2011, up 25 percent from the prior year.

Increasingly, factors such as government directives for paperless operations and public demand for online accessibility are driving opportunities for transaction-based revenues. For example, New Mexico recently signed a statewide e-filing contract for its courts in response to that state's paperless filing mandate. And in many jurisdictions, secure payment portals for utility bills, taxes and more are becoming the norm. Our solutions that generate transaction-based revenues represent one more way Tyler is empowering the public sector to adapt to changing conditions.

**From an efficiency standpoint, what are some of the advantages that Tyler solutions offer?**

Doing more with less while improving customer service is a common theme among the clients we serve. No matter what state the economy is in, local governments and schools have an obligation to provide a consistent level of service to the public. The public sector can't always add personnel to meet growing demands for services such as online payment options and document access. In fact, they're often being forced to reduce staff in response to budget pressures. Their best option is to increase productivity, which is precisely what our solutions are designed to do.

Our systems help clients eliminate redundant and manual processes, enhance service offerings, reduce wait times and provide online access to public documents — empowering them to accomplish more tasks, more accurately, with the same or fewer personnel. Our e-filing solution for courts is a great example of efficiency in action. Not only does electronic filing help expedite the process and keep lines manageable, but it also removes paper documents from the equation and eliminates the need for physical space for document storage.



### Many of your clients have won awards for the efficiencies they've achieved, correct?

Yes. In fact, more than half of the winners of the 2011 Digital Counties Survey awards use a Tyler solution. Winners showed how their IT initiatives are helping their governments reduce costs, adapt their operations to compensate for smaller work forces, and enhance customer service. Tyler is proud of the positive effect our products and services are having in the communities we serve, whether or not they've received awards for their efforts.

### Microsoft Dynamics AX 2012, a product you co-developed for the public sector, went live in 2011. How would you characterize your first deployment?

Our first client was the city of Redmond, Washington — home to approximately 54,000 residents and 5,500 businesses, including Microsoft's headquarters. This was the culmination of more than four years of collaborative development between Tyler and Microsoft, and it was a very successful implementation. Solutions included the Microsoft Dynamics AX core financial solution, as well as Tyler's payroll and cashiering applications, and Redmond city officials have noted significant improvements. We're looking forward to the expected release of additional Dynamics AX 2012 modules, including Payroll, Human Resources and Budgeting, in late 2012.

### How did Tyler put its cash to work in 2011?

The strong cash flow characteristics of our business give us the flexibility to be opportunistic with both of our primary uses of cash — acquisitions and stock repurchases. We continued to be extremely active with our repurchase program in 2011, buying back 3 million shares of Tyler stock at an average price of approximately \$23.90 per share. In the last two years, we have repurchased approximately 19 percent of our common stock. Through our repurchase program since 2002, we've created significant value for shareholders.

## APPRAISAL & TAX

Our Appraisal & Tax division experienced solid revenue and margin growth. Notable new contracts included a \$1.9 million SaaS-based appraisal and tax solution for Loudoun County, Virginia; a \$1.1 million appraisal agreement with the Northeastern Connecticut Council of Governments; a \$2 million iasWorld contract with Lucas County, Ohio; and an appraisal contract with Fairfield County, Ohio, totaling nearly \$1 million.

We completed a statewide implementation of our Orion® appraisal solution in Kansas, went live with statewide implementations of iasWorld in Tennessee, and further refined our offerings with the release of iasWorld 7.0 with user interface enhancements.



**THIRD LAW OF PERFORMANCE**

**for every action,  
there is an equal and  
opposite reaction**

As public sector budgets tightened, Tyler reacted positively by increasing investments in our products and our people. As the economy recovers, we have the momentum to capture a greater share of a growing market.



We expect to continue an active buyback program into the future, as well as pursue strategic acquisitions at reasonable valuations to expand our product and services offerings or to add clients. With our \$150 million revolving credit facility, we have the ability to use a reasonable amount of leverage to supplement cash flow as needed to repurchase stock or make acquisitions. This credit facility gives us the flexibility to take on low-cost debt to take advantage of high-value opportunities that benefit our company, our clients and our shareholders.

### **Tyler had a significant acquisition during the year. How does it fit into the company's long-term strategies?**

We take a disciplined approach to acquisitions, and the October purchase of Windsor Management Group of Tempe, Arizona, was no exception. Founded by former school business administrators and management experts, Windsor products provide financial and human resources data management solutions to the K–12 education market. The \$23.8 million acquisition broadens our geographic reach, boosting Tyler's presence in an eight-state region in which we had a limited number of clients in the K–12 market. Windsor's more than 60 employees are now a part of Tyler, which now serves the Infinite Visions client base of more than 800 school districts in 31 states. Windsor's operations contributed approximately \$2.6 million of revenues during the two-and-a-half months that it was a part of Tyler in 2011.

### **Product development has always been a priority for Tyler. How does the company manage that expense?**

The fact that we have such a broad product range enables us to leverage much of our investment in products. For example, Tyler Content Manager is a product that manages documents and workflow across many of our product suites. Instead of each product group duplicating development efforts for these common functions, we're able to leverage the development of these solutions. That said, Tyler is committed to continually enhancing the functionality and competitiveness of our public sector solutions — and our strategic stewardship of shared research and development funds also makes it possible for us to invest aggressively in product development, even in a challenging business environment.

### **How does your approach to product development relate to Tyler's evergreen service model?**

The two are inextricably connected. When schools or governments purchase solutions from Tyler, they're not just getting the latest software as of the date they sign their contract; as part of their annual maintenance agreement they're also getting the benefit of perpetual upgrades, as they happen, without paying additional licensing fees. The town of Glastonbury, Connecticut, is a great example of this relationship. Since Glastonbury's initial Tyler ERP software implementation in 1989, we've added extensive functionality and enhancements to deliver an up-to-date system that empowers employees to better serve the public. Glastonbury remains a Tyler client to this day — and in all that time, the city has never paid upgrade or relicensing fees for its Tyler solution.

## **SCHOOLS**

Tyler's financial management solutions help school districts streamline their most essential business functions, and our 2011 contract highlights included a \$7.9 million agreement with Pasco County Schools, Florida, and a \$3.4 million agreement with the Guam Department of Education.

Also of note, Tyler was selected by competitive bid to offer Tyler SIS (v9) to school districts across Missouri. Districts may also select optional Tyler products without going to bid, including Tyler financial and human resources management products, Tyler Food Service, Tyler Pulse, Tyler Special Education and our newly enhanced Versatrans<sup>®</sup> solution with My Stop and Calendar & Scheduler functionality.

## LAND & VITAL RECORDS

We continued to grow our presence in the Texas market as five counties signed agreements for Tyler's Eagle solutions in 2011. The counties of Brazoria, Clay, Jasper, Loving and Randall will join 30 other Texas counties that already use our land and vital records solutions. Other notable contracts included agreements in Roosevelt County, New Mexico; Weld County, Colorado; and Mohave County, Arizona.

In addition, our Eagle solutions were an integral part of a multi-solution agreement for Valencia County, New Mexico, worth nearly \$1 million. The contract also included appraisal and tax applications as well as Incode® financials.

## Public sector and development expertise runs deep at Tyler. What does that mean for your clients?

When we talk about our expertise, there are two key elements to consider. First, many of our employees have firsthand experience in the public sector, which helps us see the challenges and opportunities of everyday operations from the inside out. Second, the average tenure at Tyler is incredibly long compared to most corporations and, in particular, to technology companies.

In fact, more than half of our employees have at least five years of tenure, nearly one-third have more than 10 years of experience with Tyler — and more than 200 individuals have been with the company for 20 or more years. Having so many knowledgeable experts and longtime employees on our team translates to consistency for our clients. Our in-depth understanding of the public sector, combined with our ongoing commitment to channel that domain expertise toward relevant solutions, has resulted in client relationships that span decades.

## In 2011, the company launched a social networking platform called Tyler Community. What can you tell us about that?

Tyler Community allows our clients and employees to informally engage with each other to solve problems and share product knowledge. It doesn't take the place of Tyler's support organization; it's just another support tool to share experiences with peers in the public sector. Much like other social media platforms, users actually create much of the content, which includes industry information, tips and tricks, best practices, product training and online forums.

## Community service is an integral part of Tyler's corporate culture. What are some of the ways Tyler empowers its employees to help those in need?

At every Tyler location, our team members are engaged in outreach efforts with nonprofits and charities. Thanks to employee donations and Tyler Foundation contributions, we supported tsunami relief efforts in Japan and tornado relief in the southeastern United States in 2011. Tyler employees also were active in walkathons, bike rides, toy drives and other participatory events to raise money for organizations such as the American Lung Association, American Heart Association, Susan G. Komen Foundation and many others. We're immensely proud of the initiative our employees have shown at the local level, and we look forward to accomplishing even more through company-wide charitable initiatives in the future.

The preceding Q&A is a composite representation of the views of Tyler management regarding company performance and market perspectives. For further information, visit [www.tylertech.com](http://www.tylertech.com) or contact our investor relations team at [info@tylertech.com](mailto:info@tylertech.com).

## Stock Market Data

Our common stock is traded on the New York Stock Exchange under the symbol "TYL." At December 31, 2011, we had approximately 1,939 stockholders of record. A number of our stockholders hold their shares in street name; therefore, there are substantially more than 1,939 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
<b>2010:</b> First Quarter	\$ 21.52	\$ 17.13
Second Quarter	19.83	15.44
Third Quarter	20.46	15.00
Fourth Quarter	22.19	19.49
<b>2011:</b> First Quarter	\$ 23.77	\$ 19.99
Second Quarter	27.14	23.09
Third Quarter	27.56	22.15
Fourth Quarter	32.94	24.00

We did not pay any cash dividends in 2011 or 2010. 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 2011, we purchased approximately 3.0 million shares of our common stock for an aggregate purchase price of \$71.8 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, October 2008, May 2009, July 2010, October 2010 and September 2011. As of December 31, 2011, we had remaining authorization to repurchase up to 1.7 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.

## Selected Financial Data

### SELECTED FINANCIAL DATA

(In thousands, except per share data)	For the Years Ended December 31,				
	2011	2010	2009	2008	2007
<b>STATEMENT OF OPERATIONS DATA:</b>					
Revenues	\$309,391	\$288,628	\$290,286	\$265,101	\$219,796
Costs and expenses:					
Cost of revenues	167,479	160,311	161,523	155,314	135,371
Selling, general and administrative expenses	75,650	69,480	70,115	62,923	51,724
Research and development expense	16,414	13,971	11,159	7,286	4,443
Amortization of customer and trade name intangibles	3,331	3,225	2,705	2,438	1,478
Non-cash legal settlement related to warrants <sup>(1)</sup>	—	—	—	9,045	—
Operating income	46,517	41,641	44,784	28,095	26,780
Other (expense) income, net	(2,404)	(1,742)	(146)	1,181	1,800
Income from operations before income taxes	44,113	39,899	44,638	29,276	28,580
Income tax provision	16,556	14,845	17,628	14,414	11,079
Net income	\$ 27,557	\$ 25,054	\$ 27,010	\$ 14,862	\$ 17,501
Net income per diluted share	\$ 0.83	\$ 0.71	\$ 0.74	\$ 0.38	\$ 0.42
Weighted average diluted shares	33,154	35,528	36,624	39,184	41,352
<b>STATEMENT OF CASH FLOWS DATA:</b>					
Cash flows provided by operating activities	\$ 56,435	\$ 35,350	\$ 42,941	\$ 47,802	\$ 34,111
Cash flows used by investing activities	(28,809)	(8,694)	(13,658)	(9,554)	(34,275)
Cash flows used by financing activities	(28,414)	(34,238)	(21,349)	(46,128)	(7,406)
<b>BALANCE SHEET DATA:</b>					
Total assets	\$295,391	\$264,032	\$270,670	\$251,761	\$241,508
Revolving line of credit	60,700	26,500	—	—	—
Shareholders' equity	78,110	106,972	134,358	114,262	137,211

<sup>(1)</sup> On June 27, 2008, we settled outstanding litigation related to two Stock Purchase Warrants (the "Warrants") owned by Bank of America, N. A. ("BANA"). 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.

## Management's Discussion and Analysis of Financial Condition and Results of Operations

### 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. These 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 revisions to these forward-looking statements. Readers should carefully review the risk factors described in documents we file from time to time with the Securities and Exchange Commission.

When used in this Annual Report, the words "believes," "expects," "anticipates," "foresees," "forecasts," "estimates," "plans," "intends," "continues," "may," "will," "should," "projects," "might," "could" or the negative of such terms and similar expressions are intended to identify forward-looking statements. Similarly, statements that describe our business strategy, outlook, objectives, plans, intentions or goals also are forward-looking statements.

### OVERVIEW

#### General

We provide integrated information management solutions and services for the public sector, with a focus on local and state 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 as well as state governments. 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 hosted solutions as well as property appraisal outsourcing services for taxing jurisdictions. In 2010 we began providing electronic document filing solutions ("e-filings") for courts and law offices which simplify the filing and management of court related documents. Revenues for e-filings are generally derived from transaction fees.

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

We 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; maintenance and support; and appraisal services. Subscription-based services and maintenance and support services are considered recurring revenue sources and comprised approximately 57% of our revenue in 2011. The number of new subscription-based customers and the number of existing customers who convert from our traditional software arrangements to our subscription-based service arrangements are a significant driver to our business together with new software license sales and maintenance rate increases. In addition, we also monitor our customer base and churn as we historically have experienced very low customer turnover. During 2011, our customer turnover was approximately 2%.

## Management's Discussion and Analysis of Financial Condition and Results of Operations

- **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 cyclical 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, 2011, our total employee count increased to 2,091 from 2,054 at December 31, 2010. This increase includes 64 employees added as a result of an acquisition completed in 2011.
- **Selling, General and Administrative (“SG&A”) Expenses** – The primary components of SG&A expenses are administrative and sales personnel salaries and commissions, marketing expense, share-based compensation expense, rent and professional fees. Sales commissions typically fluctuate with revenues and share-based compensation expense generally increases when the market price of our stock increases. 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 discretionary purchases of treasury stock. In 2011, we purchased 3.0 million shares of our common stock for an aggregate purchase price of \$71.8 million. During 2011 we invested \$12.3 million in property and equipment and paid \$16.4 million in cash for all of the capital stock of Windsor Management Group, L.L.C. Our investment in property and equipment included \$6.6 million related to the purchase of approximately 27 acres of land and a building in Plano, Texas. We also borrowed \$60.7 million on our revolving line of credit mainly to assist in funding discretionary purchases of treasury stock. 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.

### Acquisition

In October 2011, we acquired all of the capital stock of Windsor Management Group, L.L.C. (“Windsor”) for a cash purchase price of \$16.4 million, net of cash acquired of \$7.4 million. Windsor provides a suite of financial and human capital management software solutions to the K-12 education market, primarily in the Southwest.

In connection with this transaction we recorded customer relationship of approximately \$5.6 million, acquired software of \$2.4 million, deferred revenue of \$6.2 million and net assets of \$1.5 million. We recorded goodwill of approximately \$13.3 million, all of which is expected to be deductible for tax purposes. Customer relationships and acquired software will be amortized over a weighted average period of eight years. We believe likely market participants for this transaction would be software companies with a presence in the K-12 school market. Therefore, the goodwill of \$13.3 million arising from the acquisition is primarily attributed to our ability to maximize the value of the customer base through Tyler’s software product suite that targets the K-12 school market and to a much lesser extent, the assembled workforce of Windsor. Our balance sheet as of December 31, 2011, reflects the allocation of the purchase price to the assets acquired based on their estimated fair values at the date of acquisition.

The operating results of this acquisition are included in our results of operations since the date of acquisition.

### Outlook

Consistent with 2011, we expect to continue to invest aggressively in product development in 2012. We believe that our competitive position is strong and that we are well-positioned to take advantage of an eventual return to a stronger economic environment. However, until we see indications of sustained improvement, we are expecting that the new business environment in 2012 will continue to be both challenging and unpredictable, and that the majority of our growth will again come from recurring revenues.

## Management's Discussion and Analysis of Financial Condition and Results of Operations

### 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 contingencies. 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 proportional 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 require significant judgments and estimates used in the preparation of our financial statements.

**Revenue Recognition.** We recognize revenues in accordance with the provisions of Accounting Standards Codification ("ASC") 605, Revenue Recognition and ASC 985-605, Software Revenue Recognition. 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 creating additional custom reports. These amounts have historically been 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.

We use contract accounting, primarily the percentage-of-completion method, as discussed in ASC 605-35, 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. We measure progress-to-completion primarily using labor hours incurred, or value added. In addition, we recognize revenue using the proportional performance method of revenue recognition for our property appraisal projects, some of which can range up to five years. 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

## Management's Discussion and Analysis of Financial Condition and Results of Operations

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. 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 value of products delivered and services performed in the event of an early termination.

For ASP and other hosting arrangements, we evaluate whether the customer has the contractual right to take possession of our software at any time during the hosting period without significant penalty and whether the customer can feasibly maintain the software on the customer's hardware or enter into another arrangement with a third party to host the software. 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 ASC 985-605, Software Revenue Recognition. For ASP and other hosting arrangements that do not meet the criteria for recognition under ASC 985-605, we account for the elements under ASC 605-25, Multiple Element Arrangements using all applicable facts and circumstances, including whether (i) the element has stand-alone value, (ii) there is a general right of return and (iii) the revenue is contingent on delivery of other elements. We allocate the contract value to each element of the arrangement that qualifies for treatment as a separate element based on vendor-specific objective evidence of fair value ("VSOE"), and if VSOE is not available, third party evidence, and if third party evidence is unavailable, estimated selling price. For professional services associated with ASP and hosting arrangements that we determine do not have stand-alone value to the customer or are contingent on delivery of other elements, 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 (other than goodwill) are amortized over their estimated useful lives. We currently have no intangible assets with indefinite lives other than goodwill.



## Management's Discussion and Analysis of Financial Condition and Results of Operations

We evaluate goodwill for impairment annually as of April, or more frequently if impairment indicators arise. We perform a two-step impairment test on goodwill. In the first step, we compare the fair value of each reporting unit to its carrying value. If the fair value of the reporting unit exceeds the carrying value of the net assets assigned to that unit, goodwill is not considered impaired and we are not required to perform further testing. If the carrying value of the net assets assigned to the reporting unit exceeds the fair value of the reporting unit, then we must perform the second step of the impairment test in order to determine the implied fair value of the reporting unit's goodwill. If the carrying value of a reporting unit's goodwill exceeds the asset's implied fair value, then we would record an impairment loss equal to the difference. 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. Our cash flow forecasts are based on assumptions that are consistent with the plans and estimates we are using to manage the underlying businesses. The assumptions that are used are based upon what we believe a hypothetical marketplace participant would use in estimating fair value. Assets, liabilities and goodwill have been assigned to reporting units based on assets acquired and liabilities assumed as of the date of acquisition. We evaluate the reasonableness of the fair value calculations of our reporting units by comparing the total of the fair value of all of our reporting units to our total market capitalization. We base our fair value estimates on assumptions we believe to be reasonable but that are unpredictable and inherently uncertain. Our annual goodwill impairment analysis, which we performed during the second quarter of 2011, did not result in an impairment charge. During 2011 we did not identify any triggering events which would require an update to our annual impairment review.

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 other intangible assets is 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. Such indicators may include, among others: a significant decline in expected future cash flows; a sustained, significant decline in stock price and market capitalization; a significant adverse change in legal factors or in the business climate; unanticipated competition; and reductions in growth rates. In addition, products, capabilities, or technologies developed by others may render our software products obsolete or non-competitive. Any adverse change in these factors could have a significant impact on the recoverability of goodwill or other intangible assets.

**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 ASC 718-10, Stock Compensation. 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.

## Management's Discussion and Analysis of Financial Condition and Results of Operations

### 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, 2011, 2010 and 2009.

	% of Total Revenues		
	2011	2010	2009
Revenues:			
Software licenses	10.5%	12.1%	14.5%
Subscriptions	10.1	8.1	5.9
Software services	22.5	23.7	27.7
Maintenance	47.4	47.0	42.9
Appraisal services	7.5	7.1	6.5
Hardware and other	2.0	2.0	2.5
Total revenues	100.0	100.0	100.0
Operating Expenses:			
Cost of software licenses and acquired software	1.3	1.8	2.4
Cost of software services, maintenance and subscriptions	46.5	47.8	47.3
Cost of appraisal services	4.7	4.5	4.0
Cost of hardware and other	1.6	1.5	2.0
Selling, general and administrative expenses	24.5	24.1	24.2
Research and development expense	5.3	4.8	3.8
Amortization of customer base and trade name intangibles	1.1	1.1	0.9
Operating income	15.0	14.4	15.4
Other expenses, net	0.7	0.6	0.0
Income before income taxes	14.3	13.8	15.4
Income tax provision	5.4	5.1	6.1
Net income	8.9%	8.7%	9.3%

### 2011 Compared to 2010

#### Revenues

##### *Software licenses.*

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

(\$ in thousands)	2011	2010	Change	
			\$	%
Enterprise Software Solutions	\$30,194	\$32,757	\$(2,563)	(8)%
Appraisal and Tax Software Solutions and Services	2,400	2,156	244	11
Total software license revenues	\$32,594	\$34,913	\$(2,319)	(7)%

In October 2011, we acquired Windsor, which provides a suite of financial and human capital management software solutions to the K-12 education market and is included in our ESS segment. Excluding the impact of this acquisition, total software license revenue declined by 8% and ESS software license revenue declined 9% compared to 2010. The decrease in software license revenues is mainly attributable to longer sales cycles and postponements of customer purchasing decisions mainly due to budgetary constraints related to economic conditions. In addition, a portion of the decline was due to a growing number of customers choosing our subscription-based options, rather than purchasing the software under a traditional perpetual software license arrangement. Subscription-based arrangements result in

## Management's Discussion and Analysis of Financial Condition and Results of Operations

lower software license revenues in the initial year as compared to traditional perpetual software license arrangements but generate higher overall subscription-based services revenue over the term of the contract. We had 47 new customers that entered into subscription-based arrangements in 2011 compared to 19 new customers in 2010. We expect ESS software license revenues in 2012 to be higher than 2011 but the mix of software license arrangements and subscription-based arrangements may reduce the degree of the increase.

### Subscriptions.

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

(\$ in thousands)	2011	2010	Change	
			\$	%
Enterprise Software Solutions	\$30,400	\$22,975	\$ 7,425	32%
Appraisal and Tax Software Solutions and Services	760	323	437	135
Total subscription revenues	\$31,160	\$23,298	\$ 7,862	34%

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. We also provide e-filings for courts and law offices which simplify the filing and management of court related documents. Revenues from e-filings are generally derived from transaction fees. ASP and other software subscription agreements are typically for periods of three to six years. Disaster recovery and miscellaneous other hosted service agreements are typically renewable annually. New customers for ASP and other hosted service offerings as well as existing customers who converted to our ASP model provided the majority of the subscription revenue increase together with slightly higher rates for other hosted services. In 2011, we added 47 new customers and 40 existing customers elected to convert to our hosted offerings. E-filing services also contributed approximately \$500,000 of the subscription revenue increase as a result of several counties and one state adopting or expanding mandatory e-filing for court documents in the last half of 2011.

### Software services.

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

(\$ in thousands)	2011	2010	Change	
			\$	%
Enterprise Software Solutions	\$60,840	\$58,371	\$ 2,469	4%
Appraisal and Tax Software Solutions and Services	8,777	9,969	(1,192)	(12)
Total software services revenues	\$69,617	\$68,340	\$ 1,277	2%

Software services revenues primarily consists of professional services billed in connection with the installation of our software, conversion of customer data, training customer personnel and consulting. New customers who purchase our proprietary software licenses generally also contract with us to provide for the related software services. Existing customers also periodically purchase additional training, consulting and minor programming services. Excluding the impact of the Windsor acquisition, software services increased 1%. In 2011 software services revenue included more third party vendor services to build certain software interfaces associated with a state-wide contract, and reflected slightly higher billing rates.

## Management's Discussion and Analysis of Financial Condition and Results of Operations

### Maintenance.

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

(\$ in thousands)	2011	2010	Change	
			\$	%
Enterprise Software Solutions	\$130,999	\$120,764	\$10,235	8%
Appraisal and Tax Software Solutions and Services	15,499	14,891	608	4
Total maintenance revenues	\$146,498	\$135,655	\$10,843	8%

We provide maintenance and support services for our software products and certain third party software. Excluding the impact of the Windsor acquisition, maintenance revenue grew 7% from 2010. This increase was due to growth in our installed customer base and slightly higher maintenance rates on most of our product lines. Our annual maintenance revenue growth rate has been reduced somewhat by the effect of existing installed customers converting to our hosted offering, which results in a loss of maintenance revenue offset by a larger increase in subscription revenue.

### Appraisal services.

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

(\$ in thousands)	2011	2010	Change	
			\$	%
Enterprise Software Solutions	\$ —	\$ —	\$ —	—%
Appraisal and Tax Software Solutions and Services	23,228	20,554	2,674	13
Total appraisal services revenues	\$23,228	\$20,554	\$2,674	13%

Appraisal services revenue increased 13% in 2011 compared to 2010. The appraisal services business is somewhat cyclical and driven in part by statutory revaluation cycles in various states. We began work on several new large revaluation contracts in late 2009 and mid-2010 which provided the majority of the increase in appraisal services revenues. Several of these large contracts were completed in the last half of 2011 and we expect appraisal revenues for 2012 will decline slightly compared to 2011.

### Cost of Revenues and Gross Margins

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

(\$ in thousands)	2011	2010	Change	
			\$	%
Software licenses	\$ 3,034	\$ 3,456	\$ (422)	(12)%
Acquired software	1,125	1,592	(467)	(29)
Software services, maintenance and subscriptions	143,776	138,085	5,691	4
Appraisal services	14,550	12,910	1,640	13
Hardware and other	4,994	4,268	726	17
Total cost of revenues	\$167,479	\$160,311	\$7,168	4%

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

Gross margin percentage	2011	2010	Change
Software license and acquired software	87.2%	85.5%	1.7%
Software services, maintenance and subscriptions	41.9	39.2	2.7
Appraisal services	37.4	37.2	0.2
Hardware and other	20.7	27.3	(6.6)
Overall gross margin	45.9%	44.5%	1.4%

**Software license and acquired software.** Cost of software license and acquired software is comprised of third party software costs, amortization of acquired software and amortization of capitalized development costs on certain software products. Cost of third party software comprised approximately 70% of our cost of software license revenues in 2011 compared to approximately 60% of our cost of software license in 2010. Third party software sales were slightly higher than the prior year.

Costs of acquired software, which is comprised of amortization expense for software acquired through acquisitions, was approximately 27% of our cost of software license revenues in 2011 compared to approximately 32% of our cost of software license in 2010. We completed several acquisitions in the period 2007 through 2011 and these costs are being amortized over a weighted average period of approximately five years. Cost of acquired software declined because several products became fully amortized early 2011.

The remaining cost of software license balance relates to amortization expense for capitalized development cost which 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. These costs comprised less than 10% of total software license and acquired software costs in 2011 and 2010. We did not capitalize any internal software development costs in 2011 or 2010.

In 2011, our software license gross margin percentage increased compared to the prior year period because several acquired software solutions became fully amortized in early 2011.

**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, e-filings and disaster recovery. 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. In 2011, the software services, maintenance and subscriptions gross margin increased compared to the prior year partly because we improved our utilization of our support and maintenance staff and due to annual rate increases on certain services. We are managing costs and staff levels to ensure they are in line with demand for professional services. Excluding 56 additional employees added with the Windsor acquisition, our implementation and support staff declined by 4 employees since December 31, 2010.

**Appraisal services.** Our appraisal services gross margin was flat compared to 2010. 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 blended gross margin for 2011 increased 1.4% from 2010 mainly due to leverage in the utilization of our support, maintenance and subscription-based services staff and economies of scale and slightly higher rates on certain services. The gross margin also benefited from lower acquired software amortization costs.

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### Selling, General and Administrative Expenses

SG&A expenses consist primarily of salaries, employee benefits, travel, share-based compensation expense, commissions and related overhead costs for administrative and sales and marketing employees as well as, professional fees, trade show activities, advertising costs and other marketing related costs. The following table sets forth a comparison of our SG&A expenses for the following years ended December 31:

(\$ in thousands)	2011	2010	Change	
			\$	%
Selling, general and administrative expenses	\$75,650	\$69,480	\$6,170	9%

SG&A as a percentage of revenues was 24.5% in 2011 compared to 24.1% in 2010. SG&A expenses in 2011 included costs associated with consolidating office space in our new Yarmouth, Maine facility and other facilities related costs.

### Research and Development Expense

Research and development expense consists primarily of salaries, employee benefits and related overhead costs associated with product development. The following table sets forth a comparison of our research and development expense for the years ended December 31:

(\$ in thousands)	2011	2010	Change	
			\$	%
Research and development expense	\$16,414	\$13,971	\$2,443	17%

Research and development expense consist mainly of costs associated with development of new products and new software platforms from which we do not currently generate revenue. These include the Microsoft Dynamics AX project, as well as other new product development efforts related to our proprietary products. We increased our research and development staff by seven employees during 2011. In January 2007, we entered into a Software Development and License Agreement, which provides for a strategic alliance with Microsoft Corporation ("Microsoft") to jointly develop core public sector functionality for Microsoft Dynamics AX to address the accounting needs of public sector organizations worldwide. In September 2007, Tyler and Microsoft signed an amendment to the Software Development and License Agreement, which grants Microsoft intellectual property rights in and to certain portions of the software code provided and developed by Tyler into Microsoft Dynamics AX products to be marketed and sold outside of the public sector in exchange for reimbursement payments to partially offset the research and development costs. In April 2011, Tyler and Microsoft entered into an amended and superseded Master Software Development and License Agreement, which among other things, grants Microsoft intellectual property rights in the remaining portions of the software code developed by Tyler in exchange for certain other concessions. Under the new agreement, Tyler will continue to receive the previously agreed to reimbursement payments. In addition, Tyler has agreed to commit certain resources to the development of the next version of Dynamics AX and will receive software and maintenance royalties on direct and indirect sales of the solutions co-developed under this arrangement.

Our research and development expense increased \$2.4 million in 2011 compared to 2010. The increase is mainly due to lower reimbursements from Microsoft in 2011. In 2011 we offset our research and development expense by \$3.5 million, which were the amounts earned under the terms of our agreement with Microsoft, compared to \$5.1 million in 2010. Prior to December 31, 2010, we received offsets from Microsoft to our research and development expense of approximately \$850,000 each quarter from mid-2008 through the end of 2010 as specified in a statement of work under the Amended Software Development and License Agreement with Microsoft. In addition,

## Management's Discussion and Analysis of Financial Condition and Results of Operations

in October 2009, the scope of the project was further expanded which will result in additional offsets to research and development expense, varying in amount from quarter to quarter through 2012 for a total of approximately \$6.2 million. As of December 31, 2011, we have recorded \$5.2 million in cumulative offsets under this agreement from Microsoft and expect to record the remaining \$1.0 million in the last half of 2012. The actual amount and timing of future research and development costs and related reimbursements and whether they are capitalized or expensed are subject to change.

### 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 other operating expense. The estimated useful lives of both customer and trade name intangibles are five to 25 years. The following table sets forth a comparison of amortization of customer and trade name intangibles for the years ended December 31:

(\$ in thousands)	2011	2010	Change	
			\$	%
Amortization of customer and trade name intangibles	\$3,331	\$3,225	\$106	3%

In October 2011 we completed an acquisition that increased amortizable customer and trade name intangibles by approximately \$5.6 million. This amount is being amortized over 10 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):

2012	\$ 3,711
2013	3,552
2014	3,551
2015	3,551
2016	3,551

### Other

The following table sets forth a comparison of other expense, net for the following years ended December 31:

(\$ in thousands)	2011	2010	Change	
			\$	%
Other expense, net	\$2,404	\$1,742	\$662	38%

Other expense is primarily comprised of interest expense, non-usage and other fees associated with our revolving line of credit agreement. Interest expense was higher in 2011 than 2010 due to higher debt levels associated with our stock repurchases and the acquisition of Windsor in October 2011. The effective interest rate in 2011 was 3.3% compared to 3.4% in 2010.

## Management's Discussion and Analysis of Financial Condition and Results of Operations

### Income Tax Provision

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

(\$ in thousands)	2011	2010	Change	
			\$	%
Income tax provision	\$16,556	\$14,845	\$1,711	12%
Effective income tax rate	37.5%	37.2%		

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

Approximately 35% of our stock option expense is related to incentive stock options ("ISOs"). 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.

### 2010 COMPARED TO 2009

#### Revenues

##### Software licenses.

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

(\$ in thousands)	2010	2009	Change	
			\$	%
Enterprise Software Solutions	\$32,757	\$39,484	\$(6,727)	(17)%
Appraisal and Tax Software Solutions and Services	2,156	2,647	(491)	(19)
Total software license revenues	\$34,913	\$42,131	\$(7,218)	(17)%

In 2010, ESS software license revenues recognized declined substantially compared to the prior year period. The decrease in software license revenues is mainly attributable to longer sales cycles and postponements of customer purchasing decisions mainly due to budgetary constraints related to economic conditions. In addition, a portion of the decline was due to a number of customers choosing our subscription-based options, rather than purchasing the software under a traditional perpetual software license arrangement.

##### Subscriptions.

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

(\$ in thousands)	2010	2009	Change	
			\$	%
Enterprise Software Solutions	\$22,975	\$16,870	\$6,105	36%
Appraisal and Tax Software Solutions and Services	323	311	12	4
Total subscription revenues	\$23,298	\$17,181	\$6,117	36%

In January 2010, we acquired Wiznet Inc., which provides primarily subscription-based electronic document filing solutions for courts and law offices and is included in our ESS segment. Excluding the impact of this acquisition, ESS and total subscription revenues grew by 18% in 2010. Existing customers who converted to our ASP model as well as new customers for ASP and other hosted service offerings provided the majority of the subscription revenue increase with the remaining increase due to slightly higher rates for disaster recovery services.



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### Software services.

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

(\$ in thousands)	2010	2009	Change	
			\$	%
Enterprise Software Solutions	\$58,371	\$70,041	\$(11,670)	(17)%
Appraisal and Tax Software Solutions and Services	9,969	10,364	(395)	(4)
Total software services revenues	\$68,340	\$80,405	\$(12,065)	(15)%

The decline in software services revenues in 2010 is principally due to lower new software license contract activity in recent quarters due to weak economic conditions. In addition, the increase in the mix of customers choosing our subscription-based solutions was a factor contributing to lower software services revenues.

### Maintenance.

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

(\$ in thousands)	2010	2009	Change	
			\$	%
Enterprise Software Solutions	\$120,764	\$110,404	\$10,360	9%
Appraisal and Tax Software Solutions and Services	14,891	14,108	783	6
Total maintenance revenues	\$135,655	\$124,512	\$11,143	9%

Maintenance revenues increased due to growth in our installed customer base and slightly higher maintenance rates on most of our product lines. Our annual maintenance and support growth rate has declined compared to previous year's growth rate due to a number of customers converting to ASP arrangements as well as new customers choosing our subscription-based options, rather than purchasing the software under a traditional perpetual software license arrangement.

### Appraisal services.

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

(\$ in thousands)	2010	2009	Change	
			\$	%
Enterprise Software Solutions	\$ —	\$ —	\$ —	—%
Appraisal and Tax Software Solutions and Services	20,554	18,740	1,814	10
Total appraisal services revenues	\$20,554	\$18,740	\$1,814	10%

Appraisal services revenue increased 10% in 2010 compared to 2009. The appraisal services business is somewhat cyclical and driven in part by statutory revaluation cycles in various states. We substantially completed several large appraisal projects mid-2009. We began several new revaluation contracts in late 2009 which contributed to the revenue growth in 2010.

## Management's Discussion and Analysis of Financial Condition and Results of Operations

### Cost of Revenues and Gross Margin

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

(\$ in thousands)	2010	2009	Change	
			\$	%
Software licenses	\$ 3,456	\$ 5,440	\$(1,984)	(36)%
Acquired software	1,592	1,411	181	13
Software services, maintenance and subscriptions	138,085	137,199	886	1
Appraisal services	12,910	11,518	1,392	12
Hardware and other	4,268	5,955	(1,687)	(28)
Total cost of revenues	\$160,311	\$161,523	\$(1,212)	(1)%

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

Gross margin percentage	2010	2009	Change
Software license and acquired software	85.5%	83.7%	1.8%
Software services, maintenance and subscriptions	39.2	38.2	1.0
Appraisal services	37.2	38.5	(1.3)
Hardware and other	27.3	18.6	8.7
Overall gross margin	44.5%	44.4%	0.1%

**Software license and acquired software.** Cost of third party software comprised approximately 60% of our cost of software license revenues in 2010 compared to approximately 69% of our cost of software license in 2009. Third party software sales declined due to lower proprietary software sales.

Costs of acquired software comprises approximately 32% of our cost of software license revenues in 2010 compared to approximately 21% of our cost of software license in 2009. Cost of acquired software includes amortization expense for software acquired through acquisitions.

The balance is made up of amortization of capitalized development costs on other software products. We did not capitalize any internal software development costs in 2010 or 2009.

In 2010, our software license gross margin percentage increased compared to the prior year period because our product mix included less third party software.

**Software services, maintenance and subscription-based services.** In 2010, 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, as well as annual rate increases on certain services.

**Appraisal services.** Our appraisal services gross margin declined compared to 2009. Our appraisal services gross margin in 2009 included the positive impact of cost savings and operational efficiencies experienced on an unusually complex reappraisal project that ended in mid-2009.

Our blended gross margin for 2010 increased compared to 2009 due to lower third party software expense which offset the impact of a revenue mix that included less software license revenues. The gross margin also benefited from leverage in the utilization of our support, maintenance and subscription-based service staff and economies of scale and slightly higher rates on certain services.

## Management's Discussion and Analysis of Financial Condition and Results of Operations

### Selling, General and Administrative Expenses

The following table sets forth a comparison of our SG&A expenses for the years ended December 31:

(\$ in thousands)	2010	2009	Change	
			\$	%
Selling, general and administrative expenses	\$69,480	\$70,115	\$(635)	(1)%

SG&A expenses declined in 2010 compared to 2009 due to lower commission costs and marketing expenses which were offset somewhat by higher share-based compensation expense. Marketing expenses in 2009 include costs associated with the launch of a new corporate branding initiative.

### Research and Development Expense

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

(\$ in thousands)	2010	2009	Change	
			\$	%
Research and development expense	\$13,971	\$11,159	\$2,812	25%

Research and development expense consist of costs associated with the Microsoft Dynamics AX project, in addition to costs associated with other new product development efforts. In 2010 and 2009, we offset our research and development expense by \$5.1 million and \$3.5 million, respectively, which were the amounts earned under the terms of our agreement with Microsoft.

### Amortization of Customer and Trade Name Intangibles

The following table sets forth a comparison of amortization of customer and trade name intangibles for the years ended December 31:

(\$ in thousands)	2010	2009	Change	
			\$	%
Amortization of customer and trade name intangibles	\$3,225	\$2,705	\$520	19%

In January 2010 we completed an acquisition that increased amortizable customer and trade name intangibles by approximately \$5.5 million. This amount is being amortized over 10 years.

### Other

The following table sets forth a comparison of other expense, net for the years ended December 31:

(\$ in thousands)	2010	2009	Change	
			\$	%
Other expense, net	\$1,742	\$146	\$1,596	NA

In 2010, over half of other expense is comprised of interest expense, non-usage and other fees associated with a credit agreement entered into in August 2010. Other expense in 2009 is mainly comprised of interest expense, non-usage fees and other bank fees. Interest expense was higher in 2010 than 2009 due to higher debt levels associated with our stock repurchases. In addition the effective interest rate in 2010 was 3.4% compared to 1.8% in 2009.

### Income Tax Provision

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

(\$ in thousands)	2010	2009	Change	
			\$	%
Income Tax Provision	\$14,845	\$17,628	\$(2,783)	(16)%
Effective income tax rate	37.2%	39.5%		

## Management's Discussion and Analysis of Financial Condition and Results of Operations

Our effective income tax rate declined compared to 2009 mainly due to a \$579,000 research and development tax credit in 2010. In addition to the impact of the research and development tax credit in 2010, the effective income tax rates for both years were different from the statutory United States federal income tax rate of 35% due to state income taxes, non-deductible share-based compensation expense, the qualified manufacturing activities deduction, and non-deductible meals and entertainment costs.

### FINANCIAL CONDITION AND LIQUIDITY

As of December 31, 2011, we had cash and cash equivalents of \$1.3 million and investments available-for-sale of \$2.0 million, compared to cash and cash equivalents of \$2.1 million and investments available-for-sale of \$2.2 million at December 31, 2010. As of December 31, 2011, we had \$60.7 million outstanding borrowings and outstanding letters of credit totaling \$8.3 million. Some of our customers, primarily those for our property appraisal services, require that we secure performance bonds before they will select us as a vendor. The maximum potential amount of an outstanding performance bond would be the remaining cost of work to be performed under our contracts. The notional amount of performance guarantees outstanding as of December 31, 2011 was estimated to be \$61.3 million. We provide letters of credit as security for the issuance of performance bonds. We do not believe these letters of credit will be required to be drawn upon. These letters of credit expire through mid-2012. We believe our \$150.0 million revolving line of credit provides us with sufficient flexibility to meet our long-term financial needs.

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

(\$ in thousands)	2011	2010	2009
Cash flows provided by (used by):			
Operating activities	\$ 56,435	\$ 35,350	\$ 42,941
Investing activities	(28,809)	(8,694)	(13,658)
Financing activities	(28,414)	(34,238)	(21,349)
Net (decrease) increase in cash and cash equivalents	\$ (788)	\$ (7,582)	\$ 7,934

Net cash provided by operating activities continues to be our primary source of funds to finance operating needs and capital expenditures. Other potential capital resources include cash on hand, public and private issuances of debt and equity securities, and bank borrowings. It is possible that our ability to access the capital and credit markets in the future may be limited by economic conditions or other factors. We currently believe that cash provided by operating activities, cash on hand and available credit are sufficient to fund our working capital requirements, capital expenditures, income tax obligations, and share repurchases for at least the next twelve months.

In 2011, operating activities provided net cash of \$56.4 million, primarily generated from net income of \$27.6 million, non-cash depreciation and amortization charges of \$10.7 million and non-cash share-based compensation expense of \$6.3 million. Working capital, excluding cash, declined \$17.7 million mainly due to the timing of payments on income tax liabilities and higher accrued bonus liabilities in 2011 compared to 2010 as a result of improved financial performance. Our accounts receivable and deferred revenue balances were also higher than 2010 due to an increase in annual software maintenance billings as a result of growth in our installed customer base. In addition, our growth in subscription-based arrangements has also contributed to larger deferred revenue balances.

In general, changes in the balance of deferred revenue are cyclical and primarily driven by the timing of our maintenance renewal billings. Our renewal dates occur throughout the year but our heaviest renewal cycles occur in the second and fourth quarters.

At December 31, 2011, our days sales outstanding ("DSOs") were 99 days compared to DSOs of 102 days at December 31, 2010. DSOs are calculated based on accounts receivable (excluding long-term receivables, but including unbilled receivables) divided by the quotient of annualized quarterly revenues divided by 360 days.

## Management's Discussion and Analysis of Financial Condition and Results of Operations

Investments available-for-sale consist of two auction rate municipal securities ("ARS") which are collateralized debt obligations supported by municipal agencies and do not include mortgage-backed securities. Short-term investments available-for-sale consists of a portion of one of these ARS which was partially redeemed at par during the period January 1, 2012 through February 23, 2012. These ARS are debt instruments with stated maturities of 20 to 30 years, for which the interest rate is designed to be reset through Dutch auctions approximately every 30 days. However, due to events in the credit markets, auctions for these securities have not occurred since February 2008. Both of our ARS have had very small partial redemptions at par in the period from July 2009 through February 2012. As of December 31, 2011 we have continued to earn and collect interest on both of our ARS. Because quoted prices in active markets are no longer available we determined the estimated fair values of these securities utilizing a discounted trinomial model. The model considers the probability of three potential occurrences for each auction event through the maturity date of each ARS. The three potential outcomes for each auction are (i) successful auction/early redemption, (ii) failed auction and (iii) issuer default. Inputs in determining the probabilities of the potential outcomes include but are not limited to, the securities' collateral, credit rating, insurance, issuer's financial standing, contractual restrictions on disposition and the liquidity in the market. The fair value of each ARS is determined by summing the present value of the probability-weighted future principal and interest payments determined by the model. Since there can be no assurances that auctions for these securities will be successful in the near future, we have classified our ARS as non-current investments.

In connection with this estimate of fair value, we have recorded an after-tax temporary unrealized loss on our non-current ARS of \$80,000, net of related tax effects of \$43,000 in 2011, which is included in accumulated other comprehensive loss on our balance sheet.

We consider the impairment in our ARS as temporary because we do not have the intent to sell, nor is it more-likely-than-not that we will be required to sell these securities before recovery of their cost basis. We believe that this temporary decline in fair value is due entirely to liquidity issues, because the underlying assets of these securities are supported by municipal agencies and do not include mortgage-backed securities, have redemption features which call for redemption at 100% of par value and have a current credit rating of A or AA. The ratings on the ARS take into account credit support through insurance policies guaranteeing each of the bonds' payment of principal and accrued interest, if it becomes necessary. In addition, both ARS have had very small partial redemptions at par in the period July 2009 through February 2012. Based on our cash and cash equivalents balance of \$1.3 million, expected operating cash flows and a \$150.0 million revolving credit line, we do not believe a lack of liquidity associated with our ARS will adversely affect our ability to conduct business, and believe we have the ability to hold the securities throughout the currently estimated recovery period. We will continue to evaluate any changes in the fair value of our ARS and in the future, depending upon existing market conditions, we may be required to record an other-than-temporary decline in market value.

Investing activities used cash of \$28.8 million in 2011 compared to \$8.7 million in 2010. In 2011, we completed the acquisition of Windsor. The purchase price, net of cash acquired, was approximately \$16.4 million. In March 2011 we paid \$6.6 million for approximately 27 acres of land and a building in Plano, Texas. The acquisition and capital expenditures were funded from cash generated from operations.

In January 2010, we completed the acquisition of the assets of Wiznet, Inc. for \$9.5 million in cash. Also, in connection with plans to consolidate workforces and support planned long-term growth, we paid \$1.3 million in 2010 compared to \$9.4 million in 2009 for construction of an office building in Lubbock, Texas. The impact of these investing activities in 2010 was offset somewhat by the release of \$6.0 million of restricted cash. In August 2010, we elected to replace our cash-collateralized letters of credit with ones issued under our revolving line of credit.

In 2009, we liquidated \$2.5 million of investments in ARS for cash at par. In 2009 we also completed the acquisition of all of the capital stock of Assessment Evaluation Services, Inc. for \$1.1 million in cash, paid \$700,000 in cash for certain assets of KPL, Inc. d/b/a Parker-Lowe & Associates and acquired various software assets for \$1.1 million in cash.

## Management's Discussion and Analysis of Financial Condition and Results of Operations

Cash used in financing activities was primarily comprised of purchases of treasury shares, net of proceeds from stock option exercises, borrowings and payments on our revolving credit line and contributions from our employee stock purchase plan. During 2011, we purchased 3.0 million shares of our common stock for an aggregate purchase price of \$71.8 million. These purchases were primarily funded by borrowings under our revolving credit line and cash from operations.

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, October 2008, May 2009, July 2010, October 2010 and September 2011. As of December 31, 2011, we had remaining authorization to repurchase up to 1.7 million additional shares of our common stock. Our share repurchase program allows us to repurchase shares at our discretion and market conditions influence the timing of the buybacks and the number of shares repurchased, as well as the volume of employee stock option exercises. These share repurchases are funded using our existing cash balances and borrowings under our revolving credit agreement and may occur through open market purchases and transactions structured through investment banking institutions, privately negotiated transactions and/or other mechanisms. There is no expiration date specified for the authorization and we intend to repurchase stock under the plan from time to time.

During 2010, we purchased 3.6 million shares of our common stock for an aggregate purchase price of \$65.8 million and during 2009, we purchased 1.2 million shares of our common stock for an aggregate purchase price of \$17.0 million.

In 2011 we issued 582,000 shares of common stock and received \$3.6 million in aggregate proceeds upon exercise of stock options. In 2010 we received \$3.2 million from the exercise of options to purchase approximately 615,000 shares of our common stock under our employee stock option plan and during 2009, we received \$2.3 million from the exercise of options to purchase approximately 425,000 shares of our common stock under our employee stock option plan. In 2011, 2010 and 2009 we received \$2.0 million, \$1.9 million and \$1.5 million, respectively, from contributions to the Tyler Technologies, Inc. Employee Stock Purchase Plan.

We have a \$150.0 million Credit Agreement (the "Credit Facility") and a related pledge and security agreement with a group of seven financial institutions, with Bank of America, N.A., as Administrative Agent. The Credit Facility provides for a revolving credit line of \$150.0 million (which may be increased up to \$200.0 million subject to our obtaining commitments for such increase), with a \$25.0 million sublimit for letters of credit. The Credit Facility matures on August 11, 2014. Borrowings under the Credit Facility may be used for general corporate purposes, including working capital requirements, acquisitions and share repurchases. In 2010 we paid \$2.0 million in related debt issuance costs.

Borrowings under the Credit Facility bear interest at a rate of either (1) the Bank of America's prime rate plus a margin of 1.50% to 2.75% or (2) the 30, 60, 90 or 180-day LIBOR rate plus a margin of 2.50% to 3.75%, with the margin determined by our consolidated leverage ratio. In 2011 and 2010 our effective average interest rate for borrowings was 3.3% and 3.4%, respectively. As of December 31, 2011 our interest rate was 3.4%. The Credit Facility is secured by substantially all of our assets, excluding real property. The Credit Facility requires us to maintain certain financial ratios and other financial conditions and prohibits us from making certain investments, advances, cash dividends or loans, and limits incurrence of additional indebtedness and liens. As of December 31, 2011, we were in compliance with those covenants.

As of December 31, 2011, we had \$60.7 million in outstanding borrowings and unused available borrowing capacity of \$81.0 million under the Credit Facility. In addition, as of December 31, 2011, our bank had issued outstanding letters of credit totaling \$8.3 million to secure surety bonds required by some of our customer contracts. These letters of credit reduce our available borrowing capacity and expire through mid-2012.

## Management's Discussion and Analysis of Financial Condition and Results of Operations

We paid income taxes, net of refunds received, of \$13.4 million in 2011, \$15.8 million in 2010, and \$18.1 million in 2009.

Excluding acquisitions and investments in office buildings, we anticipate that 2012 capital spending will be between \$6.0 million and \$7.0 million. We expect the majority of this capital spending will consist of computer equipment and software for infrastructure replacements and expansion. We currently do not expect to capitalize significant amounts related to software development in 2012, but the actual amount and timing of those costs, and whether they are capitalized or expensed may result in additional capitalized software development. We also plan to spend approximately \$16.7 million over the next two years in connection with the construction of an office building in Plano, Texas. We expect approximately \$9.0 million of the total cost will be paid in 2012 with the remaining \$7.7 million paid in 2013. Capital spending, including the construction of an office facility, is expected to be funded from existing cash balances and cash flows from operations.

In January 2012, we acquired substantially all of the assets of Akanda Innovation, Inc., a provider of web-based solutions to the public sector which are integrated with our property tax software, for a total purchase price of \$2.9 million. The purchase price included certain liabilities assumed by us of approximately \$800,000, resulting in net cash paid to the sellers of \$2.1 million, of which \$900,000 was paid prior to December 31, 2011 and is included with other current assets.

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 2018. Most leases contain renewal options and some contain purchase options.

Summarized in the table below are our obligations to make future payments under our long-term revolving credit agreement and lease obligations at December 31, 2011 (in thousands):

	2012	2013	2014	2015	2016	Thereafter	Total
Revolving line of credit	\$ —	\$ —	\$60,700	\$ —	\$ —	\$ —	\$60,700
Lease obligations	6,004	4,687	2,598	2,430	2,303	2,341	20,363
Total future payment obligations	\$6,004	\$4,687	\$63,298	\$2,430	\$2,303	\$2,341	\$81,063

As of December 31, 2011, 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, 2011, our capitalization consisted of \$60.7 million in long-term obligations and \$78.1 million of shareholders' equity. Our total debt-to-capital ratio was 43.7% at December 31, 2011.

## Management's Discussion and Analysis of Financial Condition and Results of Operations

### QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk represents the risk of loss that may affect us due to adverse changes in financial market prices and interest rates. As of December 31, 2011 we had \$60.7 million in outstanding borrowings under the Credit Facility. These borrowings bear interest at a rate of either (1) the Bank of America's prime rate plus a margin of 1.50% to 2.75% or (2) the 30, 60, 90 or 180-day LIBOR rate plus a margin of 2.50% to 3.75%, with the margin determined by our consolidated leverage ratio. In 2011 and 2010 our effective average interest rate for borrowings was 3.3% and 3.4%, respectively. As of December 31, 2011 our interest rate was 3.4%. Assuming borrowings of \$60.7 million, a hypothetical 10% increase in our interest rate at December 31, 2011 for a one year period would result in approximately \$206,000 of additional interest rate expense.

Investments available-for-sale consist of two ARS with stated maturities of 20 to 30 years, for which the interest rate is designed to be reset through Dutch auctions approximately every 30 days which would have qualified as Level 1 under ASC 820, Fair Value Measurements. However, due to events in the credit markets, auctions for these securities have not occurred since February 2008. Therefore, quoted prices in active markets are no longer available and we determined the estimated fair values of these securities as of December 31, 2011, 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 \$80,000, net of related tax effects of \$43,000 in 2011, which is included in accumulated other comprehensive loss on our balance sheet. We consider the impairment in our ARS as temporary because we do not have the intent to sell, nor is it more-likely-than-not that we will be required to sell these securities before recovery of their cost basis. We believe that this temporary decline in fair value is due entirely to liquidity issues, because the underlying assets of these securities are supported by municipal agencies and do not include mortgage-backed securities, have redemption features which call for redemption at 100% of par value and have a current credit rating of A or AA. The ratings on the ARS take into account credit support through insurance policies guaranteeing each of the bonds' payment of principal and accrued interest, if it becomes necessary. In addition, both ARS have had very small partial redemptions at par in the period July 2009 through February 2012. Based on our cash and cash equivalents balance of \$1.3 million, expected operating cash flows and a \$150.0 million revolving credit line, we do not believe a lack of liquidity associated with our ARS will adversely affect our ability to conduct business, and believe we have the ability to hold the securities throughout the currently estimated recovery period. We will continue to evaluate any changes in the fair value of our ARS and in the future, depending upon existing market conditions, we may be required to record an other-than-temporary decline in market value.



## Management's Report on Internal Control Over Financial Reporting

### 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, 2011. 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, 2011.

**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, 2011. 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 concluded that, as of December 31, 2011, Tyler's internal control over financial reporting was effective based on those criteria.

Tyler's internal control over financial reporting as of December 31, 2011 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 Tyler's internal control over financial reporting appears on page 40 hereof.

**Changes in Internal Control Over Financial Reporting** — During the quarter ended December 31, 2011, there were no changes in our internal control over financial reporting, as defined in Securities Exchange Act Rule 13a-15(f), that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## Report of Independent Registered Public Accounting Firm

### 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, 2011, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Tyler Technologies, Inc.'s management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying "Management's Report on Internal Control Over Financial Reporting." Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

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

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

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

In our opinion, Tyler Technologies, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2011, 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, 2011 and 2010, and the related statements of income, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2011 and our report dated February 23, 2012 expressed an unqualified opinion thereon.

The logo for Ernst & Young LLP, featuring the company name in a stylized, cursive script font.

Dallas, Texas  
February 23, 2012

## Report of Independent Registered Public Accounting Firm

### 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, 2011 and 2010, and the related statements of income, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2011. 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, 2011 and 2010, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2011, 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, 2011, 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 23, 2012 expressed an unqualified opinion thereon.

The signature of Ernst & Young LLP is written in a cursive, handwritten style in black ink.

Dallas, Texas

February 23, 2012

## Statements of Income

### STATEMENTS OF INCOME

For the years ended December 31,	2011	2010	2009
In thousands, except per share amounts			
Revenues:			
Software licenses	\$ 32,594	\$ 34,913	\$ 42,131
Subscriptions	31,160	23,298	17,181
Software services	69,617	68,340	80,405
Maintenance	146,498	135,655	124,512
Appraisal services	23,228	20,554	18,740
Hardware and other	6,294	5,868	7,317
Total revenues	309,391	288,628	290,286
Cost of revenues:			
Software licenses	3,034	3,456	5,440
Acquired software	1,125	1,592	1,411
Software services, maintenance and subscriptions	143,776	138,085	137,199
Appraisal services	14,550	12,910	11,518
Hardware and other	4,994	4,268	5,955
Total cost of revenues	167,479	160,311	161,523
Gross profit	141,912	128,317	128,763
Selling, general and administrative expenses	75,650	69,480	70,115
Research and development expense	16,414	13,971	11,159
Amortization of customer and trade name intangibles	3,331	3,225	2,705
Operating income	46,517	41,641	44,784
Other expense, net	2,404	1,742	146
Income before income taxes	44,113	39,899	44,638
Income tax provision	16,556	14,845	17,628
Net income	\$ 27,557	\$ 25,054	\$ 27,010
Earnings per common share:			
Basic	\$ 0.88	\$ 0.74	\$ 0.77
Diluted	\$ 0.83	\$ 0.71	\$ 0.74
Basic weighted average common shares outstanding	31,267	34,075	35,240
Diluted weighted average common shares outstanding	33,154	35,528	36,624

See accompanying notes.

## Balance Sheets

## BALANCE SHEETS

December 31,	2011	2010
In thousands, except share and per share amounts		
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 1,326	\$ 2,114
Short-term investments available-for-sale	25	25
Accounts receivable (less allowance for losses of \$990 in 2011 and \$1,603 in 2010)	90,012	81,860
Prepaid expenses	8,348	7,801
Other current assets	2,286	3,543
Deferred income taxes	5,095	3,106
Total current assets	107,092	98,449
Accounts receivable, long-term portion	2,095	1,231
Property and equipment, net	40,915	34,851
Non-current investments available-for-sale	1,953	2,126
Other assets:		
Goodwill	106,094	92,831
Other intangibles, net	35,628	32,307
Sundry	1,614	2,237
	<u>\$295,391</u>	<u>\$264,032</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 3,211	\$ 2,626
Accrued liabilities	24,751	19,433
Deferred revenue	123,678	102,590
Total current liabilities	151,640	124,649
Revolving line of credit	60,700	26,500
Deferred income taxes	4,941	5,911
Commitments and contingencies		
Shareholders' equity:		
Preferred stock, \$10.00 par value; 1,000,000 shares authorized, none issued	—	—
Common stock, \$0.01 par value; 100,000,000 shares authorized; 48,147,969 shares issued in 2011 and 2010	481	481
Additional paid-in capital	152,859	153,576
Accumulated other comprehensive loss, net of tax	(355)	(275)
Retained earnings	130,115	102,558
Treasury stock, at cost; 18,176,050 and 15,854,205 shares in 2011 and 2010, respectively	(204,990)	(149,368)
Total shareholders' equity	78,110	106,972
	<u>\$295,391</u>	<u>\$264,032</u>

See accompanying notes.

## Statements of Shareholders' Equity

### STATEMENTS OF SHAREHOLDERS' EQUITY

For the years ended December 31, 2011, 2010 and 2009

	Common Stock		Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Treasury Stock		Total Shareholders' Equity
	Shares	Amount				Shares	Amount	
In thousands								
Balance at December 31, 2008	48,148	\$481	\$151,245	\$(387)	\$ 50,494	(12,333)	\$ (87,571)	\$114,262
Comprehensive income:								
Net income	—	—	—	—	27,010	—	—	27,010
Unrealized loss on investment securities, net of tax	—	—	—	(18)	—	—	—	(18)
Total comprehensive income								<u>26,992</u>
Issuance of shares pursuant to stock compensation plan	—	—	(3,774)	—	—	425	6,069	2,295
Stock compensation	—	—	5,045	—	—	—	—	5,045
Treasury stock purchases	—	—	—	—	—	(1,235)	(17,000)	(17,000)
Issuance of shares pursuant to Employee Stock Purchase Plan	—	—	(118)	—	—	115	1,546	1,428
Federal income tax benefit related to exercise of stock options	—	—	1,336	—	—	—	—	1,336
Balance at December 31, 2009	48,148	481	153,734	(405)	77,504	(13,028)	(96,956)	134,358
Comprehensive income:								
Net income	—	—	—	—	25,054	—	—	25,054
Unrealized gain on investment securities, net of tax	—	—	—	130	—	—	—	130
Total comprehensive income								<u>25,184</u>
Issuance of shares pursuant to stock compensation plan	—	—	(8,157)	—	—	615	11,338	3,181
Stock compensation	—	—	6,132	—	—	—	—	6,132
Treasury stock purchases	—	—	—	—	—	(3,559)	(65,793)	(65,793)
Issuance of shares pursuant to Employee Stock Purchase Plan	—	—	(218)	—	—	118	2,043	1,825
Federal income tax benefit related to exercise of stock options	—	—	2,085	—	—	—	—	2,085
Balance at December 31, 2010	48,148	481	153,576	(275)	102,558	(15,854)	(149,368)	106,972
Comprehensive income:								
Net income	—	—	—	—	27,557	—	—	27,557
Unrealized loss on investment securities, net of tax	—	—	—	(80)	—	—	—	(80)
Total comprehensive income								<u>27,477</u>
Issuance of shares pursuant to stock compensation plan	—	—	(10,352)	—	—	582	13,905	3,553
Stock compensation	—	—	6,253	—	—	—	—	6,253
Treasury stock purchases	—	—	—	—	—	(3,004)	(71,802)	(71,802)
Issuance of shares pursuant to Employee Stock Purchase Plan	—	—	(230)	—	—	100	2,275	2,045
Federal income tax benefit related to exercise of stock options	—	—	3,612	—	—	—	—	3,612
Balance at December 31, 2011	48,148	\$481	\$152,859	\$(355)	\$130,115	(18,176)	\$(204,990)	\$ 78,110

See accompanying notes.

## Statements of Cash Flows

## STATEMENTS OF CASH FLOWS

For the years ended December 31,	2011	2010	2009
In thousands			
Cash flows from operating activities:			
Net income	\$ 27,557	\$ 25,054	\$ 27,010
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	10,676	10,788	9,497
Share-based compensation expense	6,253	6,132	5,045
Provision for losses – accounts receivable	805	1,161	1,538
Excess tax benefit from exercises of share-based arrangements	(3,590)	(2,000)	(1,125)
Deferred income tax benefit	(2,916)	(959)	(1,730)
Changes in operating assets and liabilities, exclusive of effects of acquired companies:			
Accounts receivable	(8,544)	(1,989)	(6,277)
Income tax payable	6,084	(34)	1,391
Prepaid expenses and other current assets	(214)	104	1,377
Accounts payable	575	(1,181)	1,190
Accrued liabilities	4,887	(5,200)	1,960
Deferred revenue	14,862	3,474	3,065
Net cash provided by operating activities	56,435	35,350	42,941
Cash flows from investing activities:			
Proceeds from sales of investments	50	75	2,500
Cost of acquisitions, net of cash acquired	(17,298)	(9,661)	(2,934)
Additions to property and equipment	(12,278)	(4,930)	(12,352)
Decrease (increase) in restricted investments	—	6,000	(918)
Decrease (increase) in other	717	(178)	46
Net cash used by investing activities	(28,809)	(8,694)	(13,658)
Cash flows from financing activities:			
Increase (decrease) in net borrowings on revolving line of credit	34,200	26,500	(8,000)
Purchase of treasury shares	(71,802)	(65,793)	(18,263)
Contributions from employee stock purchase plan	2,045	1,901	1,494
Proceeds from exercise of stock options	3,553	3,181	2,295
Debt issuance costs	—	(2,027)	—
Excess tax benefits from exercise of share-based arrangements	3,590	2,000	1,125
Net cash used by financing activities	(28,414)	(34,238)	(21,349)
Net (decrease) increase in cash and cash equivalents	(788)	(7,582)	7,934
Cash and cash equivalents at beginning of year	2,114	9,696	1,762
Cash and cash equivalents at end of year	\$ 1,326	\$ 2,114	\$ 9,696

See accompanying notes.

## Notes to Financial Statements

(Tables in thousands, except per share data)

### (1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### DESCRIPTION OF BUSINESS

We provide integrated software systems and related services for the public sector, with a focus on local and state 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 as well as state governments. 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.

#### 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. As of December 31, 2011, we had outstanding letters of credit totaling \$8.3 million. Some of our customers, primarily those for our property appraisal services, require that we secure performance bonds before they will select us as a vendor. The maximum potential amount of an outstanding performance bond would be the remaining cost of work to be performed under our contracts. The notional amount of performance guarantees outstanding as of December 31, 2011 was estimated to be \$61.3 million. We provide letters of credit as security for the issuance of performance bonds. These letters of credit are issued under our revolving line of credit and reduce our available borrowing capacity. We do not believe these letters of credit will be required to be drawn upon. These letters of credit expire through mid-2012.

#### 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 Accounting Standards Codification (“ASC”) 820, Fair Value Measurements and Disclosures. 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 the specific cost of the auction rate municipal security. We account for the transactions as “proceeds from sales of investments” for the security relinquished, and a “purchases of investments” for the security purchased, in the accompanying Statements 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.



## Notes to Financial Statements

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 the Construction — Type and Production — Type Contracts as discussed in ASC 605-35, Multiple Elements Arrangements.

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. collectability 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 relative 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 determine that 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," in compliance with ASC 985-605, Software Revenue Recognition, 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 collectability is not probable. If the fee is not fixed or determinable, software license revenue is generally recognized as payments become due from the customer. If collectability 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.

## Notes to Financial Statements

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, document processing transaction fees and disaster recovery services.

We recognize revenue for ASP and other hosting services, software subscriptions 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. 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 the customer has the contractual right to take possession of our software at any time during the hosting period without significant penalty and whether the customer can feasibly maintain the software on the customer’s hardware or enter into another arrangement with a third party to host the software. 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 ASC 985-605, Software Revenue Recognition. For ASP and other hosting arrangements that do not meet the criteria for recognition under ASC 985-605, we account for the elements under ASC 605-25, Multiple Element Arrangements using all applicable facts and circumstances, including whether (i) the element has stand-alone value, (ii) there is a general right of return and (iii) the revenue is contingent on delivery of other elements. We allocate contract value to each element of the arrangement that qualifies for treatment as a separate element based on VSOE, and if VSOE is not available, third party evidence, and if third party evidence is unavailable, estimated selling price. For professional services associated with ASP and hosting arrangements that we determine do not have stand-alone value to the customer or are contingent on delivery of other elements, 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.

## Notes to Financial Statements

Document processing transaction fees primarily pertain to documents filed with the courts by attorneys and other third parties via our e-filing services and retrieval of filed documents via our access services, and the elements for these arrangements are accounted for under ASC 605-25. For each document filed with a court, the filer generally pays a transaction fee and a court filing fee to us and we remit a portion of the transaction fee and the filing fee to the court. We record as revenue the transaction fee, and the portion of the transaction fee remitted to the courts is recorded as cost of sales as we are acting as a principal in the arrangement. Court filing fees collected on behalf of the courts and remitted to the courts are recorded on a net basis and do not affect the statement of income or the balance sheet.

### 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 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. VSOE of fair value for the maintenance and support obligations for software licenses is based upon the specific sale renewals to customers.

### Allocation of Revenue in Statements of Income

In our statements of income, 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 proportional 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

## Notes to Financial Statements

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 our contracts generally 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 proportional 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 \$16.4 million during 2011, \$14.0 million during 2010 and \$11.2 million during 2009. We reduced our research and development expense by approximately \$3.5 million in 2011, \$5.1 million in 2010 and \$3.5 million in 2009, which was the amount earned under the terms of our strategic alliance with a development partner.

## Notes to Financial Statements

### 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 more likely than not 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 four to six 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 pursuant to ASC 718, Stock Compensation. See Note 10 — “Share-Based Compensation” for further information.

### GOODWILL AND OTHER INTANGIBLE ASSETS

#### *Goodwill*

We have used the acquisition 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.

We review goodwill impairment annually as of April or more frequently whenever events or changes in circumstances indicate its carrying value may not be recoverable. Assets, liabilities and goodwill have been assigned to reporting units based on assets acquired and liabilities assumed as of the date of acquisition.

The provisions of ASC 350, Intangibles – Goodwill and Other, require that we perform a two-step impairment test on goodwill. In the first step, we compare the fair value of each reporting unit to its carrying value. If the fair value of the reporting unit exceeds the carrying value of the net assets assigned to that unit, goodwill is not considered impaired and we are not required to perform further testing. If the carrying value of the net assets assigned to the reporting unit exceeds the fair value of the reporting unit, then we must perform the second step of the impairment test in order to determine the implied fair value of the reporting unit’s goodwill. If the carrying value of a reporting unit’s goodwill exceeds the asset’s implied fair value, then we would record an impairment loss equal to the difference. 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. Our cash flow forecasts are based on assumptions that are consistent with the plans and estimates we are using to manage the underlying businesses. The assumptions that are used are based upon what we believe a hypothetical marketplace participant would use in estimating fair value. We evaluate the reasonableness of the fair value calculations of our reporting units by comparing the total of the fair value of all of our reporting units to our total market capitalization. We base our fair value estimates on assumptions we believe to be reasonable but that are unpredictable and inherently uncertain. A significant amount of judgment is involved in determining if an indicator of impairment has occurred between testing dates. Such indicators may include, among others: a significant decline in expected future cash flows; a sustained, significant decline in stock price and market capitalization; a significant adverse change in legal factors or in the

## Notes to Financial Statements

business climate; unanticipated competition; and reductions in growth rates. In addition, products, capabilities, or technologies developed by others may render our software products obsolete or non-competitive. Any adverse change in these factors could have a significant impact on the recoverability of goodwill. Our annual goodwill impairment analysis, which we performed during the second quarter of 2011, did not result in an impairment charge.

### *Other Intangible Assets*

We make judgments about the recoverability of purchased intangible assets other than goodwill whenever events or changes in circumstances indicate that an impairment may exist. Customer base constitutes approximately 85% of our purchased intangible assets other than goodwill. We review our customer turnover each year for indications of impairment. Our customer turnover has historically been very low. If indications of impairment are determined to exist, we measure the recoverability of assets by a comparison of the carrying amount of the asset to the estimated undiscounted future cash flows expected to be generated by the asset. 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. There have been no significant impairments of intangible assets in any of the periods presented.

### 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 in any of the periods presented.

### COSTS OF COMPUTER SOFTWARE

We capitalize software development costs upon the establishment of technological feasibility and prior to the availability of the product for general release to customers. We did not capitalize any internal software development costs in 2011, 2010 or 2009. 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 \$125,000 in 2011, \$430,000 in 2010, and \$743,000 in 2009, and is included in cost of software license revenue in the accompanying statements of income.

### FAIR VALUE OF FINANCIAL INSTRUMENTS

Cash and cash equivalents, accounts receivables, accounts payables, short-term obligations and certain other assets at cost approximate fair value because of the short maturity of these instruments. Our investments available-for-sale are recorded at fair value as of December 31, 2011 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. The fair value of our revolving line of credit approximates book value as of December 31, 2011.

## Notes to Financial Statements

### CONCENTRATIONS OF CREDIT RISK AND UNBILLED RECEIVABLES

Financial instruments that potentially subject us to significant concentrations of credit risk consist principally of cash and cash equivalents, investments in auction rate securities and accounts receivable from trade customers. Our cash and cash equivalents primarily consists of money market fund investments which are maintained at one major financial institution and the balances often exceed insured amounts. As of December 31, 2011 we had cash and cash equivalents of \$1.3 million. We perform periodic evaluations of the credit standing of this financial institution.

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, 2011.

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,	2011	2010	2009
Balance at beginning of year	\$ 1,603	\$ 2,389	\$ 2,115
Provisions for losses – accounts receivable	805	1,161	1,538
Collection of accounts previously reserved	(142)	4	—
Deductions for accounts charged off or credits issued	(1,276)	(1,951)	(1,264)
Balance at end of year	\$ 990	\$ 1,603	\$ 2,389

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 proportional 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; (4) some of our contracts provide for an amount to be withheld from a progress billing (generally a 10% retention) until final and satisfactory project completion is achieved; and (5) 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 connection with this activity, we have recorded unbilled receivables of \$7.2 million and \$11.7 million at December 31, 2011 and 2010, respectively. We also have recorded retention receivables of \$1.9 million and \$2.4 million at December 31, 2011 and 2010, 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 included with accounts receivable, long-term portion in the accompanying balance sheets.

## Notes to Financial Statements

As of December 31, 2010 our accounts receivable balance included \$4.2 million associated with one customer that terminated its arrangement with us for convenience and, in addition, had disputed certain amounts we invoiced prior to the termination. In December 2011, we negotiated a final settlement with this customer which did not have a material impact on the financial statements.

### 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. 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

Accounting Standards Update ("ASU") 2011-08 amends existing guidance by giving an entity the option to first assess qualitative factors to determine whether it is more likely than not (that is, a likelihood of more than 50%) that the fair value of a reporting unit is less than its carrying amount. If this is the case, companies will need to perform a more detailed two-step goodwill impairment test which is used to identify potential goodwill impairments and to measure the amount of goodwill impairment losses to be recognized, if any. ASU 2011-08 will be effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, which for us will be in our 2012 second quarter, with early adoption permitted. We do not believe the adoption of this update will have a material impact on our financial statements.

In June 2011, the FASB issued ASU 2011-05, Presentation of Comprehensive Income, which amends certain guidance in ASC 220, Comprehensive Income. ASU 2011-05 revises the manner in which entities present comprehensive income in their financial statements. ASU 2011-05 removes the presentation options in ASC 220 and requires entities to report components of comprehensive income in either (1) a continuous statement of comprehensive income or (2) two separate but consecutive statements. ASU 2011-05 is effective for interim and annual reporting periods beginning after December 15, 2011 and will be applied on a retrospective basis.

### (2) ACQUISITIONS

#### 2011

On October 14, 2011, we acquired all of the capital stock of Windsor Management Group, L.L.C. ("Windsor") for a cash purchase price of \$16.4 million, net of cash acquired of \$7.4 million. Windsor provides a suite of financial and human capital management solutions to the K-12 education market, primarily in the Southwest.

In connection with this transaction we recorded customer relationship of approximately \$5.6 million, acquired software of \$2.4 million, deferred revenue of \$6.2 million and net assets of \$1.5 million. We recorded goodwill of approximately \$13.3 million, all of which is expected to be deductible for tax purposes. Customer relationships and acquired software will be amortized over a weighted average period of eight years. We believe likely market participants for this transaction would be software companies with a presence in the K-12 school market. Therefore,



## Notes to Financial Statements

the goodwill of \$13.3 million arising from the acquisition is primarily attributed to our ability to maximize the value of the customer base through Tyler's software product suite that targets the K-12 school market and to a much lesser extent, the assembled workforce of Windsor. Our balance sheet as of December 31, 2011 reflects the allocation of the purchase price to the assets acquired based on their estimated fair values at the date of acquisition.

The operating results of this acquisition are included in our results of operations from the date of acquisition.

### 2010

On January 1, 2010 we acquired all of the assets of Wiznet, Inc. ("Wiznet") for a cash purchase price of \$9.5 million. Wiznet provides electronic document filing solutions for courts and law offices throughout the United States and is integrated with our primary courts and justice solution.

### 2009

On July 16, 2009, we completed the acquisition of certain assets of KPL, Inc. d/b/a Parker-Lowe & Associates ("Parker-Lowe") for \$700,000 in cash. Parker-Lowe provides scanning and retrieval software and related services for land record and social services offices in local governments primarily in the North Carolina area. This acquisition was accounted for as a purchase of a business.

On April 3, 2009, we completed the acquisition of all of the capital stock of Assessment Evaluation Services, Inc. ("AES"). AES develops integrated property appraisal solutions and specializes in applications that deal with the unique provisions of the California Revenue and Taxation Code. The purchase price was approximately \$1.1 million in cash.

In 2009, we also paid approximately \$1.1 million for certain software assets to complement our tax and appraisal solutions and our student information management solutions.

### (3) FAIR VALUE OF FINANCIAL INSTRUMENTS

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

- Level 1 – Inputs are unadjusted, quoted prices in active markets for identical assets or liabilities at the measurement date;
- Level 2 – Inputs other than Level 1 inputs that are either directly or indirectly observable; and
- Level 3 – Unobservable inputs, for which little or no market data exist, therefore requiring an entity to develop its own assumptions.

As of December 31, 2011 we held investments available-for-sale that are required to be measured at fair value on a recurring basis. The following tables summarize the fair value of these financial assets as well as cash and cash equivalents:

	December 31, 2011			
	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	\$1,326	\$1,326	\$ —	\$ —
Investments available-for-sale	1,978	25	—	1,953
	\$3,304	\$1,351	\$ —	\$1,953

## Notes to Financial Statements

	December 31, 2010			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash and cash equivalents	\$2,114	\$2,114	\$ —	\$ —
Investments available-for-sale	2,151	25	—	2,126
	\$4,265	\$2,139	\$ —	\$2,126

Cash and cash equivalents consist primarily of money market funds with original maturity dates of three months or less, for which we determine fair value through quoted market prices. These money market funds did not experience any declines in fair value in 2011.

Investments available-for-sale consist of two auction rate municipal securities (“ARS”) which are collateralized debt obligations supported by municipal agencies and do not include mortgage-backed securities. Short-term investments available-for-sale consists of a portion of one of these ARS which was partially redeemed at par during the period January 1, 2012 through February 23, 2012. These ARS are debt instruments with stated maturities of 20 and 30 years, for which the interest rate is designed to be reset through Dutch auctions approximately every 30 days. However, due to events in the credit markets, auctions for these securities have not occurred since February 2008. Both of our ARS have had very small partial redemptions at par in the period from July 2009 through February 2012. As of December 31, 2011 we have continued to earn and collect interest on both of our ARS.

Because quoted prices in active markets are no longer available we determined the estimated fair values of these securities utilizing a discounted trinomial model. The model considers the probability of three potential occurrences for each auction event through the maturity date of each ARS. The three potential outcomes for each auction are (i) successful auction/early redemption, (ii) failed auction and (iii) issuer default. Inputs in determining the probabilities of the potential outcomes include but are not limited to, the securities’ collateral, credit rating, insurance, issuer’s financial standing, contractual restrictions on disposition and the liquidity in the market. The fair value of each ARS is determined by summing the present value of the probability-weighted future principal and interest payments determined by the model. Since there can be no assurances that auctions for these securities will be successful in the near future, we have classified our ARS as non-current investments.

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

	Par Value	Temporary Impairment	Carrying Value
Non-current investments available-for-sale	\$2,500	\$547	\$1,953

In association with this estimate of fair value, we have recorded an after-tax temporary unrealized loss on our non-current ARS of \$80,000, net of related tax effects of \$43,000 in 2011, which is included in accumulated other comprehensive loss on our balance sheet. We consider the impairment in our ARS as temporary because we do not have the intent to sell, nor is it more-likely-than-not that we will be required to sell these securities before recovery of their cost basis. We believe that this temporary decline in fair value is due entirely to liquidity issues, because the underlying assets of these securities are supported by municipal agencies and do not include mortgage-backed securities, have redemption features which call for redemption at 100% of par value and have a current credit rating of A or AA. The ratings on the ARS take into account credit support through insurance policies guaranteeing each

## Notes to Financial Statements

of the bonds' payment of principal and accrued interest, if it becomes necessary. In addition, both ARS have had very small partial redemptions at par in the period July 2009 through February 2012. Based on our cash and cash equivalents balance of \$1.3 million, expected operating cash flows, and a \$150.0 million credit line, we do not believe a lack of liquidity associated with our ARS will adversely affect our ability to conduct business, and believe we have the ability to hold the securities throughout the currently estimated recovery period. We will continue to evaluate any changes in the fair value of our ARS and in the future, depending upon existing market conditions, we may be required to record an other-than-temporary decline in market value.

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

Balance as of December 31, 2008	\$ 3,779
Transfers into level 3	—
Transfers out of level 3	(75)
Purchases, sales, issuances and settlements	(1,700)
Unrealized losses included in accumulated other comprehensive loss	(28)
Balance as of December 31, 2009	1,976
Transfers into level 3	—
Transfers out of level 3	(25)
Purchases, sales, issuances and settlements	(25)
Unrealized gains included in accumulated other comprehensive loss	200
Balance as of December 31, 2010	2,126
Transfers into level 3	—
Transfers out of level 3	(25)
Purchases, sales, issuances and settlements	(25)
Unrealized losses included in accumulated other comprehensive loss	(123)
Balance as of December 31, 2011	<u>\$ 1,953</u>

## (4) PROPERTY AND EQUIPMENT, NET

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

	Useful Lives (Years)	2011	2010
Land	—	\$ 7,549	\$ 3,959
Building and leasehold improvements	5-39	29,299	26,396
Computer equipment and purchased software	3-5	21,303	23,408
Furniture and fixtures	5	7,656	7,601
Transportation equipment	5	248	305
		66,055	61,669
Accumulated depreciation and amortization		(25,140)	(26,818)
Property and equipment, net		<u>\$ 40,915</u>	<u>\$ 34,851</u>

Depreciation expense was \$5.3 million during 2011, \$5.1 million during 2010, and \$4.4 million during 2009.

We own office buildings in Yarmouth, Maine, Lubbock, Texas, and Dayton, Ohio. We lease a small amount of space in two of these buildings to third-party tenants. These leases expire between 2013 and 2015 and are expected to provide rental income of approximately \$640,000 during 2012, \$404,000 during 2013, \$235,000 during 2014, \$78,000 during 2015, and none thereafter. Rental income associated with third party tenants was \$1.2 million in 2011, \$1.4 million in 2010 and \$1.3 million in 2009, respectively and was included as a reduction of selling, general and administrative expenses.

## Notes to Financial Statements

### (5) GOODWILL AND OTHER INTANGIBLE ASSETS

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

	2011	2010
Gross carrying amount of acquisition intangibles:		
Customer related intangibles	\$ 50,552	\$ 44,992
Software acquired	26,363	23,983
Trade name	2,211	1,971
Lease acquired	1,387	1,387
	<u>80,513</u>	<u>72,333</u>
Accumulated amortization	(45,045)	(40,311)
Acquisition intangibles, net	<u>\$ 35,468</u>	<u>\$ 32,022</u>
Post acquisition software development costs	\$ 36,701	\$ 36,701
Accumulated amortization	(36,541)	(36,416)
Post acquisition software costs, net	<u>\$ 160</u>	<u>\$ 285</u>
Total other intangibles	<u>\$ 35,628</u>	<u>\$ 32,307</u>

Total amortization expense, for acquisition related intangibles and post acquisition software development costs, was \$4.9 million during 2011, \$5.5 million during 2010, and \$5.1 million during 2009.

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

	December 31, 2011			December 31, 2010		
	Gross Carrying Amount	Weighted Average Amortization Period	Accumulated Amortization	Gross Carrying Amount	Weighted Average Amortization Period	Accumulated Amortization
Non-amortizable intangibles:						
Goodwill	\$106,094	—	\$ —	\$92,831	—	\$ —
Amortizable intangibles:						
Customer related intangibles	50,552	16 years	20,409	44,992	17 years	17,163
Software acquired	26,363	5 years	22,617	23,983	5 years	21,492
Trade name	2,211	18 years	1,048	1,971	19 years	963
Lease acquired	1,387	5 years	971	1,387	5 years	693

The changes in the carrying amount of goodwill for the two years ended December 31, 2011 are as follows:

	Enterprise Software Solutions	Appraisal and Tax Software Solutions and Services	Total
Balance as of December 31, 2009	\$ 84,668	\$5,590	\$ 90,258
Goodwill acquired during the year related to the purchase of Wiznet	2,573	—	2,573
Balance as of December 31, 2010	87,241	5,590	92,831
Goodwill acquired during the year related to the purchase of Windsor	13,263	—	13,263
Balance as of December 31, 2011	<u>\$100,504</u>	<u>\$5,590</u>	<u>\$106,094</u>

## Notes to Financial Statements

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,

2012	\$5,255
2013	4,690
2014	4,215
2015	4,036
2016	3,947

### (6) ACCRUED LIABILITIES

Accrued liabilities consist of the following at December 31:

	2011	2010
Accrued wages, bonuses and commissions	\$16,971	\$11,762
Other accrued liabilities	6,510	6,367
Accrued health claims	1,270	1,304
	<u>\$24,751</u>	<u>\$19,433</u>

### (7) REVOLVING LINE OF CREDIT

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

Borrowings under the Credit Facility bear interest at a rate of either (1) the Bank of America's prime rate plus a margin of 1.50% to 2.75% or (2) the 30, 60, 90 or 180-day LIBOR rate plus a margin of 2.50% to 3.75%, with the margin determined by our consolidated leverage ratio. In 2011 and 2010, our effective average interest rate for borrowings was 3.3% and 3.4%, respectively. As of December 31, 2011, our interest rate was 3.4%. The Credit Facility is secured by substantially all of our assets, excluding real property. The Credit Facility requires us to maintain certain financial ratios and other financial conditions and prohibits us from making certain investments, advances, cash dividends or loans, and limits incurrence of additional indebtedness and liens. As of December 31, 2011, we were in compliance with those covenants.

As of December 31, 2011, we had \$60.7 million in outstanding borrowings and unused available borrowing capacity of \$81.0 million under the Credit Facility. In addition, as of December 31, 2011, our bank had issued outstanding letters of credit totaling \$8.3 million to secure surety bonds required by some of our customer contracts. These letters of credit reduce our available borrowing capacity and expire through mid-2012.

We paid interest of \$1.9 million in 2011 and \$689,000 in 2010.

## Notes to Financial Statements

### (8) INCOME TAX

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

Years ended December 31,	2011	2010	2009
Current:			
Federal	\$17,239	\$13,552	\$16,822
State	2,233	2,252	2,536
	19,472	15,804	19,358
Deferred	(2,916)	(959)	(1,730)
	\$16,556	\$14,845	\$17,628

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

Years ended December 31,	2011	2010	2009
Federal income tax expense at statutory rate	\$15,440	\$13,965	\$15,623
State income tax, net of federal income tax benefit	1,238	1,218	1,634
Non-deductible business expenses	918	976	965
Qualified manufacturing activities	(840)	(728)	(586)
Research and development credit	(177)	(579)	—
Other, net	(23)	(7)	(8)
	\$16,556	\$14,845	\$17,628

Approximately 35% of our stock option expense is derived from incentive stock options (“ISOs”). 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:

	2011	2010
Deferred income tax assets:		
Operating expenses not currently deductible	\$ 4,597	\$ 2,642
Employee benefit plans	5,156	4,020
Capital loss carryforward	203	160
Property and equipment	397	195
Total deferred income tax assets	10,353	7,017
Deferred income tax liabilities:		
Intangible assets	(10,043)	(9,673)
Other	(156)	(149)
Total deferred income tax liabilities	(10,199)	(9,822)
Net deferred income tax assets (liabilities)	\$ 154	\$(2,805)

Although realization is not assured, we believe it is more likely than not that all the deferred tax assets at December 31, 2011 and 2010 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 ASC 740-10, Income Taxes.

## Notes to Financial Statements

The Internal Revenue Service (“IRS”) is examining our U.S. income tax return for the year 2010. As of February 22, 2012, no significant adjustments have been proposed by the IRS. We are unable to make a reasonable estimate as to when cash settlements, if any, will occur.

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 2008. We are no longer subject to state and local income tax examinations by tax authorities for the years before 2007.

We paid income taxes, net of refunds received, of \$13.4 million in 2011, \$15.8 million in 2010, and \$18.1 million in 2009.

### (9) SHAREHOLDERS' EQUITY

The following table details activity in our common stock:

	Years ended December 31,					
	2011		2010		2009	
	Shares	Amount	Shares	Amount	Shares	Amount
Purchases of common stock	(3,004)	\$(71,802)	(3,559)	\$(65,793)	(1,235)	\$(17,000)
Stock option exercises	582	3,553	615	3,181	425	2,295
Employee stock plan purchases	100	2,045	118	1,825	115	1,428

As of February 22, 2012 we had authorization from our board of directors to repurchase up to 1.7 million additional shares of our common stock.

### (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 four to six 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 pursuant to ASC 718, Stock Compensation.

As of December 31, 2011, there were 3.5 million shares available for future grants under the plan from the 16.0 million shares previously approved by the stockholders.

#### Determining Fair Value of Stock Compensation

**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. As provided by ASC 718-10 we use the “simplified” method which is allowed for those companies that cannot reasonably estimate expected life of options based on its historical share option exercise experience. We use the “simplified” method to estimate expected life due to insufficient historical exercise data for the current optionee group. This 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.

## Notes to Financial Statements

**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 share-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,	2011	2010	2009
Expected life (in years)	6.7	6.7	6.5
Expected volatility	33.1%	35.0%	37.2%
Risk-free interest rate	1.7%	2.7%	3.1%
Expected forfeiture rate	3%	3%	3%

The following table summarizes share-based compensation expense related to share-based awards which is recorded in the statements of income:

Years ended December 31,	2011	2010	2009
Cost of software services, maintenance and subscriptions	\$ 871	\$ 739	\$ 540
Selling, general and administrative expense	5,382	5,393	4,505
Total share-based compensation expense	6,253	6,132	5,045
Tax benefit	(1,545)	(1,475)	(1,233)
Net decrease in net income	\$ 4,708	\$ 4,657	\$ 3,812

## 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, 2008	5,309	\$ 9.69		
Granted	835	17.25		
Exercised	(425)	5.40		
Forfeited	(15)	7.80		
Outstanding at December 31, 2009	5,704	11.12		
Granted	765	18.82		
Exercised	(615)	5.17		
Forfeited	(18)	16.59		
Outstanding at December 31, 2010	5,836	12.74		
Granted	831	26.83		
Exercised	(582)	6.10		
Forfeited	(26)	15.78		
Outstanding at December 31, 2011	6,059	15.31	6	\$89,646
Exercisable at December 31, 2011	3,177	\$11.44	5	\$59,293



## Notes to Financial Statements

We had vested options to purchase 2.7 million shares with a weighted average grant date value of \$19.35 as of December 31, 2011 and unvested options to purchase 2.7 million shares with a weighted average grant date value of \$16.04 as of December 31, 2010. As of December 31, 2011, we had \$18.9 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 four years.

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

	2011	2010	2009
Weighted average grant-date fair value of stock options granted	\$ 9.91	\$ 7.70	\$ 7.38
Total intrinsic value of stock options exercised	12,289	8,119	4,656

### 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, 2011, there were 129,000 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,	2011	2010	2009
Numerator for basic and diluted earnings per share			
Net income	\$27,557	\$25,054	\$27,010
Denominator:			
Weighted-average basic common shares outstanding	31,267	34,075	35,240
Assumed conversion of dilutive securities:			
Stock options	1,887	1,453	1,384
Denominator for diluted earnings per share – Adjusted weighted-average shares	33,154	35,528	36,624
Earnings per common share:			
Basic	\$ 0.88	\$ 0.74	\$ 0.77
Diluted	\$ 0.83	\$ 0.71	\$ 0.74

Stock options representing the right to purchase common stock of 714,000 shares in 2011, 1.8 million shares in 2010, and 2.6 million shares in 2009 were not included in the computation of diluted earnings per share because their inclusion would have had an anti-dilutive 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 an entity in which an executive's father and brother have a 100% ownership interest. The executive does not have an interest in the entity that leases the property to us and the lease arrangement existed at the time we acquired the division that occupies this property. Most of our leases are non-cancelable operating lease agreements and they expire at various dates through 2018. 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 2011, \$5.4 million in 2010, and \$6.3 million in 2009, which included rent expense associated with related party lease agreements of \$1.8 million in 2011, \$1.9 million in 2010 and \$2.0 million in 2009.

## Notes to Financial Statements

Future minimum lease payments under all non-cancelable leases at December 31, 2011 are as follows:

Years ending December 31,

2012	\$ 6,004
2013	4,687
2014	2,598
2015	2,430
2016	2,303
Thereafter	2,341
	\$ 20,363

Included in future minimum lease payments are non-cancelable payments due to related parties of \$1.7 million in 2012, \$1.7 million in 2013, \$1.7 million in 2014, \$1.7 million in 2015, \$1.7 million in 2016, and \$1.7 million 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 3% of an employee's compensation to the plan. We made contributions to the plan and charged operations \$2.9 million during 2011, \$2.8 million during 2010, and \$2.6 million during 2009.

### (14) COMMITMENTS AND CONTINGENCIES

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

### (15) SEGMENT AND RELATED INFORMATION

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

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

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

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

## Notes to Financial Statements

We evaluate performance based on several factors, of which the primary financial measure is business segment operating income. We define segment operating income as income before noncash amortization of intangible assets associated with their acquisition, share-based compensation expense, interest expense and income taxes. Segment operating income includes intercompany transactions. The majority of intercompany transactions relate to contracts involving more than one unit and are valued based on the contractual arrangement. Segment operating income for corporate primarily consists of compensation costs for the executive management team and certain accounting and administrative staff and share-based compensation expense for the entire company. Corporate segment operating income also includes revenues and expenses related to a company-wide user conference. The accounting policies of the reportable segments are the same as those described in Note 1, "Summary of Significant Accounting Policies."

Segment assets include net accounts receivable, prepaid expenses and other current assets, net property and equipment and intangibles associated with their acquisition. Corporate assets consist of cash and investments, prepaid insurance, deferred income taxes and net property and equipment mainly related to unallocated information and technology assets.

ESS segment capital expenditures in 2011 and 2009 included \$6.6 million and \$11.2 million, respectively for the purchase of buildings and land in connection with plans to consolidate workforces and support long-term growth.

In 2009 the ATSS segment had one appraisal services customer which accounted for 10.4% of this segment's total revenues. The ATSS segment did not have any customers in 2011 and 2010 that accounted for 10% or more of their total revenues.

As of and year ended December 31, 2011	Enterprise Software Solutions	Appraisal and Tax Software Solutions and Services	Corporate	Totals
Revenues				
Software licenses	\$ 30,194	\$ 2,400	\$ —	\$ 32,594
Subscriptions	30,400	760	—	31,160
Software services	60,840	8,777	—	69,617
Maintenance	130,999	15,499	—	146,498
Appraisal services	—	23,228	—	23,228
Hardware and other	5,199	—	1,095	6,294
Intercompany	2,103	—	(2,103)	—
Total revenues	\$259,735	\$50,664	\$ (1,008)	\$309,391
Depreciation and amortization expense	8,516	650	1,510	10,676
Segment operating income	56,856	9,786	(15,669)	50,973
Capital expenditures	11,143	137	998	12,278
Segment assets	\$448,015	\$56,389	\$(209,013)	\$295,391

## Notes to Financial Statements

As of and year ended December 31, 2010	Enterprise Software Solutions	Appraisal and Tax Software Solutions and Services	Corporate	Totals
Revenues				
Software licenses	\$ 32,757	\$ 2,156	\$ —	\$ 34,913
Subscriptions	22,975	323	—	23,298
Software services	58,371	9,969	—	68,340
Maintenance	120,764	14,891	—	135,655
Appraisal services	—	20,554	—	20,554
Hardware and other	5,727	6	135	5,868
Intercompany	1,978	—	(1,978)	—
Total revenues	\$ 242,572	\$ 47,899	\$ (1,843)	\$ 288,628
Depreciation and amortization expense	8,903	683	1,202	10,788
Segment operating income	51,942	8,883	(14,367)	46,458
Capital expenditures	2,960	350	310	3,620
Segment assets	\$ 373,432	\$ 45,957	\$ (155,357)	\$ 264,032

As of and year ended December 31, 2009	Enterprise Software Solutions	Appraisal and Tax Software Solutions and Services	Corporate	Totals
Revenues				
Software licenses	\$ 39,484	\$ 2,647	\$ —	\$ 42,131
Subscriptions	16,870	311	—	17,181
Software services	70,041	10,364	—	80,405
Maintenance	110,404	14,108	—	124,512
Appraisal services	—	18,740	—	18,740
Hardware and other	6,113	135	1,069	7,317
Intercompany	1,618	—	(1,618)	—
Total revenues	\$ 244,530	\$ 46,305	\$ (549)	\$ 290,286
Depreciation and amortization expense	8,031	608	858	9,497
Segment operating income	54,825	7,763	(13,688)	48,900
Capital expenditures	13,361	192	614	14,167
Segment assets	\$ 220,135	\$ 25,597	\$ 24,938	\$ 270,670

## Reconciliation of reportable segment operating income to the Company's consolidated totals:

	2011	2010	2009
Total segment operating income	\$ 50,973	\$ 46,458	\$ 48,900
Amortization of acquired software	(1,125)	(1,592)	(1,411)
Amortization of customer and trade name intangibles	(3,331)	(3,225)	(2,705)
Other expense, net	(2,404)	(1,742)	(146)
Income before income taxes	\$ 44,113	\$ 39,899	\$ 44,638

## Notes to Financial Statements

## (16) SUBSEQUENT EVENT

In January 2012, we acquired substantially all of the assets of Akanda Innovation, Inc., a provider of web-based solutions to the public sector which are integrated with our property tax software, for a total purchase price of \$2.9 million. The purchase price included certain liabilities we assumed of approximately \$800,000, resulting in net cash paid to the sellers of \$2.1 million, of which \$900,000 was paid prior to December 31, 2011 and is included with other current assets.

## (17) QUARTERLY FINANCIAL INFORMATION (unaudited)

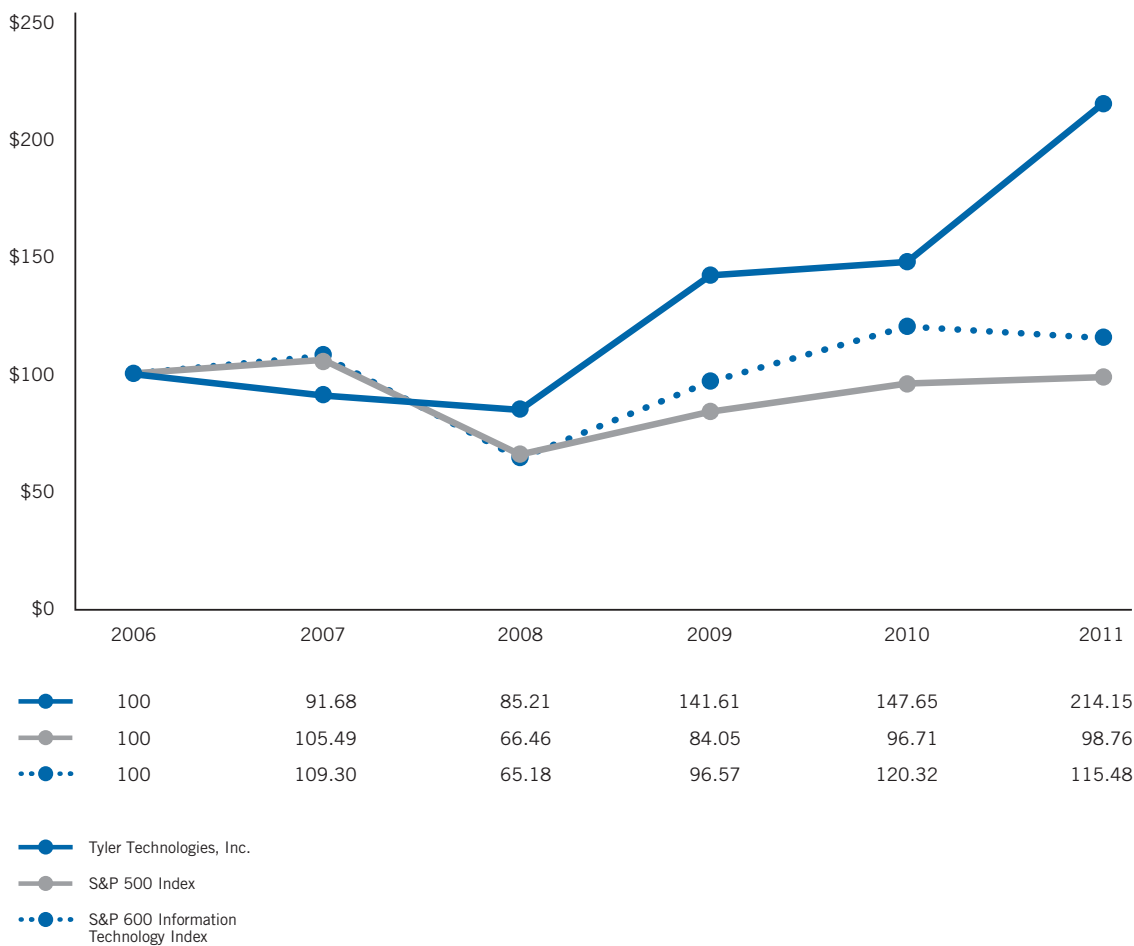
The following table contains selected financial information from unaudited statements of income for each quarter of 2011 and 2010.

Quarters ended	2011				2010			
	Dec. 31	Sept. 30	June 30	Mar. 31	Dec. 31	Sept. 30	June 30	Mar. 31
Revenues	\$82,079	\$77,184	\$76,735	\$73,393	\$72,439	\$73,769	\$72,600	\$69,820
Gross profit	39,020	36,132	34,137	32,623	32,616	33,207	32,475	30,019
Income before income taxes	13,504	11,818	9,309	9,482	10,159	11,263	10,383	8,094
Net income	8,699	7,506	5,624	5,728	7,210	6,723	6,249	4,872
Earnings per diluted share	0.27	0.23	0.17	0.17	0.21	0.19	0.17	0.13
Shares used in computing diluted earnings per share	32,031	32,960	33,848	33,720	33,895	35,410	36,203	36,655

### 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, 2006. 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





**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

Matthew B. Bieri  
Vice President  
Chief Information Officer

Samantha B. Crosby  
Vice President  
Chief Marketing 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<sup>1</sup>  
Chairman of the Board  
Tyler Technologies, Inc.

John S. Marr Jr.<sup>1</sup>  
President and Chief Executive Officer  
Tyler Technologies, Inc.

Donald R. Brattain<sup>2,3</sup>  
President  
Brattain and Associates, LLC

J. Luther King Jr.<sup>2,4</sup>  
Chief Executive Officer  
Luther King Capital Management

G. Stuart Reeves<sup>2,3,4</sup>  
Retired Executive Vice President  
Electronic Data Systems Corporation

Michael D. Richards<sup>3,4</sup>  
Executive Vice President  
Republic Title of Texas, Inc.

Dustin R. Womble<sup>1</sup>  
Executive Vice President  
Tyler Technologies, Inc.

<sup>1</sup> Executive Committee  
<sup>2</sup> Audit Committee  
<sup>3</sup> Nominating and Governance Committee  
<sup>4</sup> Compensation Committee

**Corporate Headquarters**

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718.236.2641 fax  
www.amstock.com

**Independent Registered Public Accounting Firm**

Ernst & Young LLP  
Dallas, Texas

**Annual Meeting of Stockholders**

Our Annual Meeting will be held on Thursday, May 10, 2012, at 9:30 a.m. Central Time at The Park City Club, 5956 Sherry Lane, 17th Floor, 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**

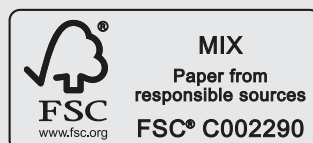
Our Annual Report on Form 10-K is available on the company's website at www.tylertech.com. A copy of the Form 10-K or other information may also be obtained by contacting the Investor Relations Department at corporate headquarters.

**Investor Relations**

Tyler Technologies, Inc.  
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**Common Stock**

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





**Empowering people who serve the public<sup>®</sup>**

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