navigating the currents

tyler technologies

Empowering people who serve the public®

2012 Annual Report

Successful navigation requires constant vigilance.

At Tyler Technologies, our course is governed by a steadfast commitment to our long-term business strategy — yet we must constantly adapt along the way to accommodate changing conditions. From market challenges to emerging technologies, Tyler relies on the power of experience to successfully navigate the currents.

to our shareholders

As general market conditions improved and budget pressures eased for many local governments, Tyler Technologies achieved double-digit growth for both revenues and backlog in 2012. Revenues rose more than 17 percent over 2011, while backlog grew by 12 percent — and our new-business pipeline remains at near-historic highs.

Total 2012 revenue reached $363.3 million. Net income was $33 million, or $1.00 per diluted share. Non-GAAP earnings per share, excluding share-based compensation expense and amortization of acquisition intangibles, was $1.29. New highs for the year included a gross margin of 46.2 percent, an operating profit margin of 15.6 percent and a non-GAAP operating margin of just under 20 percent. Free cash flow reached an all-time high of $53.9 million, excluding capital expenditures associated with real estate.

With many key metrics on the rise, it's important to note two fundamental shifts that are causing revenues to grow more slowly when considering traditional indicators such as license revenues. First, many of today's new contracts are larger and more complex than in prior years, with terms that sometimes result in revenue recognition over a longer period of time. Second, a growing portion of our business is subscription-based, which translates into lower revenues in the first year than traditional perpetual license arrangements, but generates greater returns over the life of the contract.

Organic growth and acquisitions each contributed to a 22 percent increase in recurring revenues from maintenance and subscriptions in 2012.

Total recurring revenue from maintenance and subscriptions grew 22 percent to $216.5 million, comprising almost 60 percent of total revenue. Subscription revenues, including our software as a service (SaaS) solutions, as well as transaction-based revenues from electronic filing and online payments, grew 39.8 percent organically and 3.4 percent from acquisitions during 2012, representing $44.6 million, or 12 percent of total revenue. Growth in subscription revenues is due to an increasing number of new clients, as well as a steady flow of conversions of existing on-premise clients to our hosted solutions.

Strategic Acquisitions

Tyler completed several acquisitions in 2012, which boosted revenue growth by an additional 6.3 percent over our organic growth rate of 11.1 percent. Two of these acquisitions were related to Tyler's 2011 purchase of Windsor Management, a provider of Infinite Visions® financial and human resources management solutions for the K-12 schools market. In March and April 2012, we added two longtime Infinite Visions resellers to our organization — Computer Software Associates of Billings, Montana, and UniFund, L.L.C., of Nashua, New Hampshire. These acquisitions further expanded our geographic footprint while bringing the revenue chain full circle for the Infinite Visions product suite.

We expanded our product offering with the November addition of EnerGov Solutions, a provider of enterprise permitting, land management, licensing and regulatory software solutions. With this acquisition, Tyler gained valuable capabilities geared toward the unique licensing and regulatory requirements of large, complex municipal assets. We expect this robust solution to strengthen our enterprise resource planning (ERP) offerings. EnerGov will continue to be offered as a stand-alone product, as well as an integrated component of our ERP systems. This acquisition added approximately 70 employees to our organization.

Tyler also finalized the acquisition of longtime partner Akanda Innovation, Inc., whose software is integrated into our iasWorld® appraisal and tax solution. Akanda's team now provides its expertise in geographic information systems and other disciplines as part of our organization.

Tyler Technologies has the resources and agility to adapt to market changes while staying true to our long-term strategies.

Earning Our Reputation

First and foremost, Tyler is committed to empowering people who serve the public. As we grow our business and expand our services, we're less concerned with industry accolades than with client, employee and shareholder satisfaction. That said, we do value the opinions of respected thought leaders who have recognized Tyler for our performance.

For five of the last six years, Tyler has appeared on the *Forbes* list of the Best Small Companies in America. We ranked 36 on the 2012 list — 40 spots higher than the previous year. We believe our consistent appearance on the *Forbes* list speaks to our proven ability to create long-term value.

In addition, for the fifth consecutive year, Tyler appeared in the Software 500 ranking, published by *Software Magazine*. The Software 500 is based on revenue from software licenses, maintenance and support, training, and software-related services and consulting. Tyler ranked 179 based on 2011 revenues.

Breaking Ground

In July, we broke ground on our new 142,000-square-foot corporate and division headquarters in Plano, Texas. The 26-acre campus will enable us to consolidate all staff from our growing Courts & Justice division, as well as our Dallas corporate headquarters, and provide space for anticipated long-term growth. With the completion of the Plano facility in August 2013, all of Tyler's division headquarters will have moved to new facilities within the past three years.

We believe that the investments we have made in these facilities are important to our strategic growth plans, providing us with appropriate work environments that enable us to attract and retain talented professionals in a competitive market. In addition, these investments underscore our commitment to the communities in which our operations are located, and enhance Tyler's position as an employer of choice in those regions.

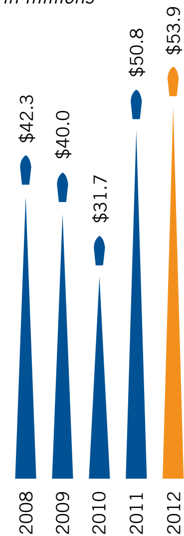
Steady Navigation

Tyler's solid performance in 2012 is the result of an enduring commitment to our core growth strategies: expanding our geographic reach, broadening our product offerings, winning large-scale contracts and extending our relationships with existing clients. Tyler is committed to staying the course with our strategy — and we are equally committed to acting swiftly and deliberately to adjust when challenges or opportunities arise. We are excited about the opportunities ahead of us and are confident in our ability to continue to evolve our business with positive results for all of our constituents.

To our valued shareholders, employees and clients, we extend our thanks for your confidence in Tyler.

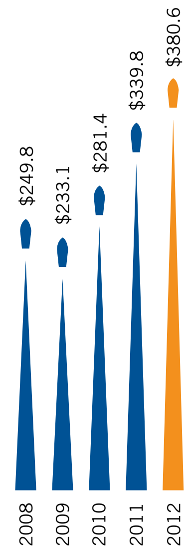
John S. Marr Jr.
President and Chief Executive Officer
March 20, 2013

Free Cash Flow[(a)]
in millions



(a) excludes capital expenditures associated with real estate

Backlog
in millions



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

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

tyler at a glance

With more than 2,400 employees and 11,000 government and school clients in all 50 states, Canada, the Caribbean, the United Kingdom, and other international jurisdictions, 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 financial systems for a 2,000-resident town in Maine to a statewide e-filing system for courts across Texas, Tyler's perpetual upgrades and comprehensive services empower our clients to serve the public with efficiency, accessibility and fiscal responsibility.

STATE & LOCAL GOVERNMENT SOLUTIONS

ERP | FINANCIAL

More than 4,000 government entities rely on Tyler's ERP financial solutions for efficient management of their accounting, payroll and human resources functions as they manage $116 billion in public sector funds annually, and our human capital management solutions process paychecks for more than 1 million public sector employees.

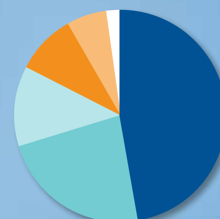
COURTS & JUSTICE

From paperless court case management to e-filing solutions, Tyler's courts and justice products offer a broad range of functionality for courts, prosecutors, law enforcement, corrections and supervision staff. With the Odyssey® product alone, more than 25 percent of the U.S. population lives in jurisdictions that have licensed Tyler's case management or e-filing products.

Recurring Revenues
in millions

Revenue Mix

- 47.3% Maintenance
- 23.0% Services
- 12.3% Subscriptions
- 9.1% Software
- 6.2% Appraisal
- 2.1% Hardware and Other



APPRAISAL & TAX

Tyler empowers 1,300 taxing authorities throughout the United States and Canada with computer-assisted mass appraisal (CAMA) solutions, tax billing and collections software, and turnkey reassessment and revaluation services. Tyler's appraisal and tax software manages 60 million parcels of property each year.

RECORDS & DOCUMENTS

Tyler solutions empower clients to manage the land, vital and official records for 19 million residents across the United States and store more than 380 million land and vital records.

PLANNING, PERMITTING & LICENSING

Tyler's planning, permitting and licensing products centralize and connect processes across building departments, code enforcement, public works and other agencies, with 24-hour citizen access and mobile solutions that extend functionality into the field. These solutions serve approximately 23 million citizens in the United States and Canada.

PUBLIC SAFETY

When it comes to public safety, timeliness and accuracy are paramount. Tyler's public safety solutions facilitate the sharing of mission-critical information and streamline records management for first responders, dispatchers, jails and others. Protecting more than 2 million citizens every day, Tyler solutions equip jurisdictions to take 1.6 million 911/ dispatch calls annually.

SCHOOL SOLUTIONS

STUDENT MANAGEMENT

Tyler offers a full suite of student management solutions to help educators and administrators put students first, including student information, data analytics, special education and student transportation. In fact, Tyler's Versatrans® solutions manage transportation for one out of every 10 U.S. school districts.

FINANCIAL

Tyler delivers integrated financial solutions that address the unique budgeting and procurement needs of educational clients. By enhancing our clients' most essential business functions, Tyler helps schools maximize their resources in the more than 1,350 school districts we serve annually.

wide perspective

While some competitors cut back their research and development spending in response to the economic downturn, Tyler continued to focus on the big picture — aggressively investing in our products to continually enhance functionality and deliver value.

Q&A:

Tyler Technologies returned to double-digit organic growth in 2012 as our increased investments in product development in recent years continued to strengthen the company's competitive position. With the public sector markets we serve showing gradual improvement, Tyler is well positioned to capture a growing market share. This question-and-answer format addresses some of the factors that contributed to Tyler's performance during 2012, as well as emerging opportunities that will help drive future growth.

How has the economy affected the public sector in recent years?

Local governments experienced significant budget pressures as a result of the recession, and those pressures certainly received a great deal of attention from the media. Many made deep budget cuts, which resulted in the postponement of some new projects and considerably extended sales cycles for many others. Our new business in 2010 and 2011 declined 15 to 20 percent from the "normal" level we experienced in 2009.

Beginning in the second half of 2011, we saw a slow but steady increase in market activity that continued through 2012. Local government revenues in many cases are growing, and many governments' budgets are stabilizing. Some projects that had been stalled during the downturn are now moving forward, and other processes are proceeding on paces that are more in line with historical norms.

While economic recovery certainly played a role in Tyler's performance during 2012, it's worth noting that the market has not fully returned to the normal activity level of 2009. We believe Tyler's strong competitive position was a more significant factor in our higher growth rate in 2012.

How was Tyler able to strengthen its competitive position in such a difficult environment?

We stayed true to our core strategies — one of which is to continually enhance our products — allowing us to compete effectively for new business while providing value to our existing maintenance and subscription customers. We chose to sacrifice some short-term earnings to build long-term benefits for our clients and value for our company. We increased our spending on product development in 2010 and 2011, despite the weakness in new business, and maintained a high level of development expense in 2012.

Some of our increased development efforts targeted specific features, functionality or technologies, allowing us in some cases to catch up with competitors, and in other cases to put distance between ourselves and our competitors. Other investments focused on the overall user experience, such as the enhanced user interface we introduced for Munis ERP.

ERP | FINANCIAL

With the signing of an $8 million agreement, Charlotte, North Carolina, became the largest city to implement Tyler's Munis® solution. Other key contracts included a Microsoft Dynamics® AX 2012 and Eden human capital/payroll solution for Nevada's Truckee Meadows Water Authority; and Munis and Incode® SaaS agreements in Missouri City, Texas.

ERP financial contracts across the country highlight Tyler's diverse geographic reach, with new Munis contracts in Santa Barbara, Beverly Hills, and Hayward, California, Des Moines, Iowa, and Butler County, Ohio; and Incode contracts in Lexington, South Carolina, Scottsbluff, Nebraska, Trussville, Alabama, and Waxahachie, Texas.

Other companies serving the local government technology market faced the same challenging environment as Tyler. However, while we continued to invest aggressively in our products, a number of competitors chose to cut back on their development spending. As a result, our win rates against key competitors have increased over the past two years, and we believe our competitive position across our product suites is stronger than it has ever been — which should serve us well as market conditions continue to improve.

COURTS & JUSTICE

Yamhill County, Oregon, successfully piloted the Odyssey case management solution, with the statewide rollout continuing rapidly in several other counties. Tyler welcomed our first Odyssey client in Illinois with an integrated justice solution for Peoria County. Other highlights included a statewide agreement for an e-filing system with the Texas Office of Court Administration (OCA), and an agreement for an Incode municipal court case management solution in Dallas, Texas, the 9th largest city in the United States.

What technology trends are you seeing in the public sector, and how is Tyler addressing them?

We believe that one of the most prevalent trends in the public sector is the growing demand for cloud-based solutions. We're well positioned to meet that demand. Virtually all Tyler software can be delivered as a service — we host software applications and client data in Tyler-managed data centers, and clients contract to use the hosted software on a subscription basis. An increasing percentage of our new clients are choosing a SaaS option, and a growing number of existing Tyler customers are converting from on-premise systems to our cloud-based offerings each quarter. The Kentucky Department of Education is a perfect example of a longtime client that's made the move to our SaaS offering. During the fourth quarter of 2012, we completed the two-year migration of 173 school districts across the state from traditional on-premise installations of our Munis financial solution to a cloud-based system.

Mobile solutions are becoming more prevalent in the public sector as well. We've made significant inroads in adapting Tyler solutions for use in mobile settings, as was the case with our first fully enabled Tyler Public Safety mobile application. It allows public safety officials to use an Apple iPad® to carry critical information with them at the scene of an incident rather than relying on car-mounted systems. As new information becomes available, it's instantly accessible to responders at the scene.

Another mobile-friendly adaptation is our iasWorld solution. We've made this software suite a browser-independent application. Based on recent product enhancements, coupled with the adaptation of HTML5 as its core technology, it's accessible via most devices with Internet connectivity. iasWorld is a trusted product in the appraisal-and-tax software marketplace, and we've continued to adapt to stay current with evolving technological capabilities and client expectations, including mobile access.

Cloud services have been popular in the private sector for quite some time. Why has the public sector been slow to adopt them, and why are they gaining momentum now?

There are some fundamental differences between the public and private sectors that contribute to governments' slow adoption of emerging solutions like cloud computing. In general, the public sector is risk averse. Governments are not motivated by profits or a desire

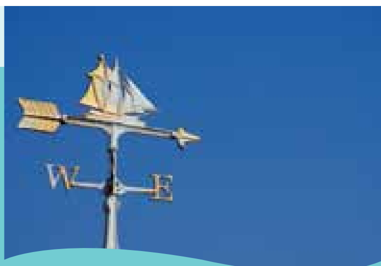
for a competitive edge over other governments. As a result, governments tend to be later adopters and often defer implementation of new technologies until they are widely accepted.

Our cloud-based solutions are certainly not new. In fact, Tyler's SaaS offerings date back more than a decade, as our first SaaS client, the city of Eau Claire, Wisconsin, adopted the Munis ERP solution in 2000. The SaaS arrangement provides new clients with an attractive funding model, reducing up-front capital costs associated with traditional license purchases in favor of a level-payment model over a multiyear contract term. In addition, many local governments face challenges associated with managing in-house IT infrastructure, especially with regard to hiring and retaining skilled technical personnel in an increasingly competitive market, as they continue to lose many long-term staff members to retirement. It's clear that local governments are continually being asked to "do more with less" — dealing with increasing workloads and transaction volumes while seeing budgets and headcounts reduced.

All of these factors are contributing to a steady increase in the adoption of our SaaS model. In 2012, we signed SaaS contracts with 76 new-name clients, representing approximately 31 percent of the total of new clients, up from 19 percent in 2011. In addition, in 2012 we converted 68 existing on-premise clients to our hosted model, compared to 40 in 2011. At the end of 2012, Tyler had a total of 438 SaaS clients — still a very small percentage of our client base. We expect that the shift toward SaaS arrangements will continue, and that SaaS will represent an increasing percentage of our new-business mix; however, we anticipate it will be a relatively gradual evolution.

How does the trend toward cloud computing affect Tyler's financials?

With an increasing percentage of business now weighted toward our SaaS offerings, it's important to understand the effect on our financial statements and cash flow. In a perpetual license model, we generally recognize revenues and receive cash for licenses and services during the initial implementation period, and also initiate a recurring stream of revenue from



A market takes a new direction

When California's Administrative Office of the Courts (AOC) abandoned a project to develop a statewide case management system in 2012, many courts found themselves with urgent needs to replace their own aging systems. Tyler's unmatched record of successfully implementing complex case management systems nationwide, along with the industry-leading technology of our Odyssey product, enabled us to win our first California court client.

APPRAISAL & TAX

A number of clients signed agreements for Tyler's CLT Appraisal Services in 2012. Notable contracts included reappraisal services in Montgomery County, Ohio, and data collection services in Loudoun County, Virginia.

We also signed contracts to deliver our iasWorld solution to several counties, including DeKalb County, Georgia, and Lucas County, Ohio. Capabilities include assessment administration, CAMA, personal property management, tax billing and collections, and delinquent tax processing. The agreements also include Tyler's Field Manager and Appeals Tracker modules, which will facilitate in-field appraisals and the management of taxpayer communications.

annual maintenance agreements. In a SaaS model, however, there's little or no revenue recognized or cash received up front. Instead, in most cases, revenue recognition and cash collections occur evenly over the term of the SaaS agreement.

With more Tyler clients moving to SaaS, what does the future hold for Tyler's on-premise solutions?

Tyler is committed to offering the most effective and efficient software delivery methods for our clients, whether online or onsite. We give our current and prospective clients a choice and allow them to adopt a cloud-based solution if and when they determine they are ready. We're positioned to take advantage of the growing demand for cloud-based offerings, even as we continue serving a large segment of the public sector that prefers an on-premise solution with a perpetual license. Our SaaS solutions provide the same features and functionality as our on-premise solutions. In other words, we don't create "light" versions for SaaS delivery, so end users have the same experience, features and functionality whether they are accessing Tyler software over a local network or online from a Tyler data center. Tyler clients can easily convert from one model to the other — without disruption. However, less than one third of our new software clients selected a SaaS model in 2012. We expect the ongoing gradual shift toward the cloud to continue over a very long time.

How did the growth rate of traditional on-premise implementations fare in 2012?

Even with the increasing interest in our SaaS offerings, Tyler posted modest growth in software licenses from on-premise implementations in 2012, after two consecutive years of declining license revenues. Software licenses grew 1.8 percent, primarily as a result of license revenues from our recently acquired Infinite Visions and EnerGov products.

How does Tyler's evergreen philosophy work with each delivery model?

Both on-premise and SaaS clients receive new releases and upgrades for the life of their maintenance or subscription agreements. In both cases, we continually provide our existing clients with the new technology features and functionality that our new clients receive — in an evolutionary manner that's not disruptive financially or operationally. It's one of the primary reasons Tyler has an exceptional client retention rate — approximately 98 percent — for both on-premise and SaaS clients.

Tyler's ERP product suites are in many ways the core strength of the company. How did they perform in 2012, and what is their outlook?

Our ERP product suites, which include Munis and Incode, address the financial management, payroll and human capital management needs of a wide spectrum of public sector clients, from cities and towns to school districts. These products performed very well in 2012, both financially and operationally, continuing a record of consistently strong results

RECORDS & DOCUMENTS

In keeping with Tyler's commitment to extend relationships with our existing clients, we signed a new agreement with Mohave County, Arizona, that will add Eagle Treasurer, Eagle Assessor and Eagle Web to the county's existing Munis ERP and Eagle recording solutions.

Other contract highlights included an Eagle local government solution for Boulder County, Colorado, and a seven-year SaaS agreement for our Eagle and Incode local government solution with Fremont County, Colorado.

dynamic stability

To stay the course during difficult business climates, Tyler Technologies continually makes tactical adjustments to minimize threats and leverage opportunities — without losing sight of our core values and strategies. This dynamic approach to changing conditions ultimately fortifies our stability in the marketplace.

and generating the majority of our revenues and earnings. Revenues from our ERP products grew at a double-digit rate in 2012, which is remarkable in an environment that hasn't yet fully recovered from the economic downturn.

This success is attributable to our dedication to continuous innovation while providing a high level of client service. As a result of our aggressive product development efforts, combined with a record of successful public sector implementations spanning decades, our competitive position in the ERP market is extremely strong, and our higher win rates versus key competitors in 2012 reflect this. New ERP clients in 2012 ranged in size from towns like Edinburgh, Indiana (population 4,543), to Charlotte, North Carolina, the nation's 17th-largest city. We expect to continue building on our market leadership position in 2013 and beyond.

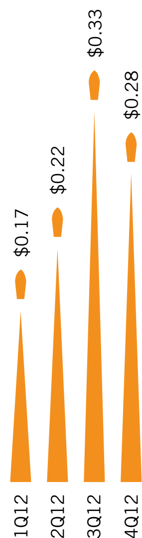
PLANNING, PERMITTING & LICENSING

With the acquisition of EnerGov Solutions in November 2012, Tyler further broadened its public sector solutions with enterprise-scale permitting, land management, licensing and regulatory capabilities that complement our Munis and Incode product suites. Contract highlights for our new Web-based automation platform include agreements with Harford County, Maryland, for a broad array of applications and related professional services, training and support; and with Lubbock, Texas, for permitting and land management, GIS, citizen self-service and other applications.

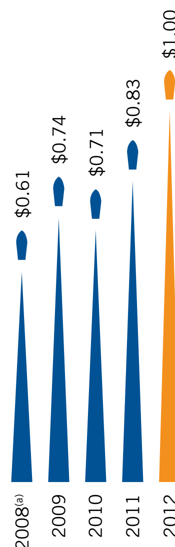
You won your first Odyssey court client in California in 2012. Can you expand on the opportunity in that market?

In recent years, Tyler's Odyssey solution has become the clear national leader in the court case management market, particularly at the upper end of the market. Including Rhode Island, which was signed in early 2013, we have nine statewide courts clients, as well as 10 of the nation's 30 largest counties in states that do not have statewide court systems. Prior to last year, we did not consider the California courts market to provide an opportunity for us. For the past decade, California's central court administration had been developing a custom statewide case management system to replace existing systems in courts in the state's 58 counties. In the spring of 2012, the project was abandoned due to lack of progress and budget overruns. As a result, trial courts across the state will need to replace aging systems on their own — and many of the existing systems are well past normal replacement cycles, as the courts have effectively been on hold for several years in anticipation of the state-developed system.

2012 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

Big opportunities in Texas

With the selection of Tyler's e-filing solution in 2012, the Texas Office of Court Administration (OCA) will implement a new unified electronic filing system for courts throughout Texas called TexFile. Since that agreement was signed, the Supreme Court of Texas has ordered mandatory e-filing in civil courts beginning in 2014 and phasing in over two years — which could generate $15 million to $20 million in recurring annual revenues for Tyler.

The first California county to make a decision was San Luis Obispo County, which went through an accelerated purchasing process and selected Tyler's Odyssey software late in 2012. That was followed by our selection in Kings County, California, early in 2013. In addition, Tyler was one of three vendors selected to enter into Master Service Agreements, which will allow courts in the state to purchase Odyssey without going through a full RFP process.

Tyler is very well positioned to compete for court case management systems in California, with industry-leading technology and an unparalleled record of successfully implementing solutions in large and small courts across the nation. We believe the California courts market represents a meaningful opportunity over the next several years, and we are dedicating significant resources to pursuing that business.

There seems to be a trend toward greater adoption of electronic filing in courts. What is driving that, and how is Tyler participating?

Courts across the country have a growing interest in implementing e-filing. Increasingly, they're recognizing that e-filing creates significant efficiencies, allowing courts to handle growing volumes of court-related documents with fewer resources. Our Odyssey File & Serve e-filing engine allows lawyers and other parties to file court documents electronically, rather than filing paper documents at the courthouse. For clients who use our Odyssey court case management solution, those documents then flow through the system electronically, saving time and money by allowing authorized parties to share critical information instantly, eliminating the need to physically print, deliver and store paper documents, and freeing up courthouse clerks.

We entered the e-filing market through the 2010 acquisition of our then-partner Wiznet (now Odyssey File & Serve). Since then, several of Tyler's existing courts clients have expanded their systems to include e-filing, and we're also attracting new clients who need a reliable, affordable way to provide this service.

PUBLIC SAFETY

Tyler Public Safety introduced the company's first iPad app to provide first responders with real-time information and interactive tools on the scene. Features include real-time mapping, silent messaging and live chatting, native dictation technology for hands-free operation, and a native camera for multimedia evidence collection. The Tyler Public Safety app is already in use in Bartow, Florida — the first beta client for the product. Significant contracts in 2012 included Gulfport, Mississippi, and Converse, Texas.

skilled teamwork

Clients who partner with Tyler Technologies not only enjoy continuous product enhancements and perpetual upgrades — they also benefit from the firsthand public sector experience that many of our employees bring to the company. Our deep-rooted industry experience helps us effectively anticipate and address client needs to deliver on our promise — empowering people who serve the public.

How are courts funding their e-filing initiatives, and what is Tyler's business model for these solutions?

Courts recognize the value of efficiencies gained by implementing e-filing and eliminating paper from the system. However, many of them struggle to fund new projects in light of ongoing budget pressures. Tyler addresses that need through our transaction-based revenue model. Under most of our new e-filing agreements, Tyler does not sell a traditional software license and collect a maintenance fee, but instead implements the solution with no up-front or ongoing out-of-pocket costs to the court. Tyler then derives recurring revenues from fees paid by the parties filing documents. In some cases we receive the entire filing fee, and in other cases it's shared with the courts. The key requirement for courts to realize the efficiencies promised is the implementation of mandatory e-filing, a trend begun by Clark County (Las Vegas), Nevada, Tyler's first client to mandate e-filing countywide in January 2010. This step, for most jurisdictions, requires a fairly lengthy lead time.

How large is Tyler's current e-filing business, and what is the opportunity for growth, especially in Texas?

Tyler currently generates transaction-based e-filing revenues from several clients, including Clark County, Nevada, the state of New Mexico and the state of Minnesota. Additional clients have implemented e-filing but have not yet fully mandated it. Newly contracted statewide clients typically include transaction-based e-filing, and implement mandatory e-filing in tandem with their implementation of the Odyssey case management system. For example, in 2012 we signed a contract to add transaction-based e-filing for the state of Oregon, which is implementing Odyssey in courts statewide.

In the fourth quarter of 2012, we also signed an agreement with the Texas Office of Court Administration (OCA) to provide a unified, statewide electronic filing system for courts. While Texas does not have a statewide court case management system, it does have one e-filing system for all of the state's courts. However, e-filing is not yet mandatory in any of the state's courts, and current adoption is low. Our solution, known as TexFile, will replace the state's current system and will reduce costs for filers while providing a robust platform for the expansion of electronic filing in Texas, thereby creating efficiencies for court clerks, staff, lawyers and litigants. The Supreme Court of Texas has since ordered mandatory electronic filing in civil courts beginning in 2014 and phasing in over two years. As a result of that change, we expect that the Texas e-filing agreement could generate from $15 million to $20 million in recurring annual revenues as it becomes mandatory.

How do transaction-based revenues impact Tyler's financials?

We exited 2012 with annualized transaction-based e-filing revenues of about $7.3 million — up nearly 70 percent from the end of 2011. Since then, we've reached agreements with additional

STUDENT MANAGEMENT

We announced the general availability of two new solutions in our suite of products for schools in 2012 — Tyler Incident Management, a Web-based solution that enables the tracking of bullying, school bus accidents, vandalism and more; and Versatrans Pay to Ride, a payment management tool for school districts that must assess ridership fees. Contract highlights included an agreement with the Socorro ISD in El Paso, Texas, that includes our Munis, Tyler SIS, Tyler Pulse and Tyler Content Manager solutions.

clients and continue to negotiate with others. The TexFile agreement will significantly increase those revenues as Texas courts implement mandatory e-filing beginning in 2014. In addition, Tyler receives transaction-based revenues from transaction fees or convenience charges associated with the online utility bill and traffic ticket payments we manage for our clients. Those annualized revenues from online payments total approximately $5 million. Both e-filing and online payment revenues are included in "Subscriptions" on our income statement.

We expect that transaction-based revenues from e-filing and online payments will continue to be one of our fastest-growing revenue sources over the next few years. We may incur significant implementation costs for new clients in advance of the revenues. For example, we expect to expense approximately $3 million of costs in 2013 associated with the TexFile start-up, prior to receiving any revenues. However, as e-filing contracts mature and volumes increase, we believe they will generate incremental margins well above our current margins.

SCHOOL FINANCIAL

We went live with Munis implementations for the Guam Department of Education and the Burlington School District of Vermont. Contract highlights included a Munis contract with Georgia's Cobb County School District; Munis contracts with Virginia's Alexandria City Public Schools and California's West Contra Costa Unified School District; and Infinite Visions ERP school solutions for California's Palmdale School District, the St. Vrain Valley School District in Colorado, and Iowa's Dubuque Community School District.

Can you provide an update on Microsoft Dynamics AX 2012 — the product you developed in collaboration with Microsoft?

We codeveloped this Microsoft-branded ERP solution, adding public sector functionality to the core Microsoft product. It was initially released by Microsoft in late 2011 and is sold in the public sector market by both our Tyler direct sales force and a wide range of other Microsoft channel partners. Since the sales cycle for this and other public sector products is typically long, many of the early sales processes have not yet reached a decision point. Our launch client, the city of Redmond, Washington, has been live on Dynamics AX 2012 since mid-2011 and is a strong reference. We added four new Dynamics AX 2012 clients through our direct channel in 2012, including two clients that went live on the new system in early 2013 — Nevada's Truckee Meadows Water Authority, whose agreement also included Eden human capital management and payroll applications, and the Global Alliance for TB Drug Development, which signed on as a subscription client. Other clients included Walker County, Texas, and the Maricopa Association of Governments in Arizona.

Tyler also receives royalties on both license and maintenance revenues generated by all sales of Dynamics AX 2012 in the public sector worldwide. We earned $756,000 in royalties in 2012 from sales in the public sector by other Microsoft partners. Most of these sales were in markets where Tyler doesn't do business, including international markets. Our 2012 royalties were generated from Microsoft partner channel deals with 46 clients in approximately 26 countries. While we are still early in the cycle for this product, we are encouraged by these successes, and by Microsoft's strong commitment to capturing a meaningful share of the worldwide public sector ERP market. We expect to continue to see revenues grow and contribute to offset our costs related to the product, but those revenues will not likely be meaningful before 2014.

The preceding Q&A is a composite representation of the views of Tyler Technologies' management regarding company performance and market perspectives. For further information, visit tylertech.com or contact our investor relations team at info@tylertech.com.

2012 financial information

tyler technologies

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Stock Market Data

Our common stock is traded on the New York Stock Exchange under the symbol "TYL." At December 31, 2012, we had approximately 1,861 stockholders of record. A number of our stockholders hold their shares in street name; therefore, there are substantially more than 1,861 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
2011:	First Quarter	$ 23.77	$ 19.99
	Second Quarter	27.14	23.09
	Third Quarter	27.56	22.15
	Fourth Quarter	32.94	24.00
2012:	First Quarter	$ 39.43	$ 29.67
	Second Quarter	41.61	36.00
	Third Quarter	44.41	36.99
	Fourth Quarter	49.60	41.95

We did not pay any cash dividends in 2012 or 2011. 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.

As of December 31, 2012, we had authorization to repurchase up to 1.7 million additional shares of Tyler common stock. There was no repurchase activity during the twelve months ended December 31, 2012. The repurchase program, which was approved by our board of directors, was announced in October 2002, and was amended in April 2003, July 2003, October 2004, October 2005, May 2007, May 2008, October 2008, May 2009, July 2010, October 2010 and September 2011. 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

	For the Years Ended December 31,				
(In thousands, except per share data)	2012	2011	2010	2009	2008
STATEMENT OF OPERATIONS DATA:					
Revenues	$363,304	$309,391	$288,628	$290,286	$265,101
Costs and expenses:					
Cost of revenues	195,602	167,479	160,311	161,523	155,314
Selling, general and administrative expenses	86,706	75,650	69,480	70,115	62,923
Research and development expense	20,140	16,414	13,971	11,159	7,286
Amortization of customer and trade name intangibles	4,279	3,331	3,225	2,705	2,438
Non-cash legal settlement related to warrants [1]	—	—	—	—	9,045
Operating income	56,577	46,517	41,641	44,784	28,095
Other (expense) income, net	(2,709)	(2,404)	(1,742)	(146)	1,181
Income from operations before income taxes	53,868	44,113	39,899	44,638	29,276
Income tax provision	20,874	16,556	14,845	17,628	14,414
Net income	$ 32,994	$ 27,557	$ 25,054	$ 27,010	$ 14,862
Net income per diluted share	$ 1.00	$ 0.83	$ 0.71	$ 0.74	$ 0.38
Weighted average diluted shares	32,916	33,154	35,528	36,624	39,184
STATEMENT OF CASH FLOWS DATA:					
Cash flows provided by operating activities	$ 58,668	$ 56,435	$ 35,350	$ 42,941	$ 47,802
Cash flows used by investing activities	(34,736)	(28,809)	(8,694)	(13,658)	(9,554)
Cash flows used by financing activities	(18,852)	(28,414)	(34,238)	(21,349)	(46,128)
BALANCE SHEET DATA:					
Total assets	$338,315	$295,391	$264,032	$270,670	$251,761
Revolving line of credit	18,000	60,700	26,500	—	—
Shareholders' equity	145,299	78,110	106,972	134,358	114,262

[1] 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.

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 opinion 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 other similar words or 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 governments. We develop and market a broad line of software products and services to address the information technology ("IT") needs of cities, counties, schools and other local government entities. In addition, we provide professional IT services to our customers, including software and hardware installation, data conversion, training and for certain customers, product modifications, along with continuing maintenance and support for customers using our systems. We also provide subscription-based services such as software as a service ("SaaS"), which utilizes the Tyler private cloud, and electronic document filing solutions ("e-filings"). In 2010 we began providing 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. We also provide property appraisal outsourcing services for taxing jurisdictions.

Our products generally automate three major functional areas: (1) financial management and education, (2) courts and justice and (3) property appraisal and tax and we report our results in two segments. The Enterprise Software Solutions ("ESS") segment provides municipal and county governments and schools with software systems 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 arrangements; software services; maintenance and appraisal services. Subscriptions and maintenance are considered recurring revenue sources and comprised approximately 60% of our revenue in 2012. The number of new SaaS customers and the number of existing customers who convert from our traditional software arrangements to our SaaS model 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 2012, 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, 2012, our total employee count increased to 2,388 from 2,091 at December 31, 2011. This increase includes 169 employees added as a result of acquisitions completed in 2012.
- 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. During 2012 we invested $9.1 million in property and equipment and paid $25.7 million in cash for four small acquisitions. Our investment in property and equipment included $4.3 million in cash in connection with the construction of an office building in Plano, Texas, and purchase of land and a building in Moraine, Ohio. Our working capital needs are fairly stable throughout the year with the significant components of cash outflows being payment of personnel expenses offset by cash inflows representing collection of accounts receivable and cash receipts from customers in advance of revenue being earned.
- Balance Sheet – Cash, accounts receivable and days sales outstanding and deferred revenue balances are important indicators of our business.

Acquisitions

In November 2012, we acquired all of the capital stock of EnerGov Solutions, L.L.C. ("EnerGov") which develops and sells enterprise permitting, land management, licensing and regulatory software solutions to governmental agencies. The purchase price, net of cash acquired of $15,000 was $10.5 million in cash and 60,000 shares of Tyler common stock valued at $2.8 million.

In April 2012, we acquired all of the capital stock of Computer Software Associates, Inc. ("CSA") for a cash purchase price of $9.4 million, net of cash acquired of $437,000. CSA is a reseller of Tyler's Infinite Visions school enterprise solution, and sells proprietary CSA tax and recording solutions to county governments, primarily in the Northwest.

In March 2012, we acquired all the capital stock of UniFund, L.L.C. ("UniFund") for a cash purchase price of $4.6 million, net of cash acquired of $780,000. UniFund provides enterprise resource planning solutions to schools and local governments, primarily in the Northeast. UniFund is also a reseller of Tyler's Infinite Visions school enterprise solution.

In January 2012, we acquired substantially all of the assets of Akanda Innovation, Inc. ("Akanda"), 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.

The operating results of these acquisitions are included in our results of operations since their dates of acquisition. The operating results of EnerGov, CSA and UniFund are included in the operating profit results of the ESS segment and the operating results of Akanda are included in the operating results of the ATSS segment.

Outlook

We expect the trend of gradual improvements in the marketplace to continue in 2013. We plan to make significant investments in our business that we believe will enhance our market leadership and improve long-term revenue and margin growth. These investments include expenses associated with new e-filing contracts as well as accelerated hiring to ensure that we are well positioned to deliver our current backlog and anticipated new business.

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 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 SaaS 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 SaaS 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 SaaS 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. We review 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. 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.

When testing goodwill for impairment quantitatively, we first compare the fair value of each reporting unit with its carrying amount. If the carrying amount of a reporting unit exceeds its fair value, a second step is performed to measure the amount of potential impairment. In the second step, we compare the implied fair value of reporting unit goodwill with the carrying amount of the reporting unit's goodwill. If the carrying amount of reporting unit goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized. The fair values calculated in our impairment tests are determined using discounted cash flow models involving several assumptions. The assumptions that are used are based upon what we believe a hypothetical marketplace participant would use in estimating fair value. We base our fair value estimates on assumptions we believe to be reasonable but that are unpredictable and inherently uncertain. 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.

In the first quarter of 2012, ASU 2011-08, "Testing Goodwill for Impairment" became effective. ASU 2011-08 allows entities testing goodwill for impairment the option of performing a qualitative assessment before calculating the fair value of a reporting unit (i.e., the first step of the goodwill impairment test). If entities determine, on the basis of qualitative factors, that the fair value of the reporting unit is more likely than not greater than the carrying amount, a quantitative calculation would not be needed.

Our annual goodwill impairment analysis, which we performed quantitatively during the second quarter of 2012, did not result in an impairment charge. During 2012 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, 2012, 2011 and 2010.

	Percentage of Total Revenues		
Years ended December 31,	2012	2011	2010
Revenue:			
Software licenses	9.1%	10.5%	12.1%
Subscriptions	12.3	10.1	8.1
Software services	23.0	22.5	23.7
Maintenance	47.3	47.4	47.0
Appraisal services	6.2	7.5	7.1
Hardware and other	2.1	2.0	2.0
Total revenue	100.0	100.0	100.0
Operating Expenses:			
Cost of software licenses and acquired software	1.1	1.3	1.8
Cost of software services, maintenance and subscriptions	47.2	46.5	47.8
Cost of appraisal services	4.1	4.7	4.5
Cost of hardware and other	1.4	1.6	1.5
Selling, general and administrative expenses	23.9	24.5	24.1
Research and development expense	5.5	5.3	4.8
Amortization of customer base and trade name intangibles	1.2	1.1	1.1
Operating income	15.6	15.0	14.4
Other expense	0.8	0.7	0.6
Income before income taxes	14.8	14.3	13.8
Income tax provision	5.7	5.4	5.1
Net income	9.1%	8.9%	8.7%

2012 Compared to 2011

Revenues

Software licenses.

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

			Change	
($ in thousands)	2012	2011	$	%
ESS	$31,304	$30,194	$1,110	4%
ATSS	1,868	2,400	(532)	(22)
Total software license revenue	$33,172	$32,594	$ 578	2%

Excluding the impact of acquisitions, total software license revenue declined by 6% compared to 2011. Most of the decline was due to fewer add-on sales to our existing customer base. In addition, software license growth was reduced somewhat because of 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 no 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 76 new customers that entered into subscription-based arrangements in 2012 compared to 47 new customers in 2011. We expect software license revenues in 2013 to be higher than 2012 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:

			Change	
($ in thousands)	2012	2011	$	%
ESS	$43,319	$30,400	$12,919	42%
ATSS	1,299	760	539	71
Total subscriptions revenue	$44,618	$31,160	$13,458	43%

Subscription-based services revenue primarily consists of revenues derived from our SaaS arrangements, which utilize the Tyler private cloud. As part of our subscription-based services, we also provide e-filings that simplify the filing and management of court related documents for courts and law offices. Revenues for e-filings are generally derived from transaction fees. The contract term for SaaS arrangements range from one to 10 years but are typically for a period of three to six years.

Excluding the impact of acquisitions, subscription-based services revenue increased 40% compared to 2011. New SaaS customers as well as existing customers who converted to our SaaS model provided the majority of the subscription-based revenue increase. In 2012, we added 76 new customers and 68 existing customers elected to convert to our SaaS model. E-filing services also contributed approximately $2.3 million of the subscription revenue increase as a result of new clients implementing e-filing and several existing clients adopting or expanding mandatory e-filing for court documents in the last half of 2011 and 2012.

Software services.

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

			Change	
($ in thousands)	2012	2011	$	%
ESS	$76,103	$60,840	$15,263	25%
ATSS	7,305	8,777	(1,472)	(17)
Total software services revenue	$83,408	$69,617	$13,791	20%

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 acquisitions, software services increased 14% compared to 2011. The increase is due partly to contract arrangements that included more programming services as well as several state-wide arrangements that in addition to services, include more third party vendor services to build certain software interfaces.

Maintenance.

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

			Change	
($ in thousands)	2012	2011	$	%
ESS	$155,290	$130,999	$24,291	19%
ATSS	16,561	15,499	1,062	7
Total maintenance revenue	$171,851	$146,498	$25,353	17%

We provide maintenance and support services for our software products and certain third party software. Excluding the impact of acquisitions, maintenance revenue grew 9% from 2011. This increase was due to growth in our installed customer base and maintenance rate increases on most of our product lines, offset slightly by customers converting to our SaaS model.

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

Appraisal services.

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

($ in thousands)	2012	2011	Change $	Change %
ESS	$ —	$ —	$ —	—%
ATSS	22,543	23,228	(685)	(3)
Total appraisal services revenue	$22,543	$23,228	$ (685)	(3)%

Appraisal services revenue declined 3% in 2012 compared to 2011. The appraisal services business is somewhat cyclical and driven in part by statutory revaluation cycles in various states. The decline is mainly due to the completion of a large contract in Pennsylvania offset slightly by the start-up of smaller projects in 2012, including several in Ohio. We expect appraisal revenues for 2013 will increase slightly compared to 2012.

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)	2012	2011	Change $	Change %
Software licenses	$ 1,983	$ 3,034	$ (1,051)	(35)%
Acquired software	1,888	1,125	763	68
Software services, maintenance and subscriptions	171,584	143,776	27,808	19
Appraisal services	14,889	14,550	339	2
Hardware and other	5,258	4,994	264	5
Total cost of revenues	$195,602	$167,479	$28,123	17%

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

Gross margin percentage	2012	2011	Change
Software license and acquired software	88.3%	87.2%	1.1%
Software services, maintenance and subscriptions	42.8	41.9	0.9
Appraisal services	34.0	37.4	(3.4)
Hardware and other	31.8	20.7	11.1
Overall gross margin	46.2%	45.9%	0.3%

Software license and acquired software. Costs of software license and acquired software are primarily comprised of third party software costs and amortization expense for software acquired through acquisitions. In 2012 our software license gross margin percentage increased compared to 2011 because our product mix included less third party software which offset higher amortization expense associated with acquisitions.

Software services, maintenance and subscription-based services. Cost of software services, maintenance and subscription-based services 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 SaaS arrangements and e-filings. Maintenance and various other services such as SaaS 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 2012, 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 147 employees added with acquisitions, our implementation and support staff has increased by 103 employees since 2011. Most of these additions occurred mid- to late 2012. We expect to increase development efforts in 2013 for geographic expansion efforts, primarily in California and in our e-filing solutions infrastructure in order to pursue more opportunities with both existing and new clients.

In late 2012 we signed a contract with the Texas Office of Court Administration for our Odyssey File and Serve e-filing offering for TexFile, a unified, statewide electronic filing system for courts. Subsequently, the state of Texas issued an order mandating e-filing in civil cases beginning in January 2014. Mandatory e-filing will be phased in over a two and a half year period, beginning with the largest counties in January 2014. We will be paid on a per-filing basis but expect very limited revenues from TexFile e-filings in 2013. However, during 2013 we will invest significant amounts in the range of $3.0 million, to prepare to implement the system with courts across the state. With the recent order mandating e-filing in Texas, we expect that this contract will provide a long-term recurring revenue stream of $15.0 million to $20.0 million when it becomes fully mandatory.

Appraisal services. Appraisal services revenues are approximately 6% of total revenues. The appraisal services gross margin declined compared to 2011. 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. The appraisal services gross margin in 2011 was also favorably impacted by operational efficiencies associated with a large revaluation contract which began in mid-2010 and was substantially complete by mid-2011.

Our blended gross margin for 2012 increased 0.3% from 2011 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 third party software costs.

Selling, General and Administrative Expenses

Selling, general and administrative ("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:

			Change	
($ in thousands)	2012	2011	$	%
Selling, general and administrative expenses	$86,706	$75,650	$11,056	15%

Excluding the impact of acquisitions, SG&A increased approximately 11% compared to 2011. SG&A as a percentage of revenues was 23.9% in 2012 compared to 24.5% in 2011. SG&A expenses increased due to higher commission expense in connection with increased sales; increased headcount in sales and related expenses to support geographic expansion; and increased incentive compensation costs due to improved results and higher stock compensation expense because our company stock price has increased substantially over the last few years.

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:

			Change	
($ in thousands)	2012	2011	$	%
Research and development expense	$20,140	$16,414	$3,726	23%

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 next version of Microsoft Dynamics AX project, as well as other new product development efforts. In 2007, we entered into a Software

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

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. This agreement and subsequent amendments granted Microsoft intellectual property rights in 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 and royalties on direct and indirect public-sector sales worldwide of the solutions co-developed under this arrangement. 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 public-sector sales worldwide of the solutions co-developed under this arrangement.

Our research and development expense increased $3.7 million in 2012 compared to 2011. The increase is mainly due to lower reimbursements from Microsoft in 2012. In 2012 we had $1.0 million in research and development expense offsets compared to $3.5 million in 2011, which were the amounts earned under the terms of our agreement with Microsoft. Under our amended agreement with Microsoft, the project included offsets to research and development expense, varying in amount from quarter to quarter from 2009 through 2012 for a total of approximately $6.2 million. As of September 30, 2012, we received the final $1.0 million under the agreement.

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:

			Change	
($ in thousands)	2012	2011	$	%
Amortization of customer and trade name intangibles	$4,279	$3,331	$948	28%

In 2012, we completed several acquisitions that increased amortizable customer and trade name intangibles by approximately $11.1 million. This amount is being amortized over a weighted average period of 11.8 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):

2013	$4,491
2014	4,490
2015	4,490
2016	4,490
2017	4,490

Other

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

			Change	
($ in thousands)	2012	2011	$	%
Other expense, net	$2,709	$2,404	$305	13%

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 2012 than 2011 due to higher debt levels associated with several acquisitions completed since October 2011 and stock repurchases in the last half of 2011. The effective interest rate in 2012 was 3.4% compared to 3.3% in 2011.

Income Tax Provision

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

($ in thousands)	2012	2011	Change $	Change %
Income tax provision	$20,874	$16,556	$4,318	26%
Effective income tax rate	38.8%	37.5%		

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, disqualifying incentive stock option ("ISOs") dispositions and non-deductible meals and entertainment costs. The effective income tax rate in 2011 was also reduced by a research and development tax credit. The qualified manufacturing activities deduction declined in 2012 contributing to a higher effective tax rate.

Approximately 35% of our stock option expense is related to 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.

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 $	Change %
ESS	$30,194	$32,757	$(2,563)	(8)%
ATSS	2,400	2,156	244	11
Total software license revenue	$32,594	$34,913	$(2,319)	(7)%

In October 2011, we acquired Windsor Management Group L.L.C. ("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% 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.

Subscriptions.

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

($ in thousands)	2011	2010	Change $	Change %
ESS	$30,400	$22,975	$7,425	32%
ATSS	760	323	437	135
Total subscriptions revenue	$31,160	$23,298	$7,862	34%

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

New customers for SaaS arrangements as well as existing customers who converted to our SaaS model provided the majority of the subscription revenue increase. In 2011, we added 47 new customers and 40 existing customers elected to convert to our SaaS model. 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 service revenues for the years ended December 31:

			Change	
($ in thousands)	2011	2010	$	%
ESS	$60,840	$58,371	$ 2,469	4%
ATSS	8,777	9,969	(1,192)	(12)
Total software services revenue	$69,617	$68,340	$ 1,277	2%

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.

Maintenance.

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

			Change	
($ in thousands)	2011	2010	$	%
ESS	$130,999	$120,764	$10,235	8%
ATSS	15,499	14,891	608	4
Total maintenance revenue	$146,498	$135,655	$10,843	8%

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 SaaS model, 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:

			Change	
($ in thousands)	2011	2010	$	%
ESS	$ —	$ —	$ —	—%
ATSS	23,228	20,554	2,674	13
Total appraisal services revenue	$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.

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)	2011	2010	Change $	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%

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 in 2011 was comprised of third party software license with the remaining balance primarily related to amortization expense related to acquired software. In 2010, cost of software license and acquired software also included amortization expense associated with capitalized software development. In early 2011 most of our capitalized software development costs became fully amortized. We did not capitalize any internal software development costs in 2011 or 2010. Cost of software license and acquired software also declined due to several acquired software solutions that became fully amortized in early 2011.

In 2011, our software license gross margin percentage increased compared to the prior year period because several acquired software solutions and substantially all of our capitalized software development became fully amortized by 2011.

Software services, maintenance and subscription-based services. 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.

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.

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

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

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

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

($ in thousands)	2011	2010	Change $	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 costs associated with the Microsoft Dynamics AX project, as well as other new product development efforts. In 2011 and 2010, we offset our research and development expense by $3.5 million and $5.1 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)	2011	2010	Change $	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.

Other

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

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

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.

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 $	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.

FINANCIAL CONDITION AND LIQUIDITY

As of December 31, 2012, we had cash and cash equivalents of $6.4 million and investments available-for-sale of $2.0 million, compared to cash and cash equivalents of $1.3 million and investments available-for-sale of $2.0 million at December 31, 2011. As of December 31, 2012, we had $18.0 million in outstanding borrowings and outstanding letters of credit totaling $5.9 million. Some of our customers, primarily those for our property appraisal services, require that we secure performance bonds in connection with our contracts. 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, 2012 was estimated to be $35.1 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 in 2013. 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)	2012	2011	2010
Cash flows provided (used) by:			
Operating activities	$ 58,668	$ 56,435	$ 35,350
Investing activities	(34,736)	(28,809)	(8,694)
Financing activities	(18,852)	(28,414)	(34,238)
Net increase (decrease) in cash and cash equivalents	$ 5,080	$ (788)	$ (7,582)

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 or 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 2012, operating activities provided net cash of $58.7 million, primarily generated from net income of $33.0 million, non-cash depreciation and amortization charges of $12.7 million and non-cash share-based compensation expense of $7.4 million. Working capital, excluding cash, declined $13.6 million mainly due to higher deferred revenue balances than 2011 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. The increase in deferred revenues was offset somewhat by higher accounts receivable balances from annual software maintenance billings.

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, 2012, our days sales outstanding ("DSOs") were 95 days compared to DSOs of 99 days at December 31, 2011. 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.

Investments available-for-sale consist of two auction rate municipal securities ("ARS") which are collateralized debt obligations supported by municipal agencies and do not include mortgage-backed securities. These ARS are debt instruments with stated maturities of 19 to 29 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 July 2012. As of December 31, 2012 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

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

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 gain on our non-current ARS of $87,000, net of related tax effects of $47,000 in 2012, 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 July 2012. Based on our cash and cash equivalents balance, 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 $34.7 million in 2012 compared to $28.8 million in 2011. In 2012, we completed the acquisitions of Akanda, UniFund, CSA and EnerGov. The combined cash purchase prices paid in 2012, net of cash acquired was approximately $25.7 million. In May 2012 we purchased land and a building in Moraine, Ohio, to support our appraisal and tax operations for a purchase price of $2.6 million, which was comprised of $1.7 million in cash and land and a building valued at $900,000. We also paid $2.3 million in 2012 in connection with the construction of an office building in Plano, Texas. These expenditures were funded from cash generated from operations and borrowings under our revolving credit line.

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.

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 in connection with the 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.

Cash used in financing activities in 2012 was mainly comprised of $42.7 million in payments on our revolving line of credit offset by collections of $15.1 million from stock option exercises and contributions from the employee stock purchase plan.

In 2011, 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.

The share repurchase program, which was approved by our board of directors, was announced in October 2002, and was amended in April 2003, 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, 2012, 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.

In 2012 we issued 1.2 million shares of common stock and received $12.4 million in aggregate proceeds upon exercise of stock options. In 2011 we received $3.6 million from the exercise of options to purchase approximately 582,000 shares of our common stock under our employee stock option plan and during 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. In 2012, 2011 and 2010 we received $2.6 million, $2.0 million and $1.9 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 2012 and 2011 our effective average interest rate for borrowings was 3.4% and 3.3%, respectively. As of December 31, 2012 our interest rate was 2.7%. 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, 2012, we were in compliance with those covenants.

As of December 31, 2012, we had $18.0 million in outstanding borrowings and unused available borrowing capacity of $126.1 million under the Credit Facility. In addition, as of December 31, 2012, our bank had issued outstanding letters of credit totaling $5.9 million to secure surety bonds required by some of our customer contracts. These letters of credit reduce our available borrowing capacity and expire in 2013.

We paid income taxes, net of refunds received, of $13.1 million in 2012, $13.4 million in 2011, and $15.8 million in 2010.

Excluding acquisitions and investments in office buildings, we anticipate that 2013 capital spending will be between $8.2 million and $9.2 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 2013, 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 $14.8 million in 2013 in connection with the completion of construction of an office building in Plano, Texas. Capital spending, including the construction of an office facility, is expected to be funded from existing cash balances and cash flows from operations.

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

We lease office facilities, as well as transportation, computer and other equipment used in our operations under non-cancelable operating lease agreements expiring at various dates through 2021. 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, 2012 (in thousands):

	2013	2014	2015	2016	2017	Thereafter	Total
Revolving line of credit	$ —	$18,000	$ —	$ —	$ —	$ —	$18,000
Lease obligations	6,278	4,519	3,949	3,682	3,223	3,482	25,133
Total future payment obligations	$6,278	$22,519	$3,949	$3,682	$3,223	$3,482	$43,133

As of December 31, 2012, 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, 2012, our capitalization consisted of $18.0 million in long-term obligations and $145.3 million of shareholders' equity. Our total debt-to-capital ratio was 11.0% at December 31, 2012.

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, 2012 we had $18.0 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 2012 and 2011 our effective average interest rate for borrowings was 3.4% and 3.3%, respectively. As of December 31, 2012 our interest rate was 2.7%. Assuming borrowings of $18.0 million, a hypothetical 10% increase in our interest rate at December 31, 2012 for a one year period would result in approximately $49,000 of additional interest rate expense.

Investments available-for-sale consist of two ARS with stated maturities of 19 to 29 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, 2012, utilizing a discounted trinomial model.

In association with this estimate of fair value, we have recorded an after-tax temporary unrealized gain on our non-current ARS of $87,000, net of related tax effects of $47,000 in 2012, 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 July 2012. Based on our cash and cash equivalents balance, 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.

CONTROLS AND PROCEDURES

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, 2012. 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, 2012.

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, 2012. 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, 2012, Tyler's internal control over financial reporting was effective based on those criteria.

Tyler's internal control over financial reporting as of December 31, 2012 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, 2012, 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

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, 2012, 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.

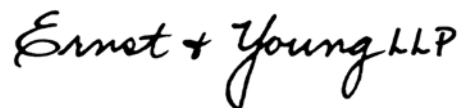
We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material 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, 2012, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Tyler Technologies, Inc. as of December 31, 2012 and 2011, and the related consolidated statements of comprehensive income, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2012 and our report dated February 20, 2013 expressed an unqualified opinion thereon.



Dallas, Texas
February 20, 2013

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

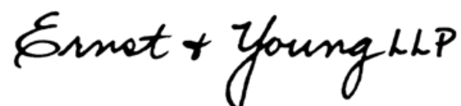
The Board of Directors and Shareholders
Tyler Technologies, Inc.

We have audited the accompanying consolidated balance sheets of Tyler Technologies, Inc. as of December 31, 2012 and 2011, and the related consolidated statements of comprehensive income, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2012. 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, 2012 and 2011, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2012, 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, 2012, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 20, 2013 expressed an unqualified opinion thereon.



Dallas, Texas
February 20, 2013

Consolidated Statements of Comprehensive Income

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

For the years ended December 31,	2012	2011	2010
In thousands, except per share amounts			
Revenues:			
Software licenses	$ 33,172	$ 32,594	$ 34,913
Subscriptions	44,618	31,160	23,298
Software services	83,408	69,617	68,340
Maintenance	171,851	146,498	135,655
Appraisal services	22,543	23,228	20,554
Hardware and other	7,712	6,294	5,868
Total revenues	363,304	309,391	288,628
Cost of revenues:			
Software licenses	1,983	3,034	3,456
Acquired software	1,888	1,125	1,592
Software services, maintenance and subscriptions	171,584	143,776	138,085
Appraisal services	14,889	14,550	12,910
Hardware and other	5,258	4,994	4,268
Total cost of revenues	195,602	167,479	160,311
Gross profit	167,702	141,912	128,317
Selling, general and administrative expenses	86,706	75,650	69,480
Research and development expense	20,140	16,414	13,971
Amortization of customer and trade name intangibles	4,279	3,331	3,225
Operating income	56,577	46,517	41,641
Other expense, net	2,709	2,404	1,742
Income before income taxes	53,868	44,113	39,899
Income tax provision	20,874	16,556	14,845
Net income	$ 32,994	$ 27,557	$ 25,054
Earnings per common share:			
Basic	$ 1.09	$ 0.88	$ 0.74
Diluted	$ 1.00	$ 0.83	$ 0.71
Unrealized gains (losses) on investment securities available-for-sale	$ 134	$ (123)	$ 200
Income tax expense (benefit) related to components of other comprehensive income (loss)	47	(43)	70
Other comprehensive income (loss), net of tax	$ 87	$ (80)	$ 130
Comprehensive income	$ 33,081	$ 27,477	$ 25,184

See accompanying notes.

CONSOLIDATED BALANCE SHEETS

December 31,	2012	2011
In thousands, except share and per share amounts		
ASSETS		
Current assets:		
Cash and cash equivalents	$ 6,406	$ 1,326
Short-term investments available-for-sale	—	25
Accounts receivable (less allowance for losses of $1,621 in 2012 and $990 in 2011)	100,327	90,012
Prepaid expenses	9,000	8,348
Other current assets	1,480	2,286
Deferred income taxes	5,544	5,095
Total current assets	122,757	107,092
Accounts receivable, long-term portion	1,187	2,095
Property and equipment, net	45,381	40,915
Non-current investments available-for-sale	2,037	1,953
Other assets:		
Goodwill	119,956	106,094
Other intangibles, net	45,800	35,628
Sundry	1,197	1,614
	$338,315	$295,391
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 3,167	$ 3,211
Accrued liabilities	26,078	24,751
Deferred revenue	140,550	123,678
Total current liabilities	169,795	151,640
Revolving line of credit	18,000	60,700
Deferred income taxes	5,221	4,941
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 2012 and 2011	481	481
Additional paid-in capital	154,018	152,859
Accumulated other comprehensive loss, net of tax	(268)	(355)
Retained earnings	163,109	130,115
Treasury stock, at cost; 16,816,903 and 18,176,050 shares in 2012 and 2011, respectively	(172,041)	(204,990)
Total shareholders' equity	145,299	78,110
	$338,315	$295,391

See accompanying notes.

Consolidated Statements of Shareholders' Equity

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

For the years ended December 31, 2012, 2011 and 2010

	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, 2009	48,148	$481	$153,734	$(405)	$ 77,504	(13,028)	$ (96,956)	$134,358
Net income	—	—	—	—	25,054	—	—	25,054
Unrealized gain on investment securities, net of tax	—	—	—	130	—	—	—	130
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
Net income	—	—	—	—	27,557	—	—	27,557
Unrealized loss on investment securities, net of tax	—	—	—	(80)	—	—	—	(80)
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
Net income	—	—	—	—	32,994	—	—	32,994
Unrealized gain on investment securities, net of tax	—	—	—	87	—	—	—	87
Issuance of shares pursuant to stock compensation plan	—	—	(17,018)	—	—	1,218	29,461	12,443
Stock compensation	—	—	7,411	—	—	—	—	7,411
Issuance of shares pursuant to Employee Stock Purchase Plan	—	—	639	—	—	81	2,002	2,641
Federal income tax benefit related to exercise of stock options	—	—	8,798	—	—	—	—	8,798
Issuance of shares for acquisition	—	—	1,329	—	—	60	1,486	2,815
Balance at December 31, 2012	48,148	$481	$154,018	$(268)	$163,109	(16,817)	$(172,041)	$145,299

See accompanying notes.

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the years ended December 31,	2012	2011	2010
In thousands			
Cash flows from operating activities:			
Net income	$ 32,994	$ 27,557	$ 25,054
Adjustments to reconcile net income to net cash provided by operations:			
Depreciation and amortization	12,711	10,676	10,788
Share-based compensation expense	7,411	6,253	6,132
Provision for losses – accounts receivable	961	805	1,161
Excess tax benefit from exercises of share-based arrangements	(8,764)	(3,590)	(2,000)
Deferred income tax benefit	(215)	(2,916)	(959)
Changes in operating assets and liabilities, exclusive of effects of acquired companies:			
Accounts receivable	(6,825)	(8,544)	(1,989)
Income tax payable	7,791	6,084	(34)
Prepaid expenses and other current assets	110	(214)	104
Accounts payable	(369)	575	(1,181)
Accrued liabilities	(530)	4,887	(5,200)
Deferred revenue	13,393	14,862	3,474
Net cash provided by operating activities	58,668	56,435	35,350
Cash flows from investing activities:			
Proceeds from sale of investments	75	50	75
Cost of acquisitions, net of cash acquired	(25,680)	(17,298)	(9,661)
Additions to property and equipment	(9,102)	(12,278)	(4,930)
Decrease in restricted investments	—	—	6,000
(Increase) decrease in other	(29)	717	(178)
Net cash used by investing activities	(34,736)	(28,809)	(8,694)
Cash flows from financing activities:			
(Decrease) increase in net borrowings on revolving line of credit	(42,700)	34,200	26,500
Purchase of treasury shares	—	(71,802)	(65,793)
Contributions from employee stock purchase plan	2,641	2,045	1,901
Proceeds from exercise of stock options	12,443	3,553	3,181
Debt issuance costs	—	—	(2,027)
Excess tax benefit from exercises of share-based arrangements	8,764	3,590	2,000
Net cash used by financing activities	(18,852)	(28,414)	(34,238)
Net increase (decrease) in cash and cash equivalents	5,080	(788)	(7,582)
Cash and cash equivalents at beginning of period	1,326	2,114	9,696
Cash and cash equivalents at end of period	$ 6,406	$ 1,326	$ 2,114

See accompanying notes.

Notes to Consolidated 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 governments. We develop and market a broad line of software solutions and services to address the information technology ("IT") needs of cities, counties, schools and other local government entities. In addition, we provide professional IT services, including software and hardware installation, data conversion, training, and for certain customers, product modifications, along with continuing maintenance and support for customers using our systems. We also provide subscription-based services such as software as a service ("SaaS") arrangements, which utilize the Tyler private cloud, and electronic document filing solutions ("e-filings"). We also provide property appraisal outsourcing services for taxing jurisdictions.

PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include our parent company and a subsidiary, which is wholly-owned as of December 31, 2012. All significant intercompany balances and transactions have been eliminated in consolidation.

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 cash on deposit with a bank and money market funds. Cash and cash equivalents are stated at cost, which approximates market value.

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 accumulated 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 Consolidated 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.

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 Consolidated 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 SaaS arrangements, which utilize the Tyler private cloud, and e-filings.

We recognize revenue for SaaS arrangements ratably over the period of the applicable agreement as services are provided. Contract terms for SaaS arrangements range from one to ten years but are typically contracted for periods of three to six years. The majority of our SaaS arrangements also include professional services and maintenance and support services, which are classified as subscription-based revenues. In certain SaaS arrangements, the customer also acquires a license to the software.

For SaaS 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 SaaS 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 SaaS arrangements that we determine do not have stand-alone value to the customer or are contingent on delivery of other elements (e.g. hosting), 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.

Electronic filing 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. 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, while 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 thus do not affect the statement of comprehensive income.

Costs of performing services under subscription-based arrangements are expensed as incurred, except for certain direct and incremental contract origination and set-up costs associated with SaaS arrangements. Such direct and incremental costs are capitalized and amortized ratably over the related SaaS hosting term.

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 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 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 such as commissions associated with arrangements for which revenue recognition has been deferred. 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 $20.1 million during 2012, $16.4 million during 2011 and $14.0 million during 2010.

We reduced our research and development expense by approximately $1.0 million in 2012, $3.5 million in 2011 and $5.1 million in 2010, which was the amount earned under the terms of our strategic alliance with a development partner.

INCOME TAXES

Income taxes are accounted for under the asset and liability method. Deferred taxes arise because of different treatment between financial statement accounting and tax accounting, known as “temporary differences.” We record the tax effect of these temporary differences as “deferred tax assets” (generally items that can be used as a tax deduction or credit in the future periods) and “deferred tax liabilities” (generally items that we received a tax deduction for, which have not yet been recorded in the income statement). The deferred tax assets and liabilities are measured

using enacted tax rules and laws that are expected to be in effect when the temporary differences are expected to be recovered or settled. A valuation allowance would be established to reduce deferred tax assets if it is 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 three 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

Goodwill represents the excess of the purchase price over the fair value of net assets acquired, including identifiable intangible assets, in connection with our business combinations. Upon acquisition, goodwill is assigned to the reporting unit that is expected to benefit from the synergies of the business combination, which is the reporting unit to which the related acquired technology is assigned. A reporting unit is the operating segment, or a business unit one level below that operating segment, for which discrete financial information is prepared and regularly reviewed by executive management. We assess goodwill for impairment annually as of April, or more frequently whenever events or changes in circumstances indicate its carrying value may not be recoverable.

When testing goodwill for impairment quantitatively, we first compare the fair value of each reporting unit with its carrying amount. If the carrying amount of a reporting unit exceeds its fair value, a second step is performed to measure the amount of potential impairment. In the second step, we compare the implied fair value of reporting unit goodwill with the carrying amount of the reporting unit's goodwill. If the carrying amount of reporting unit goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized. The fair values calculated in our impairment tests are determined using discounted cash flow models involving several assumptions. 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.

In the first quarter of 2012, ASU 2011-08, "Testing Goodwill for Impairment" became effective. ASU 2011-08 allows entities testing goodwill for impairment the option of performing a qualitative assessment before calculating the fair value of a reporting unit (i.e., the first step of the goodwill impairment test). If entities determine, on the basis of qualitative factors, that the fair value of the reporting unit is more likely than not greater than the carrying amount, a quantitative calculation would not be needed.

Our annual goodwill impairment analysis, which we performed quantitatively during the second quarter of 2012, 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 80% 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.

Notes to Consolidated Financial Statements

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 2012, 2011 or 2010. 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.

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, 2012 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, 2012, because our interest rates reset approximately every 30 days or less. See Note 7 — "Revolving Line of Credit" for further discussion.

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 operating account balances and money market fund investments which are maintained at one major financial institution and the balances often exceed insured amounts. As of December 31, 2012 we had cash and cash equivalents of $6.4 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, 2012.

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,	2012	2011	2010
Balance at beginning of year	$ 990	$ 1,603	$ 2,389
Provisions for losses – accounts receivable	961	805	1,161
Collection of accounts previously reserved	—	(142)	4
Deductions for accounts charged off or credits issued	(330)	(1,276)	(1,951)
Balance at end of year	$1,621	$ 990	$ 1,603

The termination clauses in most of our contracts provide for the payment for the 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 subsequently 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 $11.8 million and $7.2 million at December 31, 2012 and 2011, respectively. We also have recorded retention receivables of $1.3 million and $1.9 million at December 31, 2012 and 2011, 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 consolidated balance sheets.

INDEMNIFICATION

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

We have also agreed to indemnify our officers and board members if they are named or threatened to be named as a party to any proceeding by reason of the fact that they acted in such capacity. 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.

(2) ACQUISITIONS

2012

In November 2012, we acquired all of the capital stock of EnerGov Solutions, L.L.C. ("EnerGov") which develops and sells enterprise permitting, land management, licensing and regulatory software solutions to governmental agencies. The purchase price, net of cash acquired of $15,000 was $10.5 million in cash and 60,000 shares of Tyler common stock valued at $2.8 million, based on the stock price on the acquisition date. In connection with this transaction we acquired total tangible assets of approximately $2.9 million and assumed liabilities of approximately $2.1 million. We have recorded goodwill of approximately $7.2 million, all of which is expected to be deductible for tax purposes, and other intangible assets of approximately $5.2 million. The $5.2 million of intangible assets is attributable to customer relationships, acquired software and trade name that will be amortized over a weighted average period of approximately nine years. We believe this transaction will broaden our portfolio of citizen services software solutions and that likely market participants for this transaction would be software companies with a presence in the citizen services market. Therefore, the goodwill of $7.2 million arising from this acquisition is primarily attributed to our ability to integrate EnerGov software solutions with our existing portfolio and maximize the value of the customer base through Tyler's software product suite that targets the citizen services software market and to a much lesser extent, the assembled workforce of EnerGov. As of December 31, 2012, the purchase price allocation for EnerGov is not yet complete. The preliminary estimates of fair value assumed at the acquisition date are subject to change as valuations are finalized.

In April 2012, we acquired all of the capital stock of Computer Software Associates, Inc. ("CSA") for a cash purchase price of $9.4 million, net of cash acquired of $437,000. CSA is a reseller of Tyler's Infinite Visions school enterprise solution, and sells proprietary CSA tax and recording solutions to county governments, primarily in the Northwest. In connection with this transaction we acquired total tangible assets of approximately $1.3 million and assumed liabilities of approximately $1.9 million. We recorded goodwill of approximately $4.6 million, all of which is expected to be deductible for tax purposes, and other intangible assets of approximately $5.3 million. The $5.3 million of intangible assets is attributable to customer relationships, acquired software and trade name that will be amortized over a weighted average period of approximately 11 years.

In March 2012, we acquired all the capital stock of UniFund, L.L.C. ("UniFund") for a cash purchase price of $4.6 million, net of cash acquired of $780,000. UniFund provides enterprise resource planning solutions to schools and local governments, primarily in the Northeast. UniFund is also a reseller of Tyler's Infinite Visions school enterprise solution. In connection with this transaction we acquired total tangible assets of approximately $745,000 and assumed liabilities of approximately $1.5 million. We recorded goodwill of approximately $1.1 million, all of which is expected to be deductible for tax purposes, and other intangible assets of approximately $4.3 million. The $4.3 million of intangible assets is attributable to customer relationships and acquired software that will be amortized over a weighted average period of approximately 11 years.

We recorded combined goodwill of approximately $5.7 million in connection with the acquisitions of CSA and UniFund, which are both resellers of Tyler's Infinite Visions school enterprise solution. We believe likely market participants for these transactions would be software companies with a presence in the K-12 school market. Therefore, the combined goodwill of $5.7 million arising from these acquisitions 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 workforces of CSA and UniFund.

The operating results of EnerGov, CSA and UniFund are included with the operating results of the Enterprise Software Solutions segment since their dates of acquisition.

In January 2012, we acquired substantially all of the assets of Akanda Innovation, Inc. ("Akanda"), 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. We recorded goodwill of approximately $1.0 million, all of which is expected to be deductible for tax purposes, and acquired software of approximately $1.9 million that will be amortized over five years. The operating results of Akanda are included with the operating results of the Appraisal and Tax Software Solutions and Services segment since the date of acquisition.

2011

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 Infinite Visions suite of school enterprise solutions for the K-12 education market, primarily in the Southwest.

2010

In January 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.

(3) FAIR VALUE OF FINANCIAL INSTRUMENTS

Assets recorded at fair value in the balance sheet as of December 31, 2012 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, 2012 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, 2012			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash and cash equivalents	$6,406	$6,406	$ —	$ —
Investments available-for-sale	2,037	—	—	2,037
Total	$8,443	$6,406	$ —	$2,037

	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
Total	$3,304	$1,351	$ —	$1,953

Notes to Consolidated Financial Statements

Cash and cash equivalents consist of cash on deposit with a bank and 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 2012.

Investments available-for-sale consist of two auction rate municipal securities ("ARS") which are collateralized debt obligations supported by municipal agencies and do not include mortgage-backed securities. These ARS are debt instruments with stated maturities of 19 and 29 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 July 2012. As of December 31, 2012 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, 2012 are as follows:

	Par Value	Temporary Impairment	Carrying Value
Non-current investments available-for-sale	$2,450	$413	$2,037

In association with this estimate of fair value, we have recorded an after-tax temporary unrealized gain on our non-current ARS of $87,000, net of related tax effects of $47,000 in 2012, 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 July 2012. Based on our cash and cash equivalents balance, 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, 2009	$1,976
Transfers into level 3	—
Transfers out of level 3	(25)
Purchases, sales issuances and settlements	(25)
Unrealized gains included in accumulated 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 loss	(123)
Balance as of December 31, 2011	1,953
Transfers into level 3	—
Transfers out of level 3	—
Purchases, sales issuances and settlements	(50)
Unrealized gains included in accumulated loss	134
Balance as of December 31, 2012	$2,037

(4) PROPERTY AND EQUIPMENT, NET

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

	Useful Lives (Years)	2012	2011
Land	—	$ 7,800	$ 7,549
Building and leasehold improvements	5-39	33,299	29,299
Computer equipment and purchased software	3-5	24,036	21,303
Furniture and fixtures	5	8,108	7,656
Transportation equipment	5	274	248
		73,517	66,055
Accumulated depreciation and amortization		(28,136)	(25,140)
Property and equipment, net		$ 45,381	$ 40,915

Depreciation expense was $5.6 million during 2012, $5.3 million during 2011, and $5.1 million during 2010. In May 2012 we purchased land and a building in Moraine, Ohio, to support our appraisal and tax operations for a purchase price of $2.6 million, which was comprised of $1.7 million in cash and land and a building valued at $900,000.

We own office buildings in Yarmouth, Maine, Lubbock, Texas, and Moraine, Ohio. We lease some space in these buildings to third-party tenants. These leases expire between 2013 and 2017 and are expected to provide rental income of approximately $512,000 during 2013, $335,000 during 2014, $178,000 during 2015, $100,000 during 2016, and $67,000 during 2017. Rental income associated with third party tenants was $586,000 in 2012, $1.2 million in 2011 and $1.4 million in 2010, and was included as a reduction of selling, general and administrative expenses.

Notes to Consolidated Financial Statements

(5) GOODWILL AND OTHER INTANGIBLE ASSETS

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

	2012	2011
Gross carrying amount of acquisition intangibles:		
Customer related intangibles	$ 60,547	$ 50,552
Software acquired	32,003	26,363
Trade name	3,272	2,211
Lease acquired	1,387	1,387
	97,209	80,513
Accumulated amortization	(51,489)	(45,045)
Acquisition intangibles, net	$ 45,720	$ 35,468
Post acquisition software development costs	$ 36,701	$ 36,701
Accumulated amortization	(36,621)	(36,541)
Post acquisition software costs, net	$ 80	$ 160
Total other intangibles	$ 45,800	$ 35,628

Total amortization expense, for acquisition related intangibles and post acquisition software development costs, was $6.5 million during 2012, $4.9 million during 2011, and $5.5 million during 2010.

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

	December 31, 2012			December 31, 2011		
	Gross Carrying Amount	Weighted Average Amortization Period	Accumulated Amortization	Gross Carrying Amount	Weighted Average Amortization Period	Accumulated Amortization
Non-amortizable intangibles:						
Goodwill	$119,956	—	$ —	$106,094	—	$ —
Amortizable intangibles:						
Customer related intangibles	60,547	15 years	24,554	50,552	16 years	20,409
Software acquired	32,003	5 years	24,505	26,363	5 years	22,617
Trade name	3,272	15 years	1,182	2,211	18 years	1,048
Lease acquired	1,387	5 years	1,248	1,387	5 years	971

The changes in the carrying amount of goodwill for the two years ended December 31, 2012 are as follows:

	Enterprise Software Solutions	Appraisal and Tax Software Solutions and Services	Total
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	100,504	5,590	106,094
Goodwill acquired during the year related to the purchase of Akanda	—	967	967
Goodwill acquired during the year related to the purchase of UniFund	1,055	—	1,055
Goodwill acquired during the year related to the purchase of CSA	4,634	—	4,634
Goodwill acquired during the year related to the purchase of EnerGov	7,206	—	7,206
Balance as of December 31, 2012	$113,399	$ 6,557	$119,956

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,	
2013	$6,757
2014	6,282
2015	6,103
2016	6,014
2017	5,037

(6) ACCRUED LIABILITIES

Accrued liabilities consist of the following at December 31:

	2012	2011
Accrued wages, bonuses and commissions	$17,875	$16,971
Other accrued liabilities	6,724	6,510
Accrued health claims	1,479	1,270
	$26,078	$24,751

(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 2012 and 2011, our effective average interest rate for borrowings was 3.4% and 3.3%, respectively. As of December 31, 2012, our interest rate was 2.7%. 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, 2012, we were in compliance with those covenants.

As of December 31, 2012, we had $18.0 million in outstanding borrowings and unused available borrowing capacity of $126.1 million under the Credit Facility. In addition, as of December 31, 2012, we had outstanding letters of credit totaling $5.9 million. Some of our customers, primarily those for our property appraisal services, require that we obtain performance bonds in connection with our contracts. 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, 2012 was estimated to be $35.1 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 in 2013.

We paid interest of $2.0 million in 2012 and $1.9 million in 2011.

(8) INCOME TAX

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

Years ended December 31,	2012	2011	2010
Current:			
Federal	$19,113	$17,239	$13,552
State	1,976	2,233	2,252
	21,089	19,472	15,804
Deferred	(215)	(2,916)	(959)
	$20,874	$16,556	$14,845

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

Years ended December 31,	2012	2011	2010
Federal income tax expense at statutory rate	$18,854	$15,440	$13,965
State income tax, net of federal income tax benefit	1,365	1,238	1,218
Non-deductible business expenses	1,087	918	976
Qualified manufacturing activities	(717)	(840)	(728)
Research and development credit	—	(177)	(579)
Other, net	285	(23)	(7)
	$20,874	$16,556	$14,845

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:

	2012	2011
Deferred income tax assets:		
Operating expenses not currently deductible	$ 4,992	$ 4,597
Stock option and other employee benefit plans	5,666	5,156
Capital loss carryforward	145	203
Property and equipment	531	397
Total deferred income tax assets	11,334	10,353
Deferred income tax liabilities:		
Intangible assets	(10,868)	(10,043)
Other	(143)	(156)
Total deferred income tax liabilities	(11,011)	(10,199)
Net deferred income tax asset	$ 323	$ 154

Although realization is not assured, we believe it is more likely than not that all the deferred tax assets at December 31, 2012 and 2011 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.

The Internal Revenue Service ("IRS") is examining our U.S. income tax return for the year 2010. We are unable to make a reasonable estimate as to when cash settlements related to the examination, 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 2009. We are no longer subject to state and local income tax examinations by tax authorities for the years before 2008.

We paid income taxes, net of refunds received, of $13.1 million in 2012, $13.4 million in 2011, and $15.8 million in 2010.

(9) SHAREHOLDERS' EQUITY

The following table details activity in our common stock:

	Years ended December 31,					
	2012		2011		2010	
	Shares	Amount	Shares	Amount	Shares	Amount
Stock option exercises	1,218	$12,443	582	$ 3,553	615	$ 3,181
Purchases of common stock	—	—	(3,004)	(71,802)	(3,559)	(65,793)
Employee stock plan purchases	81	2,641	100	2,045	118	1,825
Shares issued for acquisition	60	2,815	—	—	—	—

As of February 18, 2013 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 three 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, 2012, there were 2.6 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 Consolidated 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,	2012	2011	2010
Expected life (in years)	6.7	6.7	6.7
Expected volatility	32.6%	33.1%	35.0%
Risk-free interest rate	1.0%	1.7%	2.7%
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 comprehensive income:

Years ended December 31,	2012	2011	2010
Cost of software services, maintenance and subscriptions	$ 1,084	$ 871	$ 739
Selling, general and administrative expense	6,327	5,382	5,393
Total share-based compensation expense	$ 7,411	$ 6,253	$ 6,132
Tax benefit	(2,040)	(1,545)	(1,475)
Net decrease in net income	$ 5,371	$ 4,708	$ 4,657

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, 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		
Granted	930	43.53		
Exercised	(1,218)	10.22		
Forfeited	(60)	28.07		
Outstanding at December 31, 2012	5,711	20.86	7	$157,481
Exercisable at December 31, 2012	2,655	$13.10	5	$ 93,849

We had unvested options to purchase 2.8 million shares with a weighted average grant date exercise price of $27.20 as of December 31, 2012 and unvested options to purchase 2.7 million shares with a weighted average grant date exercise price of $19.35 as of December 31, 2011. As of December 31, 2012, we had $25.5 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:

	2012	2011	2010
Weighted average grant-date fair value of stock options granted	$ 15.24	$ 9.91	$ 7.70
Total intrinsic value of stock options exercised	40,589	12,289	8,119

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, 2012, there were 1.1 million shares available for future grants under the ESPP from the 2.0 million shares previously approved by the stockholders.

(11) EARNINGS PER SHARE

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

Years Ended December 31,	2012	2011	2010
Numerator for basic and diluted earnings per share:			
Net income	$32,994	$27,557	$25,054
Denominator:			
Weighted-average basic common shares outstanding	30,327	31,267	34,075
Assumed conversion of dilutive securities:			
Stock options	2,589	1,887	1,453
Denominator for diluted earnings per share – Adjusted weighted-average shares	32,916	33,154	35,528
Earnings per common share:			
Basic	$ 1.09	$ 0.88	$ 0.74
Diluted	$ 1.00	$ 0.83	$ 0.71

Stock options representing the right to purchase common stock of 463,000 shares in 2012, 714,000 shares in 2011, and 1.8 million shares in 2010 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 business unit that occupies this property. Most of our leases are non-cancelable operating lease agreements and they expire at various dates through 2021. In addition to rent, the leases generally require us to pay taxes, maintenance, insurance and certain other operating expenses.

Rent expense was approximately $7.2 million in 2012, $5.9 million in 2011, and $5.4 million in 2010, which included rent expense associated with related party lease agreements of $1.7 million in 2012, $1.8 million in 2011 and $1.9 million in 2010.

Notes to Consolidated Financial Statements

Future minimum lease payments under all non-cancelable leases at December 31, 2012 are as follows:

Years ending December 31,	
2013	$ 6,278
2014	4,519
2015	3,949
2016	3,682
2017	3,223
Thereafter	3,482
	$25,133

Included in future minimum lease payments are non-cancelable payments due to related parties of $1.7 million in 2013, $1.7 million in 2014, $1.7 million in 2015, $1.7 million in 2016, and $1.7 million in 2017.

(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 operating results $3.3 million during 2012, $2.9 million during 2011, and $2.8 million during 2010.

(14) COMMITMENTS AND CONTINGENCIES

Other than 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.

During 2011, Tyler performed certain software services for a customer under a contractual arrangement with a total value of approximately $785,000. During 2012, this customer notified us that it was not going to accept our services and was considering a termination for cause. We had collected $575,000 to date from this customer. We believed the amounts collected and related services performed were valid under the terms of the arrangement. In January 2013, we settled the dispute and paid an immaterial amount that was less than cash previously collected from the customer.

(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, and land and vital records 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 and land and vital records software solutions unit and the courts and justice software solutions unit meet the criteria for aggregation and are presented in one 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.

We evaluate performance based on several factors, of which the primary financial measure is business segment operating income. We define segment operating income for our business units as income before noncash amortization of intangible assets associated with their acquisition, 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 and net property and equipment. Corporate assets consist of cash and investments, prepaid insurance, intangibles associated with acquisitions, deferred income taxes and net property and equipment mainly related to unallocated information and technology assets. Segment assets reported in 2011 and 2010 have been reclassified to conform to current year presentation.

ESS segment capital expenditures in 2012 and 2011 included $3.0 million and $6.6 million, respectively for the construction of a new building and purchase of an existing building and land in connection with plans to consolidate workforces and support long-term growth. ATSS segment capital expenditures in 2012 included $2.6 million for the purchase of a building and land to support long-term growth.

As of and year ended December 31, 2012	Enterprise Software Solutions	Appraisal and Tax Software Solutions and Services	Corporate	Totals
Revenues				
Software licenses	$ 31,304	$ 1,868	$ —	$ 33,172
Subscriptions	43,319	1,299	—	44,618
Software services	76,103	7,305	—	83,408
Maintenance	155,290	16,561	—	171,851
Appraisal services	—	22,543	—	22,543
Hardware and other	6,053	—	1,659	7,712
Intercompany	2,249	—	(2,249)	—
Total revenues	$314,318	$49,576	$ (590)	$363,304
Depreciation and amortization expense	9,929	958	1,824	12,711
Segment operating income	71,135	8,498	(16,889)	62,744
Capital expenditures	5,469	3,382	1,865	10,716
Segment assets	$134,220	$18,464	$185,631	$338,315

Notes to Consolidated Financial Statements

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	$119,595	$20,535	$155,261	$295,391

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	$100,508	$23,929	$139,595	$264,032

Reconciliation of reportable segment operating income to the Company's consolidated totals:	2012	2011	2010
Total segment operating income	$62,744	$50,973	$46,458
Amortization of acquired software	(1,888)	(1,125)	(1,592)
Amortization of customer and trade name intangibles	(4,279)	(3,331)	(3,225)
Other expense, net	(2,709)	(2,404)	(1,742)
Income before income taxes	$53,868	$44,113	$39,899

(16) QUARTERLY FINANCIAL INFORMATION (unaudited)

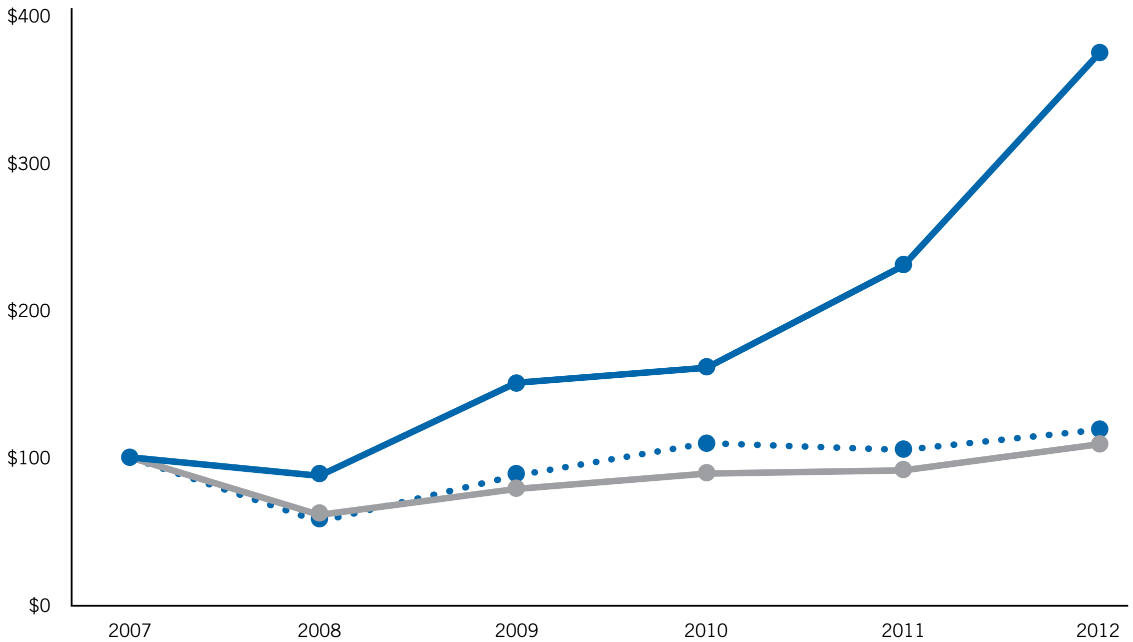
The following table contains selected financial information from unaudited statements of income for each quarter of 2012 and 2011.

	2012				2011			
Quarters ended	Dec. 31	Sept. 30	June 30	Mar. 31	Dec. 31	Sept. 30	June 30	Mar. 31
Revenues	$95,368	$93,845	$91,368	$82,723	$82,079	$77,184	$76,735	$73,393
Gross profit	44,640	44,944	40,699	37,419	39,020	36,132	34,137	32,623
Income before income taxes	15,035	17,810	11,682	9,341	13,504	11,818	9,309	9,482
Net income	9,376	10,832	7,105	5,681	8,699	7,506	5,624	5,728
Earnings per diluted share	0.28	0.33	0.22	0.17	0.27	0.23	0.17	0.17
Shares used in computing diluted earnings per share	33,421	32,986	32,769	32,530	32,031	32,960	33,848	33,720

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, 2007. 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



	2007	2008	2009	2010	2011	2012
Tyler Technologies, Inc.	100	92.94	154.46	161.06	233.59	375.80
S&P 500 Index	100	63.00	79.67	91.68	93.61	108.59
S&P 600 Information Technology Index	100	59.63	88.35	110.08	105.65	118.35

Tyler Technologies, Inc.
S&P 500 Index
S&P 600 Information Technology Index

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

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

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

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

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

Michael D. Richards[3,4]
Executive Vice President
Republic Title of Texas, Inc.

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

[1] *Executive Committee*
[2] *Audit Committee*
[3] *Nominating and Governance Committee*
[4] *Compensation Committee*

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Independent Registered Public Accounting Firm

Ernst & Young LLP
Dallas, Texas

Annual Meeting of Stockholders

Our Annual Meeting will be held on Thursday, May 9, 2013, 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

972.713.3714
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Common Stock

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

Design by Eisenberg And Associates

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