

TYLER TECHNOLOGIES INC
Form 10-Q
July 28, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.
For the quarterly period ended June 30, 2016

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)

DELAWARE 75-2303920
(State or other jurisdiction of (I.R.S. employer

incorporation or organization) identification no.)

5101 TENNYSON PARKWAY

PLANO, TEXAS

75024

(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 July 22, 2016 was 36,340,400.

PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

TYLER TECHNOLOGIES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per share amounts)

(Unaudited)

| | Three months ended | | Six months ended | |
|---|--------------------|----------|------------------|----------|
| | June 30, | 2015 | June 30, | 2015 |
| | 2016 | | 2016 | |
| Revenues: | | | | |
| Software licenses and royalties | \$17,551 | \$14,586 | \$34,401 | \$28,886 |
| Subscriptions | 33,968 | 26,949 | 68,057 | 52,237 |
| Software services | 46,040 | 34,563 | 88,470 | 65,367 |
| Maintenance | 78,743 | 59,463 | 154,775 | 116,811 |
| Appraisal services | 6,984 | 6,691 | 13,542 | 12,780 |
| Hardware and other | 5,686 | 4,043 | 9,020 | 5,180 |
| Total revenues | 188,972 | 146,295 | 368,265 | 281,261 |
| Cost of revenues: | | | | |
| Software licenses and royalties | 666 | 483 | 1,304 | 1,036 |
| Acquired software | 5,680 | 456 | 11,139 | 912 |
| Software services, maintenance and subscriptions | 86,717 | 69,678 | 171,987 | 135,055 |
| Appraisal services | 4,458 | 4,278 | 8,420 | 8,413 |
| Hardware and other | 4,515 | 3,147 | 6,361 | 3,713 |
| Total cost of revenues | 102,036 | 78,042 | 199,211 | 149,129 |
| Gross profit | 86,936 | 68,253 | 169,054 | 132,132 |
| Selling, general and administrative expenses | 42,232 | 30,396 | 82,991 | 58,941 |
| Research and development expense | 10,336 | 7,110 | 20,292 | 14,114 |
| Amortization of customer and trade name intangibles | 3,453 | 1,151 | 6,815 | 2,303 |
| Operating income | 30,915 | 29,596 | 58,956 | 56,774 |
| Other (expense) income, net | (720) | 185 | (1,187) | 366 |
| Income before income taxes | 30,195 | 29,781 | 57,769 | 57,140 |
| Income tax provision | 11,323 | 10,945 | 21,818 | 21,031 |
| Net income | \$18,872 | \$18,836 | \$35,951 | \$36,109 |
| Earnings per common share: | | | | |
| Basic | \$0.52 | \$0.56 | \$0.99 | \$1.07 |
| Diluted | \$0.49 | \$0.52 | \$0.94 | \$1.00 |

See accompanying notes.

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TYLER TECHNOLOGIES, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except par value and share amounts)

| | June 30, 2016 (unaudited) | December 31, 2015 |
|---|---------------------------------|-------------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$41,327 | \$33,087 |
| Accounts receivable (less allowance for losses of \$1,560 in 2016 and \$1,640 in 2015) | 209,483 | 176,360 |
| Short-term investments | 22,642 | 13,423 |
| Prepaid expenses | 22,976 | 22,334 |
| Income tax receivable | 23,994 | 21,080 |
| Other current assets | 3,529 | 1,931 |
| Total current assets | 323,951 | 268,215 |
| Accounts receivable, long-term | 2,579 | 2,777 |
| Property and equipment, net | 115,886 | 101,112 |
| Other assets: | | |
| Goodwill | 655,393 | 653,666 |
| Other intangibles, net | 285,491 | 295,378 |
| Non-current investments and other assets | 29,752 | 35,422 |
| | \$1,413,052 | \$1,356,570 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$6,574 | \$6,789 |
| Accrued liabilities | 49,875 | 49,156 |
| Deferred revenue | 296,481 | 281,627 |
| Total current liabilities | 352,930 | 337,572 |
| Revolving line of credit | 135,000 | 66,000 |
| Deferred revenue, long-term | 3,704 | 3,115 |
| Deferred income taxes | 92,110 | 91,026 |
| 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 and outstanding as of June 30, 2016 and December 31, 2015 | 481 | 481 |
| Additional paid-in capital | 605,179 | 607,755 |

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| | | |
|--|-------------|-------------|
| Accumulated other comprehensive loss, net of tax | (46) | (46) |
| Retained earnings | 361,970 | 326,019 |
| Treasury stock, at cost; 11,867,051 and 11,373,666 shares in 2016 and 2015, respectively | (138,276) | (75,352) |
| Total shareholders' equity | 829,308 | 858,857 |
| | \$1,413,052 | \$1,356,570 |

See accompanying notes.

TYLER TECHNOLOGIES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

| | Six months ended June 30, | |
|---|------------------------------|-----------|
| | 2016 | 2015 |
| Cash flows from operating activities: | | |
| Net income | \$35,951 | \$36,109 |
| Adjustments to reconcile net income to cash provided (used) by operations: | | |
| Depreciation and amortization | 24,850 | 7,484 |
| Share-based compensation expense | 13,692 | 8,861 |
| Excess tax benefit from exercises of share-based arrangements | (6,694) | (8,827) |
| Changes in operating assets and liabilities, exclusive of effects of acquired companies: | | |
| Accounts receivable | (35,530) | (36,624) |
| Income taxes | 4,207 | 2,735 |
| Prepaid expenses and other current assets | (1,435) | (549) |
| Accounts payable | (236) | (371) |
| Accrued liabilities | 4,883 | (5,685) |
| Deferred revenue | 14,459 | 11,680 |
| Net cash provided by operating activities | 54,147 | 14,813 |
| Cash flows from investing activities: | | |
| Additions to property and equipment | (21,959) | (6,126) |
| Purchase of marketable security investments | (10,607) | (6,449) |
| Proceeds from marketable security investments | 6,526 | — |
| Investment in Record Holdings Pty Limited | — | (15,000) |
| Cost of acquisitions, net of cash acquired | (9,394) | (6,447) |
| Increase in other | (281) | (9) |
| Net cash used by investing activities | (35,715) | (34,031) |
| Cash flows from financing activities: | | |
| Increase in net borrowings on revolving line of credit | 69,000 | — |
| Purchase of treasury shares | (94,497) | (645) |
| Proceeds from exercise of stock options | 5,793 | 6,729 |
| Contributions from employee stock purchase plan | 2,818 | 2,243 |
| Excess tax benefit from exercises of share-based arrangements | 6,694 | 8,827 |
| Net cash (used) provided by financing activities | (10,192) | 17,154 |
| Net increase (decrease) in cash and cash equivalents | 8,240 | (2,064) |
| Cash and cash equivalents at beginning of period | 33,087 | 206,167 |

| | | |
|--|----------|-----------|
| Cash and cash equivalents at end of period | \$41,327 | \$204,103 |
|--|----------|-----------|

See accompanying notes.

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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 June 30, 2016 and December 31, 2015 and operating result amounts are for the three and six months ended June 30, 2016 and 2015, respectively, 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, 2015. 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.

Comprehensive income (loss) is defined as the change in equity of a business enterprise during a period from transactions, and other events and circumstances from non-owner sources and includes all components of net income (loss) and other comprehensive income (loss). We had no items of other comprehensive income (loss) for the three and six months ended June 30, 2016 and 2015.

Certain amounts for the previous year have been reclassified to conform to the current year presentation.

(2) Acquisitions

In November 2015, we acquired all of the capital stock of New World Systems Corporation (“NWS”), which provides public safety and financial solutions for local governments. In the six months ended June 30, 2016, we paid \$2.0 million related to the working capital holdback of \$4.0 million, which was accrued at December 31, 2015. We reduced the remaining working capital accrued liability and also recorded several miscellaneous adjustments to the preliminary opening balance sheet related to additional reserves for receivables and contingencies and other miscellaneous items for a net decrease to goodwill of approximately \$2.4 million. As of June 30, 2016, the purchase price allocation for NWS is not yet complete. The preliminary estimates of fair value assumed at the acquisition date for intangibles, liabilities, deferred revenue, and related deferred taxes are subject to change as valuations are finalized.

The operating results of NWS are included with the operating results of the Enterprise Software Solutions segment, since the date of acquisition.

(3) Other Assets

Cash and cash equivalents consist of cash on deposit with several domestic banks and money market funds.

As of June 2016, we have \$34.4 million in investment grade corporate and municipal bonds with maturity dates ranging from 2016 through mid-2018. We intend to hold these bonds to maturity and have classified them as such. We believe cost approximates fair value because of the relatively short duration of these investments. The fair value of these securities are considered Level II as they are based on inputs from quoted prices in markets that are not active or other observable market data. These investments are included in short-term investments and non-current investments and other assets.

We have a \$15.0 million investment in convertible preferred stock representing a 20% interest in Record Holdings Pty Limited, a privately held Australian company specializing in digitizing the spoken word in court and legal proceedings. The fair value of this investment is based on valuations using Level III, unobservable inputs that are supported by little or no market value activity and that are significant to the fair value of the investment. This investment is included in non-current investments and other assets.

(4) Shareholders' Equity

The following table details activity in our common stock:

| | Six months ended June 30, | | | |
|-------------------------------|---------------------------|------------|--------|----------|
| | 2016 | | 2015 | |
| | Shares | Amount | Shares | Amount |
| Purchases of common stock | (758) | \$(94,497) | (5) | (645) |
| Stock option exercises | 241 | 5,793 | 355 | \$ 6,729 |
| Employee stock plan purchases | 23 | 2,818 | 23 | 2,243 |
| Shares issued for acquisition | — | — | 13 | 1,519 |

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As of June 30, 2016, we had authorization from our board of directors to repurchase up to 2.1 million additional shares of Tyler common stock.

(5) Revolving Line of Credit

On November 16, 2015, we entered into a \$300.0 million Credit Agreement (the “Credit Facility”) with the various lenders party thereto and Wells Fargo Bank, National Association, as Administrative Agent. The Credit Facility provides for a revolving credit line up to \$300.0 million, including a \$10.0 million sublimit for letters of credit. The Credit Facility matures on November 16, 2020. 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) Wells Fargo Bank’s prime rate (subject to certain higher rate determinations) plus a margin of 0.25% to 1.00% or (2) the 30, 60, 90 or 180 day LIBOR rate plus a margin of 1.25% to 2.00%. As of June 30, 2016, our interest rate was 1.7%. The Credit Facility is secured by substantially all of our assets. 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 June 30, 2016, we were in compliance with those covenants.

As of June 30, 2016, we had \$135.0 million in outstanding borrowings and two outstanding letters of credit totaling \$2.2 million. Unused borrowing capacity under the Credit Facility was \$162.8 million.

(6) Income Tax Provision

For the three and six months ended June 30, 2016, respectively, we had effective income tax rates of 37.5% and 37.8%, respectively, compared to 36.8% for the three and six months ended June 30, 2015. The effective income tax rates for the periods presented were different from the statutory United States federal income tax rate of 35% principally due to state income taxes, non-deductible share-based compensation expense, the qualified manufacturing activities deduction, disqualifying incentive stock option dispositions and non-deductible meals and entertainment costs.

We made tax payments of \$17.6 million and \$18.3 million in the six months ended June 30, 2016 and June 30, 2015, respectively.

(7) Earnings Per Share

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

| | Three months ended June 30, | | Six months ended June 30, | |
|---|--------------------------------|----------|------------------------------|----------|
| | 2016 | 2015 | 2016 | 2015 |
| Numerator for basic and diluted earnings per share: | | | | |
| Net income | \$18,872 | \$18,836 | \$35,951 | \$36,109 |
| Denominator: | | | | |
| Weighted-average basic common shares outstanding | 36,160 | 33,751 | 36,316 | 33,756 |
| Assumed conversion of dilutive securities: | | | | |
| Stock options | 2,036 | 2,346 | 2,023 | 2,340 |
| Denominator for diluted earnings per share | | | | |
| - Adjusted weighted-average shares | 38,196 | 36,097 | 38,339 | 36,096 |
| Earnings per common share: | | | | |
| Basic | \$0.52 | \$0.56 | \$0.99 | \$1.07 |
| Diluted | \$0.49 | \$0.52 | \$0.94 | \$1.00 |

For the three and six months ended June 30, 2016, stock options representing the right to purchase common stock of approximately 708,000 shares and 735,000 shares, respectively, were not included in the computation of diluted earnings per share because their inclusion would have had an anti-dilutive effect. For the three and six months ended June 30, 2015, stock options representing the right to purchase common stock of approximately 492,000 shares and 570,000 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 income, pursuant to Accounting Standards Codification (“ASC”) 718, Stock Compensation:

| | Three months | | Six months | |
|--|----------------|---------|----------------|---------|
| | ended June 30, | | ended June 30, | |
| | 2016 | 2015 | 2016 | 2015 |
| Cost of software services, maintenance and subscriptions | \$1,571 | \$746 | \$2,888 | \$1,447 |
| Selling, general and administrative expenses | 5,641 | 3,857 | 10,804 | 7,414 |
| Total share-based compensation expenses | \$7,212 | \$4,603 | \$13,692 | \$8,861 |

(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, education and planning, regulatory and maintenance software solutions;
- financial management, municipal courts, planning, regulatory and maintenance, and land and vital records management software solutions;
- courts and justice and public safety software solutions; and
- appraisal and tax software solutions and property appraisal services.

In accordance with ASC 280-10, Segment Reporting, the financial management, education and planning, regulatory and maintenance software solutions unit; financial management, municipal courts, planning, regulatory and maintenance, and land and vital records management software solutions unit; and the courts and justice and public safety 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 non-cash 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 June 30, 2016

| | Enterprise | Appraisal and Tax | | |
|---------------------------------|------------|--------------------|--------------|------------|
| | Software | Software Solutions | | |
| | Solutions | and Services | Corporate | Totals |
| Revenues | | | | |
| Software licenses and royalties | \$ 16,439 | \$ 1,112 | \$— | \$17,551 |
| Subscriptions | 32,316 | 1,652 | — | 33,968 |
| Software services | 42,159 | 3,881 | — | 46,040 |
| Maintenance | 74,110 | 4,633 | — | 78,743 |
| Appraisal services | — | 6,984 | — | 6,984 |
| Hardware and other | 2,942 | — | 2,744 | 5,686 |
| Intercompany | 1,612 | — | (1,612) | — |
| Total revenues | \$ 169,578 | \$ 18,262 | \$ 1,132 | \$ 188,972 |
| Segment operating income | \$ 46,109 | \$ 3,990 | \$ (10,051) | \$ 40,048 |

For the six months ended June 30, 2016

| | Enterprise | Appraisal and Tax | | |
|---------------------------------|------------|--------------------|--------------|------------|
| | Software | Software Solutions | | |
| | Solutions | and Services | Corporate | Totals |
| Revenues | | | | |
| Software licenses and royalties | \$ 32,093 | \$ 2,308 | \$— | \$34,401 |
| Subscriptions | 64,301 | 3,756 | — | 68,057 |
| Software services | 80,763 | 7,707 | — | 88,470 |
| Maintenance | 145,510 | 9,265 | — | 154,775 |
| Appraisal services | — | 13,542 | — | 13,542 |
| Hardware and other | 5,977 | 16 | 3,027 | 9,020 |
| Intercompany | 2,772 | — | (2,772) | — |
| Total revenues | \$ 331,416 | \$ 36,594 | \$ 255 | \$ 368,265 |
| Segment operating income | \$ 86,778 | \$ 8,821 | \$ (18,689) | \$ 76,910 |

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For the three months ended June 30, 2015

| | Enterprise | Appraisal and Tax | | |
|---------------------------------|-------------------|--------------------|-----------------|-------------------|
| | Software | Software Solutions | | |
| | Solutions | and Services | Corporate | Totals |
| Revenues | | | | |
| Software licenses and royalties | \$ 13,556 | \$ 1,030 | \$ — | \$ 14,586 |
| Subscriptions | 25,733 | 1,216 | — | 26,949 |
| Software services | 31,826 | 2,737 | — | 34,563 |
| Maintenance | 54,992 | 4,471 | — | 59,463 |
| Appraisal services | — | 6,691 | — | 6,691 |
| Hardware and other | 1,330 | 11 | 2,702 | 4,043 |
| Intercompany | 979 | — | (979) | — |
| Total revenues | \$ 128,416 | \$ 16,156 | \$ 1,723 | \$ 146,295 |
| Segment operating income | \$ 34,408 | \$ 3,903 | \$(7,108) | \$ 31,203 |

For the six months ended June 30, 2015

| | Enterprise | Appraisal and Tax | | |
|---------------------------------|-------------------|--------------------|---------------|-------------------|
| | Software | Software Solutions | | |
| | Solutions | and Services | Corporate | Totals |
| Revenues | | | | |
| Software licenses and royalties | \$ 25,883 | \$ 3,003 | \$ — | \$ 28,886 |
| Subscriptions | 50,042 | 2,195 | — | 52,237 |
| Software services | 60,994 | 4,373 | — | 65,367 |
| Maintenance | 108,007 | 8,804 | — | 116,811 |
| Appraisal services | — | 12,780 | — | 12,780 |
| Hardware and other | 2,468 | 11 | 2,701 | 5,180 |
| Intercompany | 1,905 | — | (1,905) | — |
| Total revenues | \$ 249,299 | \$ 31,166 | \$ 796 | \$ 281,261 |
| Segment operating income | \$ 66,660 | \$ 6,971 | \$(13,642) | \$ 59,989 |

| | Three months ended June 30, | | Six months ended June 30, | |
|---|-----------------------------|-----------|---------------------------|-----------|
| | 2016 | 2015 | 2016 | 2015 |
| Reconciliation of reportable segment operating income to the Company's consolidated totals: | | | | |
| Total segment operating income | \$ 40,048 | \$ 31,203 | \$ 76,910 | \$ 59,989 |
| Amortization of acquired software | (5,680) | (456) | (11,139) | (912) |
| Amortization of customer and trade name intangibles | (3,453) | (1,151) | (6,815) | (2,303) |
| Other (expense) income, net | (720) | 185 | (1,187) | 366 |
| Income before income taxes | \$ 30,195 | \$ 29,781 | \$ 57,769 | \$ 57,140 |

(10) Commitments and Contingencies

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

(11) New Accounting Pronouncements

Revenue from Contracts with Customers. On May 28, 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2014-09, “Revenue from Contracts with Customers.” This ASU is the result of a convergence project between the FASB and the International Accounting Standards Board. The core principle behind ASU 2014-09 is that an entity should recognize revenue to depict the transfer of promised goods and services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for delivering those goods and services. This model involves a five-step process that includes identifying the contract with the customer, identifying the performance obligations in the contract, determining the transaction price, allocating the transaction prices to the performance obligations in the contract and recognizing revenue when (or as) the entity satisfies the performance obligations. The guidance in the ASU supersedes existing revenue recognition guidance and is

effective for annual reporting periods beginning after December 15, 2016 with early application not permitted. The ASU allows two methods of adoption; a full retrospective approach where three years of financial information are presented in accordance with the new standard, and a modified retrospective approach where the ASU is applied to the most current period presented in the financial statements.

On August 12, 2015, the FASB voted for a one-year deferral of the effective date of the new standard and now requires application of the new standard no later than annual reporting periods beginning after December 15, 2017, including interim reporting periods therein. However, under the proposal, public entities would be permitted to elect to early adopt the new standard as of the original effective date. We are currently assessing the financial impact of adopting the new standard and the methods of adoption, however, we are currently unable to provide a reasonable estimate regarding the financial impact or which method of adoption of the new standard we will elect. We currently expect to adopt the new standard in fiscal year 2018 in accordance with the revised effective date.

Leases. On February 25, 2016, the FASB issued its new lease accounting guidance in ASU No. 2016-02, "Leases (Topic 842)." Under the new guidance, lessees will be required to recognize the following for all leases (with the exception of short-term leases) at the commencement date:

- A lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and
- A right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term.

Lessees (for capital and operating leases) and lessors (for sales-type, direct financing, and operating leases) must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The modified retrospective approach would not require any transition accounting for leases that expired before the earliest comparative period presented. Lessees and lessors may not apply a full retrospective transition approach.

The ASU is effective for fiscal years beginning after December 15, 2018, including interim periods therein. Early application is permitted for all business entities upon issuance. We are currently assessing the financial impact of adopting the new standard, however; we are currently unable to provide a reasonable estimate regarding the financial impact. We currently expect to adopt the new standard in fiscal year 2019.

Compensation-Stock Compensation. On March 31, 2016, the FASB issued ASU No. 2016-09, "Compensation – Stock Compensation (Topic 718)", that will require entities to recognize the income tax effects of share based payments to employees in the income statement when the awards vest or are settled. The guidance is effective for public business entities for fiscal years beginning after December 15, 2016, and interim periods within those years and early adoption is permitted. We are currently assessing the financial impact of adopting the new standard. We are currently unable to provide a reasonable estimate regarding the financial impact, but expect it will impact our income tax expense and effective tax rate. We currently plan to adopt the new standard in fiscal year 2016.

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" or other similar words or 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 clients, 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) our ability to successfully achieve growth or operational synergies through the integration of acquired businesses, while avoiding unanticipated costs and disruptions to existing operations; (4) material portions of our business require the Internet infrastructure to be adequately maintained; (5) our ability to achieve our financial forecasts due to various factors, including project delays by our clients, reductions in transaction size, fewer transactions, delays in delivery of new products or releases or a decline in our renewal rates for service agreements; (6) general economic, political and market conditions; (7) technological and market risks associated with the development of new products or services or of new versions of existing or acquired products or services; (8) competition in the industry in which we conduct business and the impact of competition on pricing, client 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 Item 1A, "Risk Factors." 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 IT needs of cities, counties, schools and other local government entities. In addition, we provide professional IT services to our clients, including software and hardware installation, data conversion, training and for certain clients, product modifications, along with continuing maintenance and support for clients 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-filing"), which simplify the filing and management of court related documents. We also provide property appraisal outsourcing services for taxing jurisdictions.

Our products generally automate six major functional areas: (1) financial management and education, (2) courts and justice, (3) public safety, (4) property appraisal and tax, (5) planning, regulatory and maintenance, and (6) land and vital records management. 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; courts and justice processes; public safety; planning, regulatory and maintenance; and land and vital records management. 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 3,723 at June 30, 2016 from 3,068 at June 30, 2015. This increase includes 515 employees added as the result of two acquisitions.

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For the three and six months ended June 30, 2016, total revenues increased 29% and 31%, respectively, compared to the prior year periods. Organic revenue increased 11% and 12% for the three and six months ended June 30, 2016, respectively, compared to the prior year periods and revenues from acquisitions completed in 2015 and 2016 contributed 18% and 19% for the three and six months ended June 30, 2016, respectively.

Subscriptions revenue grew 26% and 30% for the three and six months ended June 30, 2016, respectively, due to a gradual shift toward cloud-based, software as a service business, as well as continued strong growth in our e-filing revenues from courts. Organic subscriptions revenue increased 22% and 26% for the three and six months ended June 30, 2016, respectively. Activity in the local government software market continues to be strong, and with the inclusion of New World Systems Corporation (“NWS”), which was acquired in November 2015, our backlog at June 30, 2016 reached \$867.6 million, a 20% increase from last year.

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 the interim period 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, 2015. There have been no material changes to our critical accounting policies and estimates from the information provided in our Form 10-K for the year ended December 31, 2015.

ANALYSIS OF RESULTS OF OPERATIONS

| | Percent of Total Revenues | | | |
|--|---------------------------|--------------|---------------|--------------|
| | Second Quarter | | Six Months | |
| | 2016 | 2015 | 2016 | 2015 |
| Revenues: | | | | |
| Software licenses and royalties | 9.3 | 10.0 | 9.3 | 10.3 |
| Subscriptions | 18.0 | 18.4 | 18.5 | 18.6 |
| Software services | 24.4 | 23.6 | 24.0 | 23.2 |
| Maintenance | 41.7 | 40.6 | 42.0 | 41.5 |
| Appraisal services | 3.7 | 4.6 | 3.7 | 4.5 |
| Hardware and other | 2.9 | 2.8 | 2.5 | 1.9 |
| Total revenues | 100.0 | 100.0 | 100.0 | 100.0 |
| Operating Expenses: | | | | |
| Cost of software licenses, royalties and acquired software | 3.4 | 0.6 | 3.4 | 0.6 |
| Cost of software services, maintenance and subscriptions | 45.9 | 47.6 | 46.7 | 48.0 |
| Cost of appraisal services | 2.4 | 2.9 | 2.3 | 3.0 |
| Cost of hardware and other | 2.4 | 2.2 | 1.7 | 1.3 |
| Selling, general and administrative expenses | 22.3 | 20.8 | 22.5 | 21.0 |
| Research and development expense | 5.5 | 4.9 | 5.5 | 5.0 |
| Amortization of customer and trade name intangibles | 1.8 | 0.8 | 1.9 | 0.9 |
| Operating income | 16.3 | 20.2 | 16.0 | 20.2 |
| Other (expense) income, net | (0.3) | 0.1 | (0.3) | 0.1 |
| Income before income taxes | 16.0 | 20.3 | 15.7 | 20.3 |
| Income tax provision | 6.0 | 7.5 | 5.9 | 7.5 |

| | | | | | | | | |
|------------|------|---|------|---|-----|---|------|---|
| Net income | 10.0 | % | 12.8 | % | 9.8 | % | 12.8 | % |
|------------|------|---|------|---|-----|---|------|---|

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Revenues

On November 16, 2015, we acquired NWS, which provides public safety and financial solutions for local governments. The following table details revenue for NWS for the periods presented as of June 30, 2016, which is included in our consolidated statement of income:

| | Second Quarter | Six Months |
|--------------------|-------------------|---------------|
| Revenues: | | |
| Software licenses | \$3,040 | \$6,548 |
| Subscriptions | 1,017 | 2,028 |
| Software services | 6,323 | 11,499 |
| Maintenance | 14,977 | 28,186 |
| Hardware and other | 610 | 1,355 |
| Total revenues | \$25,967 | \$49,616 |

In June 2016, we acquired a company which provides scheduling, time and attendance software. The impact of this acquisition on our operating results is not considered material and is not included in the table above.

The results of these acquisitions are included with the operating results of the ESS segment from their dates of acquisition.

Software licenses and royalties

The following table sets forth a comparison of our software licenses and royalties revenue for the periods presented as of June 30:

| (\$ in thousands) | Second Quarter | | Change | | Six Months | | Change | |
|---|----------------|----------|---------|------|------------|----------|---------|------|
| | 2016 | 2015 | \$ | % | 2016 | 2015 | \$ | % |
| ESS | \$16,439 | \$13,556 | \$2,883 | 21 % | \$32,093 | \$25,883 | \$6,210 | 24 % |
| ATSS | 1,112 | 1,030 | 82 | 8 | 2,308 | 3,003 | (695) | (23) |
| Total software licenses and royalties revenue | \$17,551 | \$14,586 | \$2,965 | 20 % | \$34,401 | \$28,886 | \$5,515 | 19 % |

Excluding the results of acquisitions, software license revenue decreased 1% and 5% for the three and six months ended June 30, 2016, respectively, compared to the prior year periods. The decline for the three and six months ended June 30, 2016 was mainly due to lower add-on sales from our existing customer base of approximately \$650,000 and \$785,000, respectively, for courts and justice related solutions that assist and support the transition to a paperless environment. By the end of 2015, the majority of our courts and justice clients had implemented these add-on solutions. Software license revenue also declined in the six months ended June 30, 2016, due to more clients choosing our subscription-based option, rather than purchasing the software under a traditional perpetual software arrangement.

Although the mix of new contracts between subscription-based and perpetual license arrangements may vary from quarter to quarter and year to year, we expect our longer-term software license growth rate to continue to be negatively impacted by 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 lower software license revenue in the initial year as compared to perpetual software license arrangements but generate higher overall revenue over the term of the contract. Our new client mix for the six months ended June 30, 2016 was approximately 66% selecting perpetual software license arrangements and approximately 34% selecting subscription-based arrangements compared to a client mix for the six months ended June 30, 2015, of approximately 74% selecting perpetual software license arrangements and approximately 26% selecting subscription-based arrangements. 74 and 139 new clients entered into subscription-based software arrangements for the three and six months ended June 30, 2016 compared to 34 and 66 new clients for the three and six months ended June 30, 2015, respectively.

Subscriptions

The following table sets forth a comparison of our subscriptions revenue for the periods presented as of June 30:

| (\$ in thousands) | Second Quarter | | Change | | Six Months | | Change | |
|-----------------------------|----------------|----------|---------|------|------------|----------|----------|------|
| | 2016 | 2015 | \$ | % | 2016 | 2015 | \$ | % |
| ESS | \$32,316 | \$25,733 | \$6,583 | 26 % | \$64,301 | \$50,042 | \$14,259 | 28 % |
| ATSS | 1,652 | 1,216 | 436 | 36 | 3,756 | 2,195 | 1,561 | 71 |
| Total subscriptions revenue | \$33,968 | \$26,949 | \$7,019 | 26 % | \$68,057 | \$52,237 | \$15,820 | 30 % |

Subscription-based services revenue primarily consists of revenue derived from our SaaS arrangements, which utilize the Tyler private cloud. As part of our subscription-based services, we also provide e-filing arrangements that simplify the filing and management of court related documents for courts and law offices. E-filing revenue is derived from transaction fees and fixed fee arrangements.

Excluding acquisitions, subscriptions revenue grew 22% and 26% for the three and six months ending June 30, 2016, respectively, compared to the prior year periods. New SaaS clients as well as existing clients who converted to our SaaS model provided the majority of the subscriptions revenue increase. In the three and six months ending June 30, 2016, respectively, we added 74 and 139 new SaaS clients and 18 and 29 existing on-premises clients converted to our SaaS model, respectively. Since June 30, 2015, we added 207 new SaaS clients and 56 existing on-premises clients have converted to our SaaS model. Also, e-filing services contributed approximately \$1.3 million and \$2.8 million to the subscriptions revenue increase for the three and six months ended June 30, 2016, respectively, due to the addition of new e-filing clients, as well as increased volumes as the result of several existing clients mandating e-filing.

Software services

The following table sets forth a comparison of our software services revenue for the periods presented as of June 30:

| (\$ in thousands) | Second Quarter | | Change | | Six Months | | Change | |
|---------------------------------|----------------|----------|----------|------|------------|----------|----------|------|
| | 2016 | 2015 | \$ | % | 2016 | 2015 | \$ | % |
| ESS | \$42,159 | \$31,826 | \$10,333 | 32 % | \$80,763 | \$60,994 | \$19,769 | 32 % |
| ATSS | 3,881 | 2,737 | 1,144 | 42 | 7,707 | 4,373 | 3,334 | 76 |
| Total software services revenue | \$46,040 | \$34,563 | \$11,477 | 33 % | \$88,470 | \$65,367 | \$23,103 | 35 % |

Software services revenue primarily consists of professional services billed in connection with implementing our software, converting client data, training client personnel, custom development activities and consulting. New clients who purchase our proprietary software licenses generally also contract with us to provide for the related software services. Existing clients also periodically purchase additional training, consulting and minor programming services. Excluding the results of acquisitions, for the three and six months ended June 30, 2016, respectively, software services revenue grew 15% and 17% compared to the prior year periods. This growth is partly due to additions to our implementation and support staff, which increased our capacity to deliver backlog, and a contract mix that included more custom development and other services.

Maintenance

The following table sets forth a comparison of our maintenance revenue for the periods presented as of June 30:

| (\$ in thousands) | Second Quarter | | Change | | Six Months | | Change | |
|---------------------------|----------------|----------|----------|------|------------|-----------|----------|------|
| | 2016 | 2015 | \$ | % | 2016 | 2015 | \$ | % |
| ESS | \$74,110 | \$54,992 | \$19,118 | 35 % | \$145,510 | \$108,007 | \$37,503 | 35 % |
| ATSS | 4,633 | 4,471 | 162 | 4 | 9,265 | 8,804 | 461 | 5 |
| Total maintenance revenue | \$78,743 | \$59,463 | \$19,280 | 32 % | \$154,775 | \$116,811 | \$37,964 | 33 % |

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We provide maintenance and support services for our software products and certain third-party software. Excluding the results of acquisitions, maintenance revenue grew approximately 7% for both the three and six months ended June 30, 2016 compared to the prior year. Maintenance and support revenue increased mainly due to growth in our installed customer base from new software license sales, as well as annual maintenance rate increases.

Appraisal services

The following table sets forth a comparison of our appraisal services revenue for the periods presented as of June 30:

| (\$ in thousands) | Second Quarter | | Change | | Six Months | | Change | |
|----------------------------------|----------------|---------|--------|-----|------------|----------|--------|-----|
| | 2016 | 2015 | \$ | % | 2016 | 2015 | \$ | % |
| ESS | \$— | \$— | \$— | —% | \$— | \$— | \$— | —% |
| ATSS | 6,984 | 6,691 | 293 | 4 | 13,542 | 12,780 | 762 | 6 |
| Total appraisal services revenue | \$6,984 | \$6,691 | \$293 | 4 % | \$13,542 | \$12,780 | \$762 | 6 % |

The appraisal services business is somewhat cyclical and driven in part by statutory revaluation cycles in various states. Appraisal services revenue for the six months ended June 30, 2016, increased primarily due to the Franklin County, Ohio revaluation, which began late in the first quarter of 2015.

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 June 30:

| (\$ in thousands) | Second Quarter | | Change | | Six Months | | Change | |
|--|----------------|----------|----------|------|------------|-----------|----------|------|
| | 2016 | 2015 | \$ | % | 2016 | 2015 | \$ | % |
| Software licenses and royalties | \$666 | \$483 | \$183 | 38 % | \$1,304 | \$1,036 | \$268 | 26 % |
| Acquired software | 5,680 | 456 | 5,224 | N/M | 11,139 | 912 | 10,227 | N/M |
| Software services, maintenance and subscriptions | 86,717 | 69,678 | 17,039 | 24 | 171,987 | 135,055 | 36,932 | 27 |
| Appraisal services | 4,458 | 4,278 | 180 | 4 | 8,420 | 8,413 | 7 | — |
| Hardware and other | 4,515 | 3,147 | 1,368 | 43 | 6,361 | 3,713 | 2,648 | 71 |
| Total cost of revenues | \$102,036 | \$78,042 | \$23,994 | 31 % | \$199,211 | \$149,129 | \$50,082 | 34 % |

The following table sets forth a comparison of gross margin percentage by revenue type for the periods presented as of June 30:

| | Second Quarter | | | Six Months | | |
|--|----------------|--------|----------|------------|--------|----------|
| | 2016 | 2015 | Change | 2016 | 2015 | Change |
| Software licenses, royalties and acquired software | 63.8 % | 93.6 % | (29.8) % | 63.8 % | 93.3 % | (29.5) % |
| Software services, maintenance and subscriptions | 45.4 | 42.4 | 3.0 | 44.8 | 42.4 | 2.4 |

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| | | | | | | |
|----------------------|--------|--------|---------|--------|--------|---------|
| Appraisal services | 36.2 | 36.1 | 0.1 | 37.8 | 34.2 | 3.6 |
| Hardware and other | 20.6 | 22.2 | (1.6) | 29.5 | 28.3 | 1.2 |
| Overall gross margin | 46.0 % | 46.7 % | (0.7)% | 45.9 % | 47.0 % | (1.1)% |

Software licenses, royalties and acquired software. Amortization expense for acquired software comprises the majority of costs of software licenses, royalties and acquired software. We do not have any direct costs associated with royalties. In the three and six months ended June 30, 2016, respectively, our software licenses, royalties and acquired software gross margin percentage declined compared to the prior year periods due to much higher amortization expense for acquired software resulting from our acquisition of NWS. Excluding the impact of NWS revenues and amortization expense, our software license, royalties and acquired software gross margin was 93.6% and 93.8% for the three and six months ended June 30, 2016, respectively.

Software services, maintenance and subscriptions. Cost of software services, maintenance and subscriptions primarily consists of personnel costs related to installation of our software, conversion of client data, training client personnel and support activities and various other services such as custom client development and on-going operation of SaaS and e-filing arrangements. The software services, maintenance and subscription gross margin in the three and six months ended June 30, 2016, respectively, was 3.0% and 2.4% higher than the comparable prior year periods. Excluding 283 employees added with acquisitions, our implementation and support staff has grown by 109 employees since June 30, 2015. To support sales growth, we began making significant investments in our implementation and support staff in early 2015. Since December 31, 2014, we have added 259 employees, excluding employees added with acquisitions. These additions contributed to revenue growth in 2016. In addition, the NWS revenue mix includes a lower

proportion of software services compared to Tyler's historical revenue mix, which also benefited the gross margin. Costs related to maintenance and various other services such as SaaS and e-filing typically grow at a slower rate than related revenue due to leverage in the utilization of support and maintenance staff and economies of scale. Maintenance and subscription price increases also resulted in slightly higher gross margins.

Appraisal services. Appraisal services revenue comprised approximately 4% of total revenue. The appraisal services gross margin for the three and six months ended June 30, 2016, respectively, increased 0.1% and 3.6% compared to the same periods in 2015. A high proportion of the costs of appraisal services revenue are variable, as we often hire temporary employees to assist in appraisal projects, whose terms of employment generally end with the projects' completions.

For the three and six months ended June 30, 2016, respectively, our blended gross margin declined 0.7% and 1.1%, respectively, compared to the prior year periods. The gross margin was negatively impacted by increased acquired software amortization expense associated with the NWS acquisition and a contract mix that included less software license revenues. Improved utilization of our support and maintenance staff slightly offset the gross margin decline.

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 June 30:

| (\$ in thousands) | Second Quarter | | Change | | Six Months | | Change | |
|--|----------------|----------|----------|------|------------|----------|----------|------|
| | 2016 | 2015 | \$ | % | 2016 | 2015 | \$ | % |
| Selling, general and administrative expenses | \$42,232 | \$30,396 | \$11,836 | 39 % | \$82,991 | \$58,941 | \$24,050 | 41 % |

SG&A as a percentage of revenues was 22.3% and 22.5% for the three and six months ended June 30, 2016, respectively, compared to 20.8% and 21.0% for the three and six months ended June 30, 2015, respectively. Excluding acquisitions, SG&A expense increased approximately 15% and 16% for the three and six months ended June 30, 2016, respectively. These increases are mainly due to compensation cost related to increased staff levels, higher stock compensation expense and increased commission expense as a result of higher sales. Excluding 144 employees added with acquisitions, we have added 11 employees since June 30, 2015. In addition, for the three and six months ended June 30, 2016, respectively, stock compensation expense rose \$1.8 million and \$3.4 million compared to the same periods in 2015, mainly due to increases in our stock price over the last few years.

Research and Development Expense

The following table sets forth a comparison of our research and development expense for the periods presented as of June 30:

| (\$ in thousands) | Second Quarter | | Change | | Six Months | | Change | |
|----------------------------------|----------------|---------|---------|------|------------|----------|---------|------|
| | 2016 | 2015 | \$ | % | 2016 | 2015 | \$ | % |
| Research and development expense | \$10,336 | \$7,110 | \$3,226 | 45 % | \$20,292 | \$14,114 | \$6,178 | 44 % |

Research and development expense consists mainly of costs associated with development of new products and technologies from which we do not currently generate revenue, as well as costs related to the ongoing development efforts for Microsoft Dynamics AX. Our contractual research and development commitment to develop public sector functionality for Microsoft Dynamics AX was amended in March 2016 and significantly reduced our development commitment through March 2018. However, we will continue to provide sustained engineering and technical support for the public sector functionality within Dynamics AX. License and maintenance royalties for all applicable domestic and international sales of Dynamics AX to public sector entities will continue under the terms of the contract.

Excluding the results of acquisitions, research and development expense in the three and six months ended June 30, 2016 declined 4% and 3%, respectively, mainly due to reduced development efforts for Microsoft Dynamics AX, offset somewhat by other research and development efforts related to new Tyler product development initiatives. As a result of the Microsoft Dynamics AX amendment, we plan to re-deploy certain development resources to enhance functionality on several existing solutions and these costs will be recorded in cost of sales – software services, maintenance and subscriptions.

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 of customer and trade name intangibles increased substantially from the comparable prior year periods due to the acquisition of NWS in November 2015. Amortization expense related to acquired software is included with cost of revenues while amortization expense of customer and trade name intangibles is recorded as operating expense.

The following table sets forth a comparison of amortization of customer and trade name intangibles for the periods presented as of June 30:

| (\$ in thousands) | Second Quarter | | Change | | Six Months | | Change | |
|---|----------------|---------|---------|-------|------------|---------|---------|-------|
| | 2016 | 2015 | \$ | % | 2016 | 2015 | \$ | % |
| Amortization of customer and trade name intangibles | \$3,453 | \$1,151 | \$2,302 | 200 % | \$6,815 | \$2,303 | \$4,512 | 196 % |

Other (Expense) Income, Net

The following table sets forth a comparison of our other (expense) income, net for the periods presented as of June 30:

| (\$ in thousands) | Second Quarter | | Change | | Six Months | | Change | |
|-----------------------------|----------------|-------|---------|-----|------------|-------|-----------|-----|
| | 2016 | 2015 | \$ | % | 2016 | 2015 | \$ | % |
| Other (expense) income, net | \$(720) | \$185 | \$(905) | N/M | \$(1,187) | \$366 | \$(1,553) | N/M |

Other (expense) income, net is comprised of interest expense and non-usage and other fees associated with our revolving credit agreement, as well as interest income from invested cash. In 2015, we had significantly higher invested cash balances and no outstanding debt until we completed the NWS acquisition on November 16, 2015.

Income Tax Provision

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The following table sets forth a comparison of our income tax provision for the periods presented as of June 30:

| (\$ in thousands) | Second Quarter | | Change | | Six Months | | Change | |
|---------------------------|----------------|----------|--------|-----|------------|----------|--------|-----|
| | 2016 | 2015 | \$ | % | 2016 | 2015 | \$ | % |
| Income tax provision | \$11,323 | \$10,945 | \$378 | 3 % | \$21,818 | \$21,031 | \$787 | 4 % |
| Effective income tax rate | 37.5 % | 36.8 % | | | 37.8 % | 36.8 % | | |

The effective income tax rates for the three and six months ended June 30, 2016 and 2015, were different from the statutory United States federal income tax rate of 35% primarily due to state income taxes, non-deductible share-based compensation expense, the qualified manufacturing activities deduction and non-deductible meals and entertainment costs. The effective income tax rate for the three and six months ended June 30, 2016, increased compared to the prior year period mainly due to higher non-deductible share-based compensation.

In the past few years a relatively high amount of excess tax benefits related to stock option exercises have resulted in a reduction in our qualified manufacturing activities deduction. The qualified manufacturing activities deduction can be limited to a certain level of taxable income on the tax return. Therefore any significant items that reduce taxable income, such as excess tax benefits on stock options, can reduce the amount of the qualified manufacturing activities deduction. It is possible that significant excess tax benefits related to stock option exercises for the remainder of the year could reduce the qualified manufacturing activities deduction. A reduction in the qualified manufacturing activities deduction could result in a higher effective tax rate. The excess tax benefits for the three and six months ended June 30, 2016, respectively, were \$5.6 million and \$6.7 million and did not materially impact the tax rate.

FINANCIAL CONDITION AND LIQUIDITY

As of June 30, 2016, we had cash and cash equivalents of \$41.3 million compared to \$33.1 million at December 31, 2015. We also had \$34.4 million invested in investment grade corporate and municipal bonds as of June 30, 2016. These investments mature between 2016 and mid-2018 and we intend to hold these investments until maturity. As of June 30, 2016, we had \$135.0 million in outstanding borrowings and two outstanding letters of credit totaling \$2.2 million. We do not believe the letters of credit will be required to be drawn upon. These letters of credit expire mid-2017. We believe our cash from operating activities, revolving line of credit, cash on hand and access to the capital markets provides us with sufficient flexibility to meet our long-term financial needs.

The following table sets forth a summary of cash flows for the six months ended June 30:

| (\$ in thousands) | 2016 | 2015 |
|--|----------|-----------|
| Cash flows provided (used) by: | | |
| Operating activities | \$54,147 | \$14,813 |
| Investing activities | (35,715) | (34,031) |
| Financing activities | (10,192) | 17,154 |
| Net increase (decrease) in cash and cash equivalents | \$8,240 | \$(2,064) |

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.

For the six months ended June 30, 2016, operating activities provided cash of \$54.1 million. Operating activities that provided cash were primarily comprised of net income of \$36.0 million, non-cash depreciation and amortization charges of \$24.9 million and non-cash share-based compensation expense of \$13.7 million. Working capital, excluding cash and investments, increased approximately \$13.7 million mainly due to higher accounts receivable because our maintenance billing cycle peaks in June. Working capital also increased due to timing of payments on bonuses and prepaid commissions. These increases were offset slightly by timing of payments for wages.

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 largest renewal billing cycles occur in the second and fourth quarters. However, we recorded a significant amount of new software license arrangements in 2015, which is a factor in maintenance growth. The related maintenance billings for these new arrangements were processed at various times throughout 2015, rather than on our normal maintenance billing cycles which slightly altered our typical deferred revenue cycle in 2015. In addition, subscription renewals are billed throughout the year.

Our days sales outstanding (“DSO”) was 100 days at June 30, 2016, compared to 100 days at December 31, 2015 and 94 days at June 30, 2015. 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. Our DSO increased compared to June 30, 2015 due to the inclusion of NWS maintenance billings which peak in June. 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 \$35.7 million in the six months ending June 30, 2016. Approximately \$22.0 million was invested in property and equipment. We purchased an office building in Falmouth, Maine that was previously leased from an entity owned by an executive’s father and brother, for approximately \$9.7 million and paid \$1.9 million for construction to expand a building in Yarmouth, Maine. We plan to spend approximately \$11.5 million in 2016 and approximately \$15.5 million in 2017 in connection with the completion of this office expansion. The remaining additions were for computer equipment, furniture and fixtures in support of internal growth, particularly with respect to growth in our cloud-based offerings. In the six months ended June 2016, we acquired

ExecuTime Software, LLC for approximately \$7.4 million and paid \$2.0 million related to the working capital holdback in connection with the NWS acquisition.

In the six months ended June 30, 2015, investing activities used cash of \$34.0 million. On January 30, 2015, we made a \$15.0 million investment in convertible preferred stock representing a 20% interest in Record Holdings Pty Limited, a privately held Australian company specializing in digitizing the spoken word in court and legal settings. On May 29, 2015, we paid \$6.1 million in cash, net of cash acquired and including debt assumed, to acquire all of the capital stock of Brazos Technology Corporation. The remaining use of cash related to computer equipment, furniture and fixtures in support of internal growth, particularly with respect to growth in our cloud-based offerings.

Financing activities used cash of \$10.2 million in the six months ended June 30, 2016 and were comprised of purchases of treasury shares, net borrowings from our revolving line of credit and proceeds from stock option exercises and employee stock purchase plan activity. During the six months ended June 30, 2016, we purchased 758,000 shares of our common stock for an aggregate purchase price of \$94.5 million at an average price paid per share of \$124.75.

In the six months ended June 30, 2015, financing activities provided cash of \$17.2 million and were comprised of \$9.0 million from stock option exercises and employee stock purchase plan activity and \$8.8 million excess tax benefit from exercises of share-based arrangements. We also purchased approximately 5,400 shares of our common stock for an aggregate purchase price of \$645,000 in the six months ended June 30, 2015.

On May 11, 2016, our board of directors authorized the repurchase of an additional 1.5 million shares of Tyler common stock and as a result we had authorization to repurchase up to 2.1 million shares of Tyler common stock as of June 30, 2016. The repurchase program, which was approved by our board of directors, was announced in October 2002, and was amended at various times from 2003 through 2016. There is no expiration date specified for the authorization, and we intend to repurchase stock under the plan from time to time.

We made tax payments of \$17.6 million in the six months ended June 30, 2016 compared to tax payments of \$18.3 million in the six months ended June 30, 2015.

Excluding acquisitions, we anticipate that 2016 capital spending will be between \$42.0 million and \$44.0 million. Capital spending includes \$9.7 million paid in March for an office building in Falmouth, Maine and approximately \$11.5 million of additional funds we plan to spend to expand an office building in Yarmouth, Maine. We expect the remaining capital spending will consist primarily of computer equipment and software for infrastructure replacements and expansion. We currently do not expect to capitalize significant amounts related to software development in 2016, but the actual amount and timing of those costs, and whether they are capitalized or expensed, may result in additional capitalized software development. Capital spending is expected to be funded from existing cash balances, cash flows from operations and borrowings under our revolving line of credit.

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 incur debt or issue 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.

As of June 30, 2016, we had \$135.0 million in outstanding borrowings under the Credit Facility. Loans under the Credit Facility bear interest, at Tyler's option, at a per annum rate of either (1) the Wells Fargo Bank prime rate (subject to certain higher rate determinations) plus a margin of 0.25% to 1.00% or (2) the 30, 60, 90 or 180-day LIBOR rate plus a margin of 1.25% to 2.00%.

During the six months ended June 30, 2016, our effective average interest rate for borrowings was 1.8%. As of June 30, 2016, our interest rate was 1.7%. The Credit Facility is secured by substantially all of our assets.

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 period 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 June 30, 2016.

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 June 30, 2016, 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 2015 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 June 30, 2016, 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, 2015.

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
- 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: July 28, 2016