

TYLER TECHNOLOGIES INC
Form 10-Q
April 25, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2013

OR

.. **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**

Commission File Number 1-10485

TYLER TECHNOLOGIES, INC.

(Exact name of registrant as specified in its charter)

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DELAWARE
(State or other jurisdiction of
incorporation or organization)

75-2303920
(I.R.S. employer
identification no.)

5949 SHERRY LANE, SUITE 1400

DALLAS, TEXAS

75225

(Address of principal executive offices)

(Zip code)

(972) 713-3700

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data file required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

(Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller Reporting Company

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

The number of shares of common stock of registrant outstanding on April 19, 2013 was 31,504,000.

PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

TYLER TECHNOLOGIES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands, except per share amounts)

(Unaudited)

| | Three months ended March 31, | |
|---|---------------------------------|-----------------|
| | 2013 | 2012 |
| Revenues: | | |
| Software licenses and royalties | \$ 8,830 | \$ 7,563 |
| Subscriptions | 13,473 | 9,968 |
| Software services | 20,461 | 18,530 |
| Maintenance | 46,050 | 39,850 |
| Appraisal services | 5,591 | 5,682 |
| Hardware and other | 1,394 | 1,130 |
| Total revenues | 95,799 | 82,723 |
| Cost of revenues: | | |
| Software licenses and royalties | 426 | 566 |
| Acquired software | 549 | 410 |
| Software services, maintenance and subscriptions | 46,382 | 39,813 |
| Appraisal services | 3,799 | 3,796 |
| Hardware and other | 798 | 719 |
| Total cost of revenues | 51,954 | 45,304 |
| Gross profit | 43,845 | 37,419 |
| Selling, general and administrative expenses | 22,646 | 21,335 |
| Research and development expense | 5,598 | 5,094 |
| Amortization of customer and trade name intangibles | 1,131 | 946 |
| Operating income | 14,470 | 10,044 |
| Other expense, net | 338 | 703 |
| Income before income taxes | 14,132 | 9,341 |
| Income tax provision | 5,639 | 3,660 |
| Net income | \$ 8,493 | \$ 5,681 |
| Earnings per common share: | | |
| Basic | \$ 0.27 | \$ 0.19 |
| Diluted | \$ 0.25 | \$ 0.17 |
| Comprehensive income | \$ 8,493 | \$ 5,681 |

See accompanying notes.

TYLER TECHNOLOGIES, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except par value and share amounts)

| | March 31, 2013 (Unaudited) | December 31, 2012 |
|--|----------------------------------|----------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 4,495 | \$ 6,406 |
| Accounts receivable (less allowance for losses of \$1,507 in 2013 and \$1,621 in 2012) | 76,220 | 99,212 |
| Prepaid expenses | 10,255 | 9,000 |
| Other current assets | 1,035 | 1,480 |
| Deferred income taxes | 5,544 | 5,544 |
| Total current assets | 97,549 | 121,642 |
| Accounts receivable, long-term portion | 1,621 | 1,187 |
| Property and equipment, net | 48,170 | 45,381 |
| Non-current investments available-for-sale | 2,012 | 2,037 |
| Other assets: | | |
| Goodwill | 121,011 | 121,011 |
| Other intangibles, net | 44,031 | 45,800 |
| Sundry | 980 | 1,197 |
| | \$ 315,374 | \$ 338,255 |
| LIABILITIES AND SHAREHOLDERS EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$ 2,528 | \$ 3,167 |
| Accrued liabilities | 21,900 | 26,018 |
| Deferred revenue | 125,385 | 140,550 |
| Total current liabilities | 149,813 | 169,735 |
| Revolving line of credit | | 18,000 |
| Deferred income taxes | 5,363 | 5,221 |
| 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 2013 and 2012 | 481 | 481 |
| Additional paid-in capital | 156,604 | 154,018 |
| Accumulated other comprehensive loss, net of tax | (268) | (268) |
| Retained earnings | 171,602 | 163,109 |
| Treasury stock, at cost; 16,662,488 and 16,816,903 shares in 2013 and 2012, respectively | (168,221) | (172,041) |
| Total shareholders' equity | 160,198 | 145,299 |
| | \$ 315,374 | \$ 338,255 |

See accompanying notes.

TYLER TECHNOLOGIES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

| | Three months ended March 31, | |
|---|------------------------------|-----------------|
| | 2013 | 2012 |
| Cash flows from operating activities: | | |
| Net income | \$ 8,493 | \$ 5,681 |
| Adjustments to reconcile net income to net cash provided by operations: | | |
| Depreciation and amortization | 3,322 | 3,026 |
| Share-based compensation expense | 2,575 | 1,835 |
| Excess tax benefit from exercises of share-based arrangements | (1,523) | (686) |
| Changes in operating assets and liabilities, exclusive of effects of acquired companies: | | |
| Accounts receivable | 22,558 | 32,037 |
| Income tax payable | 5,638 | 2,267 |
| Prepaid expenses and other current assets | (1,204) | (341) |
| Accounts payable | (579) | (629) |
| Accrued liabilities | (7,031) | (9,379) |
| Deferred revenue | (15,165) | (15,727) |
| Net cash provided by operating activities | 17,084 | 18,084 |
| Cash flows from investing activities: | | |
| Proceeds from sale of investments | 25 | 25 |
| Cost of acquisitions, net of cash acquired | | (5,874) |
| Additions to property and equipment | (5,089) | (1,048) |
| Decrease in other | 239 | |
| Net cash used by investing activities | (4,825) | (6,897) |
| Cash flows from financing activities: | | |
| Decrease in net borrowings on revolving line of credit | (18,000) | (4,700) |
| Contributions from employee stock purchase plan | 670 | 509 |
| Proceeds from exercise of stock options | 1,637 | 924 |
| Excess tax benefit from exercises of share-based arrangements | 1,523 | 686 |
| Net cash used by financing activities | (14,170) | (2,581) |
| Net (decrease) increase in cash and cash equivalents | (1,911) | 8,606 |
| Cash and cash equivalents at beginning of period | 6,406 | 1,326 |
| Cash and cash equivalents at end of period | \$ 4,495 | \$ 9,932 |

See accompanying notes.

Tyler Technologies, Inc.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

(Tables in thousands, except per share data)

(1) Basis of Presentation

We prepared the accompanying condensed consolidated financial statements following the requirements of the Securities and Exchange Commission (SEC) and accounting principles generally accepted in the United States, or GAAP, for interim reporting. As permitted under those rules, certain footnotes or other financial information that are normally required by GAAP can be condensed or omitted for interim periods. Balance sheet amounts are as of March 31, 2013 and December 31, 2012 and operating result amounts are for the three months ended March 31, 2013 and 2012, and include all normal and recurring adjustments that we considered necessary for the fair summarized presentation of our financial position and operating results. As these are condensed financial statements, one should also read the financial statements and notes included in our latest Form 10-K for the year ended December 31, 2012. Revenues, expenses, assets and liabilities can vary during each quarter of the year. Therefore, the results and trends in these interim financial statements may not be the same as those for the full year.

Royalty revenue is recognized when the fees are fixed or determinable, which is known when we receive notice of the amounts earned pursuant to our third party royalty arrangements. Typically, we receive notice of royalty revenues earned on a quarterly basis 30 to 60 days after the end of the reporting period.

Certain amounts for the previous periods presented have been reclassified to conform to the current period presentation.

(2) 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. As of December 31, 2012 the purchase price allocation was not yet complete. In the three months ended March 31, 2013, we finalized the EnerGov purchase price allocation which resulted in additional goodwill of \$1.1 million and a corresponding reduction in tangible assets. The balance sheet at December 31, 2012 has been retrospectively revised to include this adjustment.

(3) Financial Instruments

Assets recorded at fair value in the balance sheet as of March 31, 2013 are categorized based upon the level of judgment associated with the inputs used to measure their fair value. Hierarchical levels, defined by Accounting Standards Codification (ASC) 820, Fair Value Measurements and Disclosures, which are directly related to the amount of subjectivity associated with the inputs to fair valuation of these assets, are as follows:

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

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

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

As of March 31, 2013 we held certain items that are required to be measured at fair value on a recurring basis. The following table summarizes the fair value of these financial assets:

| Total | Quoted prices in active markets for identical assets (Level 1) | Significant other observable inputs (Level 2) | Significant unobservable inputs (Level 3) |
|-------|--|--|---|
|-------|--|--|---|

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| Investments available-for-sale | 2,012 | 2,012 |
|--------------------------------|-------|-------|
|--------------------------------|-------|-------|

Investments available-for-sale consist of two auction rate municipal securities (ARS) which are collateralized debt obligations supported by municipal agencies and do not include mortgage-backed securities. These ARS are debt instruments with stated maturities ranging from 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 a series of small partial redemptions at par in the period from July 2009 through February 2013. As of March 31, 2013 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 March 31, 2013 are as follows:

| | Par Value | Temporary Impairment | Carrying Value |
|--------------------------------|-----------|----------------------|----------------|
| Investments available-for-sale | \$ 2,425 | \$ 413 | \$ 2,012 |

We consider the impairment in our ARS as temporary because we do not have the intent to sell, nor is it more-likely-than-not that we will be required to sell these securities before recovery of their cost basis. We believe that this decline in fair value is temporary, because the underlying assets of these securities are supported by municipal agencies and do not include mortgage-backed securities, have redemption features which call for redemption at 100% of par value and have a current credit rating of A or AA. The ratings on the ARS take into account credit support through insurance policies guaranteeing each of the bonds' payment of principal and accrued interest, if it becomes necessary. In addition, both ARS have had a series of small partial redemptions at par in the period July 2009 through February 2013. Based on our cash and cash equivalents balance, expected operating cash flows and availability under our credit facility, we do not believe a lack of liquidity associated with our ARS will adversely affect our ability to conduct business, and believe we have the ability to hold the securities throughout the currently estimated recovery period. We will continue to evaluate any changes in the market value of our ARS and in the future, depending upon existing market conditions, we may be required to record an other-than-temporary decline in market value.

The following table reflects the activity for assets measured at fair value using level 3 inputs for the three months ended March 31, 2013:

| | |
|---|----------|
| Balance as of December 31, 2012 | \$ 2,037 |
| Transfers into level 3 | |
| Transfers out of level 3 | |
| Purchases, sales, issuances and settlements | (25) |
| Unrealized gains included in accumulated loss | |
| Balance as of March 31, 2013 | \$ 2,012 |

(4) Shareholders' Equity

The following table details activity in our common stock:

| | Three months ended March 31, | | | |
|-------------------------------|------------------------------|----------|--------|--------|
| | 2013 | | 2012 | |
| | Shares | Amount | Shares | Amount |
| Stock option exercises | 138 | \$ 1,637 | 93 | \$ 924 |
| Employee stock plan purchases | 16 | 670 | 20 | 509 |

As of March 31, 2013 we had authorization from our board of directors to repurchase up to 1.7 million additional shares of Tyler common stock.

(5) Revolving Line of Credit

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

Borrowings under the Credit Facility bear interest at a rate of either (1) the Bank of America's prime rate plus a margin of 1.50% to 2.75% or (2) the 30, 60, 90 or 180-day LIBOR rate plus a margin of 2.50% to 3.75%, with the margin determined by our consolidated leverage ratio. Our effective average interest rate for borrowings the three months ended March 31, 2013 was 3.2%. The Credit Facility is secured by substantially all of our assets, excluding real property. The Credit Facility requires us to maintain certain financial ratios and other financial conditions and prohibits us from making certain investments, advances, cash dividends or loans, and limits incurrence of additional indebtedness and liens. As of March 31, 2013, we were in compliance with those covenants.

As of March 31, 2013, we had no outstanding borrowings and available borrowing capacity of \$144.6 million under the Credit Facility. We had outstanding letters of credit totaling \$5.4 million as of March 31, 2013. Some of our customers, primarily those for our property appraisal services, require that we obtain performance bonds in connection with our contract. 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 March 31, 2013 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 throughout 2013.

(6) Income Tax Provision

For the three months ended March 31, 2013, we had an effective income tax rate of 39.9% compared to 39.2% for the three months ended March 31, 2012, respectively. The effective income tax rates for the periods presented were different from the statutory United States federal income tax rate of 35% primarily due to state income taxes, non-deductible share-based compensation expense, the qualified manufacturing activities deduction, and non-deductible meals and entertainment costs.

We did not make any federal and state income tax payments in the three months ended March 31, 2013, compared to \$1.4 million in net payments for the same period of the prior year.

(7) Earnings Per Share

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

| | Three months ended March 31, | |
|---|---------------------------------|----------|
| | 2013 | 2012 |
| Numerator for basic and diluted earnings per share: | | |
| Net income | \$ 8,493 | \$ 5,681 |
| Denominator: | | |
| Weighted-average basic common shares outstanding | 31,403 | 30,015 |
| Assumed conversion of dilutive securities: | | |
| Stock options | 2,545 | 2,515 |
| Denominator for diluted earnings per share - Adjusted weighted-average shares | 33,948 | 32,530 |
| Earnings per common share: | | |
| Basic | \$ 0.27 | \$ 0.19 |
| Diluted | \$ 0.25 | \$ 0.17 |

For the three months ended March 31, 2013 and March 31, 2012, stock options representing the right to purchase common stock of approximately 950,000 shares and 433,000 shares, respectively, were not included in the computation of diluted earnings per share because their inclusion would have had an anti-dilutive effect.

(8) Share-Based Compensation

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

| | Three months ended March 31, | |
|--|---------------------------------|----------|
| | 2013 | 2012 |
| Cost of software services, maintenance and subscriptions | \$ 336 | \$ 248 |
| Selling, general and administrative expense | 2,239 | 1,587 |
| Total share-based compensation expense | \$ 2,575 | \$ 1,835 |

(9) Segment and Related Information

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

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

financial management and education software solutions;

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

We evaluate performance based on several factors, of which the primary financial measure is business segment operating income. We define segment operating income as income before noncash amortization of intangible assets associated with their acquisition, 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.

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For the three months ended March 31, 2013

| | Enterprise Software Solutions | Appraisal and Tax Software Solutions and Services | Corporate | Totals |
|---------------------------------|-------------------------------------|---|-----------------|------------------|
| Revenues | | | | |
| Software licenses and royalties | \$ 8,100 | \$ 730 | \$ | \$ 8,830 |
| Subscriptions | 12,901 | 572 | | 13,473 |
| Software services | 18,741 | 1,720 | | 20,461 |
| Maintenance | 41,882 | 4,168 | | 46,050 |
| Appraisal services | | 5,591 | | 5,591 |
| Hardware and other | 1,394 | | | 1,394 |
| Intercompany | 589 | | (589) | |
| Total revenues | \$ 83,607 | \$ 12,781 | \$ (589) | \$ 95,799 |
| Segment operating income | \$ 17,828 | \$ 2,326 | \$ (4,004) | \$ 16,150 |

For the three months ended March 31, 2012

| | Enterprise Software Solutions | Appraisal and Tax Software Solutions and Services | Corporate | Totals |
|---------------------------------|-------------------------------------|---|-----------------|------------------|
| Revenues | | | | |
| Software licenses and royalties | \$ 6,950 | \$ 613 | \$ | \$ 7,563 |
| Subscriptions | 9,712 | 256 | | 9,968 |
| Software services | 16,614 | 1,916 | | 18,530 |
| Maintenance | 35,745 | 4,105 | | 39,850 |
| Appraisal services | | 5,682 | | 5,682 |
| Hardware and other | 1,130 | | | 1,130 |
| Intercompany | 345 | | (345) | |
| Total revenues | \$ 70,496 | \$ 12,572 | \$ (345) | \$ 82,723 |
| Segment operating income | \$ 13,419 | \$ 2,077 | \$ (4,096) | \$ 11,400 |

| Reconciliation of reportable segment operating income to the Company's consolidated totals: | Three months ended | |
|--|--------------------|-----------|
| | 2013 | 2012 |
| Total segment operating income | \$ 16,150 | \$ 11,400 |
| Amortization of acquired software | (549) | (410) |
| Amortization of customer and trade name intangibles | (1,131) | (946) |
| Other expense, net | (338) | (703) |
| Income before income taxes | \$ 14,132 | \$ 9,341 |

(10) Commitments and Contingencies

Other than routine litigation arising in the ordinary course of our business, there are no material legal proceedings pending to which we are party or to which any of our properties are subject.

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

CAUTIONARY NOTE CONCERNING FORWARD-LOOKING STATEMENTS

This document contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 that are not historical in nature and typically address future or anticipated events, trends, expectations or beliefs with respect to our financial condition, results of operations or business. Forward-looking statements often contain words such as believes, expects, anticipates, foresees, forecasts, estimates, plans, intends, continues, may, will, should, projects, might, could, and other similar phrases. Similarly, statements that describe our business strategy, outlook, objectives, plans, intentions or goals also are forward-looking statements. We believe there is a reasonable basis for our forward-looking statements, but they are inherently subject to risks and uncertainties and actual results could differ materially from the expectations and beliefs reflected in the forward-looking statements. We presently consider the following to be among the important factors that could cause actual results to differ materially from our expectations and beliefs: (1) changes in the budgets or regulatory environments of our customers, primarily local and state governments, that could negatively impact information technology spending; (2) our ability to protect client information from security breaches and provide uninterrupted operations of data centers; (3) material portions of our business require the Internet infrastructure to be further developed or adequately maintained; (4) our ability to achieve our financial forecasts due to various factors, including project delays by our customers, reductions in transaction size, fewer transactions, delays in delivery of new products or releases or a decline in our renewal rates for service agreements; (5) economic, political and market conditions, including the global economic and financial crisis, and the general tightening of access to debt or equity capital; (6) technological and market risks associated with the development of new products or services or of new versions of existing or acquired products or services; (7) our ability to successfully complete acquisitions and achieve growth or operational synergies through the integration of acquired businesses, while avoiding unanticipated costs and disruptions to existing operations; (8) competition in the industry in which we conduct business and the impact of competition on pricing, customer retention and pressure for new products or services; (9) the ability to attract and retain qualified personnel and dealing with the loss or retirement of key members of management or other key personnel; and (10) costs of compliance and any failure to comply with government and stock exchange regulations. A detailed discussion of these factors and other risks that affect our business are described in our filings with the Securities and Exchange Commission, including the detailed Risk Factors contained in our most recent annual report on Form 10-K. We expressly disclaim any obligation to publicly update or revise our forward-looking statements.

GENERAL

We provide integrated information management solutions and services for 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 as well as state governments. In addition, we provide professional IT services to our customers, including software and hardware installation, data conversion, and training and for certain customers, product modifications, along with continuing maintenance and support for customers using our systems. We also provide subscription-based services such as software as a service (SaaS), which utilize 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 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.

Our total employee count increased to 2,406 at March 31, 2013 from 2,112 at March 31, 2012. This increase includes 117 employees added as a result of several acquisitions.

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

The discussion and analysis of our financial condition and results of operations are based upon our condensed consolidated financial statements. These condensed consolidated financial statements have been prepared following the requirements of accounting principles generally accepted in the United States (GAAP) for interim periods and require us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates, including those related to revenue recognition and amortization and potential impairment of intangible assets and goodwill and share-based compensation expense. As these are condensed financial statements, one should also read expanded information about our critical accounting policies and estimates provided in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, included in our Form 10-K for the year ended December 31, 2012. There have been no material changes to our critical accounting policies and estimates from the information provided in our 10-K for the year ended December 31, 2012.

ANALYSIS OF RESULTS OF OPERATIONS

Revenues

| | Percentage of Total Revenue First Quarter | |
|--|--|-------|
| | 2013 | 2012 |
| Revenue: | | |
| Software licenses and royalties | 9.2% | 9.1% |
| Subscriptions | 14.0 | 12.0 |
| Software services | 21.4 | 22.4 |
| Maintenance | 48.1 | 48.2 |
| Appraisal services | 5.8 | 6.9 |
| Hardware and other | 1.5 | 1.4 |
| Total revenue | 100.0 | 100.0 |
| Operating Expenses: | | |
| Cost of software licenses, royalties and acquired software | 1.0 | 1.2 |
| Cost of software services, maintenance and subscriptions | 48.4 | 48.1 |
| Cost of appraisal services | 4.0 | 4.6 |
| Cost of hardware and other | 0.8 | 0.9 |
| Selling, general and administrative expenses | 23.6 | 25.8 |
| Research and development expense | 5.8 | 6.2 |
| Amortization of customer base and trade name intangibles | 1.2 | 1.1 |
| Operating income | 15.2 | 12.1 |
| Other expense | 0.4 | 0.8 |
| Income before income taxes | 14.8 | 11.3 |
| Income tax provision | 5.9 | 4.4 |
| Net income | 8.9% | 6.9% |

Software licenses and royalties.

The following table sets forth a comparison of our software license revenues for the periods presented as of March 31:

| (\$ in thousands) | First Quarter | | Change | |
|--|-----------------|-----------------|-----------------|------------|
| | 2013 | 2012 | \$ | % |
| ESS | \$ 8,100 | \$ 6,950 | \$ 1,150 | 17% |
| ATSS | 730 | 613 | 117 | 19 |
| Total software licenses and royalties revenue | \$ 8,830 | \$ 7,563 | \$ 1,267 | 17% |

Since March 2012, we have acquired two companies which provide financial and human capital management software solutions to the K-12 education market and one company that provides enterprise permitting, land management, licensing and regulatory software solutions to governmental agencies. The results of these acquisitions are included in our ESS segment from the dates of their acquisitions. Excluding the results of acquisitions, software license and royalty revenue for the three months ended March 31, 2013 increased 10% compared to the prior year period. The majority of the growth was due to an increase of approximately \$770,000 in royalties on sales of Microsoft Dynamics AX by other Microsoft partners in the fourth quarter of 2012. We record royalty revenue when the fees are fixed or determinable, which is known when we receive notice of the amounts earned pursuant to our royalty arrangements which are generally 30 to 60 days after each quarterly reporting period. Royalty revenue is dependent upon sales volume from Microsoft partners and can vary substantially from period to period. Software license revenues were flat compared to the prior year period because of a growing number of customers choosing our subscription-based options, rather than purchasing the software under a traditional perpetual software arrangement. Subscription-based arrangements result in lower software license revenues in the initial year as compared to traditional perpetual software license arrangements but generate higher overall subscription-based revenue over the term of the contract. We had 22 new customers enter into subscription-based arrangements in the three months ending March 31, 2013 compared to 11 new customers in the three months ended March 31, 2012, respectively.

Subscriptions.

The following table sets forth a comparison of our subscription revenues for the periods presented as of March 31:

| (\$ in thousands) | First Quarter | | Change | |
|------------------------------------|------------------|-----------------|-----------------|------------|
| | 2013 | 2012 | \$ | % |
| ESS | \$ 12,901 | \$ 9,712 | \$ 3,189 | 33% |
| ATSS | 572 | 256 | 316 | 123 |
| Total subscriptions revenue | \$ 13,473 | \$ 9,968 | \$ 3,505 | 35% |

Excluding the impact of acquisitions, subscription-based services revenue grew approximately 34% for the three ending March 31, 2013 compared to the prior year period. Subscription-based services revenue primarily consists of revenues derived from SaaS arrangements, which utilize the Tyler private cloud. As part of our subscription-based services, we also provide electronic document filing solutions (e-filings) that simplify the filing and management of court related documents for courts and law offices. Revenues from e-filings are generally derived from transaction fees. The contract term for SaaS arrangements range from one to 10 years but are typically for periods of three to six years. New SaaS customers as well as existing customers who converted to our SaaS model provided the majority of the subscription revenue increase. In the three months ending March 31, 2013, we added 22 new customers and 19 existing customers elected to convert to our SaaS model. Since March 31, 2012, we have added 87 new customers and 70 existing customers elected to convert to our SaaS model. E-filing services also contributed approximately \$500,000 of the subscription revenue increase for the three ended March 31, 2013 as the result of new clients implementing e-filing and one existing client expanding mandatory e-filing for court documents.

Software services.

The following table sets forth a comparison of our software service revenues for the periods presented as of March 31:

| (\$ in thousands) | First Quarter | | Change | |
|--|------------------|------------------|-----------------|------------|
| | 2013 | 2012 | \$ | % |
| ESS | \$ 18,741 | \$ 16,614 | \$ 2,127 | 13% |
| ATSS | 1,720 | 1,916 | (196) | (10) |
| Total software services revenue | \$ 20,461 | \$ 18,530 | \$ 1,931 | 10% |

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 revenue grew 6% for the three months ended March 31, 2013 compared to the prior year period. The increase in software services revenues is due to larger contract arrangements that included more programming and other services.

Maintenance.

The following table sets forth a comparison of our maintenance revenues for the periods presented as of March 31:

| (\$ in thousands) | First Quarter | | Change | |
|----------------------------------|------------------|------------------|-----------------|------------|
| | 2013 | 2012 | \$ | % |
| ESS | \$ 41,882 | \$ 35,745 | \$ 6,137 | 17% |
| ATSS | 4,168 | 4,105 | 63 | 2 |
| Total maintenance revenue | \$ 46,050 | \$ 39,850 | \$ 6,200 | 16% |

We provide maintenance and support services for our software products and third party software. Excluding acquisitions, maintenance revenue increased 11% for the three ended March 31, 2013, respectively, compared to the prior year periods. Maintenance and support revenues increased due to growth in our installed customer base from new software license sales and maintenance rate increases on most of our product lines.

Appraisal services.

The following table sets forth a comparison of our appraisal service revenues for the periods presented as of March 31:

| (\$ in thousands) | First Quarter | | Change | |
|---|-----------------|-----------------|----------------|-------------|
| | 2013 | 2012 | \$ | % |
| ESS | \$ 5,591 | \$ 5,682 | \$ (91) | (2)% |
| ATSS | 5,591 | 5,682 | (91) | (2) |
| Total appraisal services revenue | \$ 5,591 | \$ 5,682 | \$ (91) | (2)% |

The appraisal services business is somewhat cyclical and driven in part by statutory revaluation cycles in various states. 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 periods presented as of March 31:

| (\$ in thousands) | First Quarter | | Change | |
|--|------------------|------------------|-----------------|------------|
| | 2013 | 2012 | \$ | % |
| Software licenses and royalties | \$ 426 | \$ 566 | \$ (140) | (25)% |
| Acquired software | 549 | 410 | 139 | 34 |
| Software services, maintenance and subscriptions | 46,382 | 39,813 | 6,569 | 16 |
| Appraisal services | 3,799 | 3,796 | 3 | 0 |
| Hardware and other | 798 | 719 | 79 | 11 |
| Total cost of revenues | \$ 51,954 | \$ 45,304 | \$ 6,650 | 15% |

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

| | First Quarter | | Change |
|--|---------------|--------------|-------------|
| | 2013 | 2012 | % |
| Software licenses, royalties and acquired software | 89.0% | 87.1% | 1.9% |
| Software services, maintenance and subscriptions | 42.0 | 41.7 | 0.3 |
| Appraisal services | 32.1 | 33.2 | (1.1) |
| Hardware and other | 42.8 | 36.4 | 6.4 |
| Overall gross margin | 45.8% | 45.2% | 0.6% |

Software licenses, royalties and acquired software. Costs of software licenses, royalties and acquired software are primarily comprised of third party software costs and amortization expense for software acquired through acquisitions. We do not have any direct costs associated with royalties. For the three months ended March 31, 2013, our software licenses, royalties and acquired software gross margin percentage increased due to higher revenues from royalties. Increased amortization expense associated with four acquisitions from January through November 2012 were offset by lower third party software costs.

Software services, maintenance and subscription services. Cost of software services, maintenance and subscriptions primarily consists of personnel costs related to installation of our software, conversion of customer data, training customer personnel and support activities and various other services such as SaaS arrangements and e-filings. For the three months ended March 31, 2013, the software services, maintenance and subscriptions gross margin percentage increased 0.3% compared to the prior year period in part because 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, as well as slightly higher rates on certain services. The increase in the gross margin was offset somewhat by our investment in TexFile, a unified, statewide electronic filing system for Texas courts. 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. 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 (which will be expensed as incurred) in the range of approximately \$3.0 million to \$3.5 million, in connection with implementing the system in courts across the state. Excluding the cost incurred in connection with implementing TexFile in the three months ended March 31, 2013, our software services, maintenance and subscription services gross margin would have been 42.5%. 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 annually when it becomes fully mandatory.

Excluding 101 additional employees added with acquisitions our implementation and support staff has increased by 164 employees since March 31, 2012.

Our blended gross margin increased 0.6% in the three months ended March 31, 2013 compared to the prior year period. This increase was due to higher royalty revenue and 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 increase in our gross margin was offset somewhat by costs incurred related to our investment in TexFile with no related revenues for the three months ended March 31, 2013. Our blended gross margin would have been 46.2% excluding our investment in TexFile.

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 periods presented as of March 31:

| (\$ in thousands) | First Quarter | | Change | |
|--|---------------|-----------|----------|----|
| | 2013 | 2012 | \$ | % |
| Selling, general and administrative expenses | \$ 22,646 | \$ 21,335 | \$ 1,311 | 6% |

SG&A as a percentage of revenues was 23.6% for the three months ended March 31, 2013 compared to 25.8% for the three months ended March 31, 2012. Approximately half of the SG&A expense increase is due higher stock compensation expense resulting from the substantial increase in our stock price over the last twelve months.

Research and Development Expense

The following table sets forth a comparison of our research and development expense for the periods presented as of March 31:

| (\$ in thousands) | First Quarter | | Change | |
|----------------------------------|---------------|----------|--------|-----|
| | 2013 | 2012 | \$ | % |
| Research and development expense | \$ 5,598 | \$ 5,094 | \$ 504 | 10% |

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, as well as other new product development efforts. In 2007, we entered into a Software Development and License Agreement, which provides for a strategic alliance with Microsoft Corporation (Microsoft) to jointly develop core public sector functionality for Microsoft Dynamics AX to address the accounting needs of public sector organizations worldwide. 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 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 of the co-developed solutions.

We did not have any research and development expense offsets earned under the terms of our agreement with Microsoft in the three months ended March 31, 2013 or 2012.

Amortization of Customer and Trade Name Intangibles

Acquisition intangibles are composed of the excess of the purchase price over the fair value of net tangible assets acquired that is allocated to acquired software and customer and trade name intangibles. The remaining excess purchase price is allocated to goodwill that is not subject to amortization. Amortization expense related to acquired software is included with cost of revenues while amortization expense of customer and trade name intangibles is recorded as a non-operating expense. The following table sets forth a comparison of amortization of customer and trade name intangibles for the periods presented as of March 31:

| (\$ in thousands) | First Quarter | | Change | |
|---|---------------|--------|--------|-----|
| | 2013 | 2012 | \$ | % |
| Amortization of customer and trade name intangibles | \$ 1,131 | \$ 946 | \$ 185 | 20% |

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

Other Expense, Net

| (\$ in thousands) | First Quarter | | Change | |
|--------------------|---------------|--------|----------|-------|
| | 2013 | 2012 | \$ | % |
| Other expense, net | \$ 338 | \$ 703 | \$ (365) | (52)% |

The majority of other expense is comprised of interest expense, non-usage and other fees associated with our revolving credit agreement. Interest expense was lower than the prior year period because we maintained higher debt levels in 2012 associated primarily with several acquisitions completed from October 2011 through November 2012. The effective interest rate for the three months ended March 31, 2013 and 2012, was 3.2% and 3.3%, respectively.

Income Tax Provision

The following table sets forth a comparison of our income tax provision for the periods presented as of March 31:

| (\$ in thousands) | First Quarter | | Change | |
|---------------------------|---------------|----------|----------|-----|
| | 2013 | 2012 | \$ | % |
| Income tax provision | \$ 5,639 | \$ 3,660 | \$ 1,979 | 54% |
| Effective income tax rate | 39.9% | 39.2% | | |

The effective income tax rates for the three months ended March 31, 2013 and 2012 were different from the statutory United States federal income tax rate of 35% primarily due to state income taxes, non-deductible share-based compensation expense, the qualified manufacturing activities deduction, and non-deductible meals and entertainment costs.

FINANCIAL CONDITION AND LIQUIDITY

As of March 31, 2013, we had cash and cash equivalents of \$4.5 million and investments available-for-sale of \$2.0 million, compared to cash and cash equivalents of \$6.4 million and investments available-for-sale of \$2.0 million at December 31, 2012. As of March 31, 2013, we had no outstanding borrowings and outstanding letters of credit totaling \$5.4 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 March 31, 2013 was estimated to be \$35.1 million. We provide letters of credit as security for issuance of performance bonds. We do not believe these letters of credit will be required to be drawn upon. These letters of credit expire throughout 2013. We currently 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 three months ended March 31:

| (\$ in thousands) | 2013 | 2012 |
|--|------------|-----------|
| Cash flows provided (used) by: | | |
| Operating activities | \$ 17,084 | \$ 18,084 |
| Investing activities | (4,825) | (6,897) |
| Financing activities | (14,170) | (2,581) |
| Net (decrease) increase in cash and cash equivalents | \$ (1,911) | \$ 8,606 |

Net cash provided by operating activities continues to be our primary source of funds to finance operating needs and capital expenditures. Other capital resources include cash on hand, public and private issuances of debt and equity securities, and bank borrowings. 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.

For the three months ended March 31, 2013, operating activities provided net cash of \$17.1 million, primarily generated from net income of \$8.5 million, non-cash depreciation and amortization charges of \$3.3 million and non-cash share-based compensation expense of \$2.6 million. Working capital, excluding cash, decreased approximately \$4.2 million mainly due to collections of annual maintenance renewal billings that are billed near the end of December and timing of federal and state income tax payments. The decline in working capital was offset slightly by bonus payments.

In general, changes in 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.

Our days sales outstanding (DSO) was 72 days at March 31, 2013, compared to 95 days at December 31, 2012 and 64 days at March 31, 2012. Our maintenance billing cycle typically peaks at its highest level in June and second highest level in December of each year and is followed by collections in the subsequent quarter. As a result our DSO is usually lower in the first quarter than the fourth quarter. Our DSO at March 31, 2013 increased compared to the prior year period because our maintenance billing volume in the first quarter has increased somewhat to accommodate billing practices related to several acquisitions completed in 2012. DSO is calculated based on quarter-end accounts receivable divided by the quotient of annualized quarterly revenues divided by 360 days.

Investing activities used cash of \$4.8 million in the three months ending March 31, 2013 compared to \$6.9 million for the same period in 2012. In the three months ended March 31, 2013, we paid approximately \$2.9 million in connection with the construction of an office building in Plano, Texas. In 2012, we completed the acquisitions of Akanda Innovations, Inc. and UniFund, L.L.C. The combined cash purchase price paid in 2012, net of cash acquired, was approximately \$5.8 million. These expenditures were funded from cash generated from operations and borrowings under our revolving credit line.

Non-current investments available-for-sale consist of two auction rate municipal securities (ARS) which are collateralized debt obligations supported by municipal agencies and do not include mortgage-backed securities. These ARS are debt instruments with stated maturities ranging from 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 a series of small partial redemptions at par in the period from July 2009 through February 2013. As of March 31, 2013, 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.

We consider the impairment in our ARS as temporary because we do not have the intent to sell, nor is it more-likely-than-not that we will be required to sell these securities before recovery of their cost basis. We believe that this decline in fair value is temporary because the underlying assets of these securities are supported by municipal agencies and do not include mortgage-backed securities, have redemption features which call for redemption at 100% of par value and have a current credit rating of A or AA. The ratings on the ARS take into account credit support through insurance policies guaranteeing each of the bonds' payment of principal and accrued interest, if it becomes necessary. In addition, both ARS have had a series of small partial redemptions at par in the period July 2009 through February 2013. Based on our cash and cash equivalents balance, expected operating cash flows and availability under our credit facility, we do not believe a lack of liquidity associated with our ARS will adversely affect our ability to conduct business, and believe we have the ability to hold the securities throughout the currently estimated recovery period. We will continue to evaluate any changes in the market value of our ARS and in the future, depending upon existing market conditions, we may be required to record an other-than-temporary decline in market value.

Financing activities used cash of \$14.2 million in the three months ended March 31, 2013 compared to \$2.6 million for the same period for 2012. Cash used by financing activities in 2013 was comprised of \$18.0 million in net payments on our revolving line of credit offset slightly by collections of \$2.3 million from stock option exercises and employee stock purchase plan activity. Cash used by financing activities in 2012 consisted of net payments of \$4.7 million on our revolving line of credit which were somewhat offset by collections of \$1.4 million from stock option exercises and employee stock purchase plan activity.

At March 31, 2013, we had authorization to repurchase up to 1.7 million additional shares of Tyler common stock. There was no repurchase activity during the three months ended March 31, 2013. 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, 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 in the future.

Our Credit Agreement (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. We had available borrowing capacity of \$144.6 million as of March 31, 2013. The Credit Facility matures on August 11, 2014. Borrowings under the Credit Facility may be used for general corporate purposes, including working capital requirements, acquisitions and share repurchases.

Borrowings under the Credit Facility bear interest at a rate of either (1) the Bank of America's prime rate plus a margin of 1.50% to 2.75% or (2) the 30, 60, 90 or 180-day LIBOR rate plus a margin of 2.50% to 3.75%, with the margin determined by our consolidated leverage ratio. As of March 31, 2013, our effective average interest rate for borrowings during the three months ended March 31, 2013 was 3.2%. The Credit Facility is secured by substantially all of our assets, excluding real property. The Credit Facility requires us to maintain certain financial ratios and other financial conditions and prohibits us from making certain investments, advances, cash dividends or loans, and limits incurrence of additional indebtedness and liens. As of March 31, 2013, we were in compliance with those covenants.

We did not make any federal and state income tax payments in the three months ended March 31, 2013 compared to payments of \$1.4 million in the prior year.

Excluding acquisitions and investments in office buildings, we anticipate that 2013 capital spending will be between \$8.5 million and \$9.5 million. We expect the majority of our capital expenditures 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 \$15.5 million in 2013 in connection with the construction of an office building in Plano, Texas. Capital spending, including the construction of the office facility, is expected to be funded from cash flows from operations and borrowings under our revolving credit line.

From time to time we engage in discussions with potential acquisition candidates. In order to consummate any 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 acquisitions and how such acquisitions may be financed.

ITEM 3. Quantitative and Qualitative Disclosures About Market Risk

Market risk represents the risk of loss that may affect us due to adverse changes in financial market prices and interest rates. Our investments available-for-sale consist of auction rate municipal securities (ARS) which are collateralized debt obligations supported by municipal agencies and do not include mortgage-backed securities.

Non-current investments available-for-sale consist of two ARS with stated maturities ranging from 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 March 31, 2013 utilizing a discounted trinomial model.

We consider the impairment in our ARS as temporary because we do not have the intent to sell, nor is it more-likely-than-not that we will be required to sell these securities before recovery of their cost basis. We believe that this decline in fair value is temporary, because the underlying assets of these securities are supported by municipal agencies and do not include mortgage-backed securities, have redemption features which call for redemption at 100% of par value and have a current credit rating of A or AA. The ratings on the ARS take into account credit support through insurance policies guaranteeing each of the bonds' payment of principal and accrued interest, if it becomes necessary. In addition, both ARS have had a series of small partial redemptions at par in the period July 2009 through February 2013. Based on our cash and cash equivalents balance, expected operating cash flows and availability under our credit facility, 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.

As of March 31, 2013 we had no outstanding borrowings under our Credit Facility. 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.

ITEM 4. 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 the end of the period covered by this report. Based on this evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were effective as of March 31, 2013.

Changes in Internal Control over Financial Reporting. There were no changes in our internal control over financial reporting (as defined in Rule 13a-15(f) of the Exchange Act) during the three months ended March 31, 2013, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Part II. OTHER INFORMATION

ITEM 1. Legal Proceedings

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

ITEM 1A. Risk Factors

In addition to the other information set forth in this report, one should carefully consider the discussion of various risks and uncertainties contained in Part I, Item 1A. Risk Factors in our 2012 Annual Report on Form 10-K. We believe those risk factors are the most relevant to our business and could cause our results to differ materially from the forward-looking statements made by us. Please note, however, that those are not the only risk factors facing us. Additional risks that we do not consider material, or of which we are not currently aware, may also have an adverse impact on us. Our business, financial condition and results of operations could be seriously harmed if any of these risks or uncertainties actually occurs or materializes. In that event, the market price for our common stock could decline, and our shareholders may lose all or part of their investment. During the three months ended March 31, 2013, there were no material changes in the information regarding risk factors contained in our Annual Report on Form 10-K for the year ended December 31, 2012.

ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds

None

ITEM 3. Defaults Upon Senior Securities

None

ITEM 4. Submission of Matters to a Vote of Security Holders

None

ITEM 5. Other Information

None

ITEM 6. Exhibits

| | |
|--------------|---|
| Exhibit 31.1 | Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| Exhibit 31.2 | Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| Exhibit 32.1 | Certifications Pursuant to 18 U.S.C. Section 1350, as adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| Exhibit 101 | Instance Document |
| Exhibit 101 | Schema Document |
| Exhibit 101 | Calculation Linkbase Document |

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Exhibit 101 Labels Linkbase Document

Exhibit 101 Definition Linkbase Document

Exhibit 101 Presentation Linkbase Document

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

TYLER TECHNOLOGIES, INC.

By: /s/ Brian K. Miller
Brian K. Miller
Executive Vice President and Chief Financial
Officer (principal financial officer and an authorized
signatory)

Date: April 24, 2013