TYLER TECHNOLOGIES INC
Form 10-K
March 01, 2007

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES AND EXCHANGE ACT OF 1934**

For the Fiscal Year Ended December 31, 2006

OR

o **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 incorporation or organization)	(I.R.S. employer identification no.)
5949 Sherry Lane, Suite 1400 Dallas, Texas (Address of principal executive offices)	**75225** (Zip code)

Registrant s telephone number, including area code: **(972) 713-3700**

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	**Name of each exchange on which registered**
COMMON STOCK, $0.01 PAR VALUE	NEW YORK STOCK EXCHANGE

Securities registered pursuant to Section 12(g) of the Act:
NONE

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES þ NO o

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. YES o NO þ

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 þ NO o

Indicate by check mark if disclosure of delinquent filer pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant s knowledge, in definitive proxy or information statements incorporate by reference in Part III of the Form 10-K or any amendment to the Form 10-K. YES o NO þ

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 o Accelerated filer þ Non-accelerated filer o

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

The aggregate market value of the voting stock held by non-affiliates of the registrant was $405,517,000 based on the reported last sale price of common stock on June 30, 2006, which is the last business day of the registrant s most recently completed second fiscal quarter.

The number of shares of common stock of the registrant outstanding on February 23, 2007 was 38,728,261.

DOCUMENTS INCORPORATED BY REFERENCE

Certain information required by Part III of this annual report is incorporated by reference from the registrant s definitive proxy statement for its annual meeting of stockholders to be held on May 17, 2007.

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PART I

ITEM 1. BUSINESS.

DESCRIPTION OF BUSINESS

Tyler Technologies, Inc. (Tyler) is a major provider of integrated information management solutions and services for local governments. We partner with clients to make local government more accessible to the public, more responsive to the needs of citizens and more efficient in its operations. We have a broad line of software products and services to address the information technology (IT) needs of virtually every major area of operation for cities, counties, schools and other local government entities. Most of our customers have our software installed in-house. For customers who prefer not to physically acquire the software and hardware, we provide outsourced hosting for some of our applications at one of our data centers through an applications service provider (ASP) arrangement. We provide professional IT services to our customers, including software and hardware installation, data conversion, training and, at times, product modifications. In addition, we are the nation s largest provider of outsourced property appraisal services for taxing jurisdictions. We also provide continuing customer support services to ensure proper product performance and reliability, which provides us with long-term customer relationships and a significant base of recurring maintenance revenue.

Tyler was founded in 1966. Prior to 1998, we operated as a diversified industrial conglomerate, with operations in various industrial, retail and distribution businesses, all of which have been sold or otherwise disposed. In 1997, we embarked on a multi-phase growth plan focused on serving the specialized information management needs of local governments nationwide. In 1998 and 1999, we made a series of strategic acquisitions of companies in the local government IT market.

MARKET OVERVIEW

The state and local government market is one of the largest and most decentralized IT markets in the country, consisting of all 50 states, approximately 3,100 counties, 36,000 cities and towns and 14,400 school districts. This market is also comprised of approximately 35,000 special districts and other agencies, each with specialized delegated responsibilities and unique information management requirements.

Traditionally, local government bodies and agencies performed state-mandated duties, including property assessment, record keeping, road maintenance, law enforcement, administration of election and judicial functions, and the provision of welfare assistance. Today, a host of emerging and urgent issues are confronting local governments, each of which demands a service response. These areas include criminal justice and corrections, administration and finance, public safety, health and human services, and public works. Transfers of responsibility from the federal and state governments to county and municipal governments and agencies in these and other areas also place additional service and financial requirements on these local government units. In addition, constituents of local governments are increasingly demanding improved service and better access to information from public entities. As a result, local governments recognize the increasing value of information management systems and services to, among other things, improve revenue collection, provide increased access to information, and streamline delivery of services to their constituents. Local government bodies are now recognizing that e-government is an additional responsibility for community development. From integrated tax systems to integrated civil and criminal justice information systems, many counties and cities have benefited significantly from the implementation of jurisdiction-wide systems that allow different agencies or government offices to share data and provide a more comprehensive approach to information management. Many city and county governmental agencies also have unique individual information management requirements, which must be tailored to the specific functions of each particular office.

Many local governments also have difficulties attracting and retaining the staff necessary to support their IT functions. As a result, they seek to establish long-term relationships with reliable providers of high quality IT products and services such as Tyler.

Although local governments generally face budgetary constraints in their operations, their primary revenue sources are usually property taxes, and to a lesser extent, utility fees, which tend to be relatively stable. In addition, the acquisition of new technology typically enables local governments to operate more efficiently, and often provides a measurable return on investment that justifies the purchase of software and related services.

Gartner estimates that state and local government IT spending will grow from $48.4 billion in 2007 to $55.6 billion in 2010, with local government accounting for $25.1 billion of IT spending in 2007 and $28.9 billion in 2010. The external services and software

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segments of the market, where our business is primarily focused, are expected to be the most rapidly growing areas of the local government IT market, expanding from $13.1 billion in 2007 to $16.1 billion in 2010.

PRODUCTS AND SERVICES

We provide a comprehensive and flexible suite of products and services that address the information technology needs of cities, counties, schools and other local government entities. We derive our revenues from four primary sources:

sales of software licenses;

software services;

maintenance and support; and

appraisal services.

We design, develop and market a broad range of software products to serve mission-critical back-office functions of local governments. Many of our software applications include Internet-accessible solutions that allow for real-time public access to a variety of information or that allow the public to transact business with local governments via the Internet. Our software products and services are generally grouped in four major product areas:

Financials;

Courts and Justice;

Property Appraisal and Tax; and

Document Management.

Each of our core software systems consists of several fully integrated application modules. For customers who acquire the software for use in-house, we generally license our systems under standard license agreements that provide the customer with a fully paid, nonexclusive, nontransferable right to use the software. In some of the product areas, such as financials and property appraisal, we offer multiple solutions designed to meet the needs of different sized governments.

We also offer certain software products on an outsourced basis for customers who do not wish to maintain, update and operate these systems or to make large up-front capital expenditures to implement these advanced technologies. For these customers, we host the applications and data at one of our data centers. Customers typically pay monthly fees under multi-year contracts for these services.

Historically, we have had a greater proportion of our annual revenues in the second half of our fiscal year due to governmental budget and spending cycles and the timing of system implementations for customers desiring to go live at the beginning of the calendar year.

A description of our suite of products and services follows:

Software Licensing

Financials

Our financials products are ERP (Enterprise Resource Planning) systems for local governments, which integrate information across all facets of a client organization. Our financial products include modular fund accounting systems that can be tailored to meet the needs of virtually any government agency or not-for-profit entity. Our financial systems include modules for general ledger, budget preparation, fixed assets, requisitions, purchase orders, bid management, accounts payable, contract management, accounts receivable, investment management, inventory control, project and grant accounting, work orders, job costing, GASB 34 reporting, payroll and human resources. All of our financial systems are intended to conform to government auditing and financial reporting requirements and generally accepted accounting principles.

We sell utility billing systems that support the billing and collection of metered and non-metered services, along with multiple billing cycles. Our Web-enabled utility billing solutions allow customers to access information online such as average consumption and transaction history. In addition, our systems can accept secured Internet payments via credit

cards and checks.

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We also offer specialized products that automate numerous city functions, including municipal courts, parking tickets, equipment and project costing, animal licenses, business licenses, permits and inspections, code enforcement, citizen complaint tracking, ambulance billing, fleet maintenance, and cemetery records management.

In 2006 we began offering a student information system for K-12 schools, which manages such applications as scheduling, grades and attendance and software products to manage public sector pension funds.

Tyler s financial products include Web components that enhance local governments service capabilities by facilitating online access to information for both employees and citizens and enabling online transactions.

Courts and Justice

We offer a complete, integrated suite of products designed to automate, track and manage the law enforcement and judicial process, from the initiation of incidents in computer-aided dispatch/emergency 911 systems through the process of arrest, court appearances and final disposition to probation. These applications may be installed on a stand-alone basis or integrated with our other products to eliminate duplicate entries and improve efficiency.

Our Web-enabled court systems are designed to automate the tracking and management of information involved in criminal and civil court cases, including municipal, family and probate courts. These applications track the status of criminal and civil cases, process fines and fees and generate the specialized judgment and sentencing documents, citations, notices and forms required in court proceedings. Additional judicial applications automate the management of court calendars, coordinate judge s schedules, generate court dockets, manage justice of the peace processes and automate district attorney and prosecutor functions. Related products include jury selection, hot check processing, and adult and juvenile probation management applications. Our courtroom technologies allow judges to review cases, calendars, and to scan documents and mug shots using a Web browser. Additionally, document-imaging options include the ability to scan, store, retrieve and archive a variety of criminal and civil case-related documents.

Our law enforcement systems automate police and sheriff functions from dispatch and records management through booking and jail management. Searching, reporting and tracking features are integrated, allowing reliable, up-to-date access to current arrest and incarceration data. The systems also provide warrant checks for visitors or book-ins, inmate classification and risk assessment, commissary, property and medical processing, and automation of statistics and state and federal reporting. Our computer-aided dispatch/emergency 911 system tracks calls and the availability of emergency response vehicles, interfaces with local and state searches, and generally assists dispatchers in processing emergency situations. The law enforcement and jail management systems are fully integrated with the suite of court products that manages the judicial process.

Our court and law enforcement systems allow the public to access, via the Internet, a variety of information, including criminal and civil court records, jail booking and release information, bond and bondsmen information, and court calendars and dockets. In addition, our systems allow cities and counties to accept payments for traffic and parking tickets over the Internet, with a seamless and automatic interface to back-office justice and financial systems.

In 2003 we released Odyssey, an all-new unified court case management system. Odyssey uses enhanced Web-browser concepts to render a unique user interface. It incorporates current technology XML, n-tier architecture, component-based design, and an ultra-thin client footprint to maximize the value of a court s investment in new software. We believe that some of Odyssey s design concepts, including embedded imaging functionality, COM+ objects to enable local customization, and an architecture that enables multiple deployment options, are unique in the court automation marketplace.

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Property Appraisal and Tax

We provide systems and software that automate the appraisal and assessment of real and personal property, including record keeping, mass appraisal, inquiry and protest tracking, appraisal and tax roll generation, tax statement processing, and electronic state-level reporting. These systems are image- and video-enabled to facilitate the storage of and access to the many property-related documents and for the online storage of digital photographs of properties for use in defending values in protest situations. Other related tax applications are available for agencies that bill and collect taxes, including cities, counties, school tax offices, and special taxing and collection agencies. These systems support billing, collections, lock box operations, mortgage company electronic payments, and various reporting requirements.

Document Management

We offer a number of specialized applications designed to help county governments enhance and automate courthouse operations. These systems record and index information for the many documents maintained at the courthouse, such as deeds, mortgages, liens, UCC financing statements and vital records (birth, death and marriage certificates).

Software Services

We provide a variety of professional IT services to customers who utilize our software products. Virtually all of our customers contract with us for installation, training, and data conversion services in connection with their purchase of Tyler s software products. The complete implementation process for a typical system includes planning, design, data conversion, set-up and testing. At the culmination of the implementation process, an installation team travels to the customer s facility to ensure the smooth transfer of data to the new system. Installation fees are charged separately to customers on either a fixed-fee or hourly charge basis, depending on the contract, with full pass-through to customers of travel and other out-of-pocket expenses.

Both in connection with the installation of new systems and on an ongoing basis, we provide extensive training services and programs related to our products and services. Training can be provided in our training centers, onsite at customers locations, or at meetings and conferences, and can be customized to meet customers requirements. The vast majority of our customers contract with us for training services, both to improve their employees proficiency and productivity and to fully utilize the functionality of our systems. Training services are generally billed on an hourly basis, along with travel and other expenses.

Maintenance and Support

Following the implementation of our software systems, we provide ongoing software support services to assist our customers in operating the systems and to periodically update the software. Support is provided over the phone to customers through help desks staffed by our customer support representatives. For more complicated issues, our staff, with the customers permission, can log on to customers systems remotely. We maintain our customers software largely through releases that contain improvements and incremental additions, along with updates necessary because of legislative or regulatory changes.

Virtually all of our software customers contract with us for maintenance and support, which provides us with a significant source of recurring revenue. We generally provide maintenance and support under annual contracts, with a typical fee based on a percentage of the software product s license fee. These fees can be increased annually and may also increase as new license fees increase. Maintenance and support fees are generally paid in advance for the entire maintenance contract period. Most maintenance contracts automatically renew unless the customer or Tyler gives notice of termination prior to expiration. Similar support is provided to our ASP customers, and is included in their overall monthly fees.

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Appraisal Services

We are the nation s largest provider of property appraisal outsourcing services for local government taxing authorities. These services include:

- the physical inspection of commercial and residential properties;
- data collection and processing;
- sophisticated computer analyses for property valuation;
- preparation of tax rolls;
- community education regarding the assessment process; and
- arbitration between taxpayers and the assessing jurisdiction.

Local government taxing entities normally reappraise properties from time to time to update values for tax assessment purposes and to maintain equity in the taxing process. In some jurisdictions, reassessment cycles are mandated by law; in others, they are discretionary. While some taxing jurisdictions perform reappraisals in-house, many local governments outsource this function because of its cyclical nature and because of the specialized knowledge and expertise requirements associated with it. Our business unit that provides appraisal outsourcing services to local governments has been in this business since 1938.

In some instances, we also sell property tax and/or appraisal software products in connection with appraisal outsourcing projects, while other customers may only engage us to provide appraisal services. Appraisal outsourcing services are somewhat seasonal in nature to the extent that winter weather conditions reduce the productivity of data collection activities in connection with those projects.

STRATEGY

Our objective is to grow our revenue and earnings internally, supplemented by focused strategic acquisitions. The key components of our business strategy are to:

Provide high quality, value added products and services to our clients. We compete on the basis of, among other things, delivering to customers our deep domain expertise in local government operations through the highest value products and services in the market. We believe we have achieved a reputation as a premium product and service provider to the local government market.

Continue to expand our product and service offerings. While we already have what we believe to be the broadest line of software products for local governments, we continually upgrade our core software applications and expand our complementary product and service offerings to respond to technological advancements and the changing needs of our clients. For example, we offer solutions that allow the public to access data and conduct transactions with local governments, such as paying traffic tickets, property taxes and utility bills, via the Internet. We believe that the addition of such features enhance the market appeal of our core products. Since 2001, we have also offered certain of our software products in an ASP environment, a delivery model that we believe will, over time, have increasing appeal to local governments and will be expanded to include more applications. We have also increased our offerings of consulting and business process reengineering services.

Leverage a core technology framework across multiple product development efforts. We have developed a core technology framework upon which we have developed or are developing a new generation of a number of products. By leveraging the core framework, which is based on an n-tier, browser-based architecture, for the development of multiple products, we believe we can develop new-generation products more efficiently, and at a lower total cost. In addition, utilizing a core framework is also expected to help us bring new products to market more rapidly. By having more products built on a common technology framework, we expect to

enhance our cross-selling opportunities and be able to provide maintenance and other services more efficiently.

Expand our customer base. We seek to establish long-term relationships with new customers primarily through our sales and marketing efforts. While we currently have customers in all 50 states, Canada, Puerto Rico, and the United Kingdom, not all of our product lines have nationwide geographic penetration. We intend to continue to expand into new geographic markets

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by adding sales staff and targeting marketing efforts by product in those areas. We also intend to continue to expand our customer base to include larger governments. While our traditional market focus has primarily been on small and mid-sized governments, our increased size and market presence, together with the technological advances and improved scalability of certain of our products, are allowing us to achieve success in selling to larger customers.

Expand our existing customer relationships. Our existing customer base offers significant opportunities for additional sales of IT products and services that we currently offer, but that existing customers do not fully utilize. Add-on sales to existing customers typically involve lower sales and marketing expenses than sales to new customers.

Grow recurring revenue. We have a large recurring revenue base from maintenance and support, with an annual run rate of $73 million. We have historically experienced very low customer turnover (less than 2% annually for our major software business units) and recurring revenues continue to grow as the installed customer base increases. In addition, since the beginning of 2001, we have established a growing recurring revenue stream from ASP hosting and other similar services.

Maximize economies of scale and take advantage of financial leverage in our business. We seek to build and maintain a large client base to create economies of scale, enabling us to provide value-added products and services to our customers while expanding our operating margins. Because we sell primarily off-the-shelf software, increased sales of the same products result in incrementally higher gross margins. In addition, we believe that we have a marketing and administrative infrastructure in place that we can leverage to accommodate significant long-term growth without proportionately increasing selling, general and administrative expenses.

Attract and retain highly qualified employees. We believe that the depth and quality of our operating management and staff is one of our significant strengths, and that the ability to retain such employees is crucial to our continued growth and success. We believe that our stable management team, financial strength and growth opportunities, as well as our leadership position in the local government market, enhance our attractiveness as an employer for highly skilled employees.

Pursue selected strategic acquisitions. While we expect to primarily grow internally, we may from time to time selectively pursue strategic acquisitions that provide us with one or more of the following:

- products and services to complement our existing offerings;
- entry into new markets related to local governments; and
- new customers and/or geographic expansion.

Establish strategic alliances. In January 2007 we announced a strategic alliance with Microsoft Corporation to jointly develop core public sector functionality for Microsoft Dynamics AX to address the unique accounting needs of public sector organizations worldwide. As part of this alliance we will enhance Microsoft Dynamics AX with public sector-specific functionality. The co-development will broaden the functionality of Microsoft Dynamics AX, providing both Tyler and Microsoft with a public sector accounting platform to support their existing and prospective clients well into the future. Microsoft Dynamics AX with public sector functionality will be sold in the United States and internationally through Microsoft s distribution channels and is expected to be available for delivery in 2010. Tyler will also become an authorized Microsoft reseller for the Microsoft Dynamics solutions developed under this arrangement, and will sell the solutions directly into the government market. Tyler will receive license and maintenance royalties on direct and indirect sales of the solutions co-developed under this multi-year term of this relationship.

SALES, MARKETING, AND CUSTOMERS

We market our products and services through direct sales and marketing personnel located throughout the United States. Other in-house marketing staff focuses on add-on sales, professional services and support.

Sales of new systems are typically generated from referrals from other government offices or departments within a county or municipality, referrals from other local governments, relationships established between sales representatives and county or local officials, contacts at trade shows, direct mailings, and direct contact from prospects already familiar with us. We are active in numerous national, state, county, and local government associations, and participate in annual meetings, trade shows, and educational events.

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Customers consist primarily of county and municipal agencies, school districts and other local government offices. In counties, customers include the auditor, treasurer, tax assessor/collector, county clerk, district clerk, county and district court judges, probation officers, sheriff, and county appraiser. At municipal government sites, customers include directors from various departments, including administration, finance, utilities, public works, code enforcement, personnel, purchasing, taxation, municipal court, and police. Contracts for software products and services are generally implemented over periods of three months to one year, with annually renewing maintenance and support update agreements thereafter. Although either the customer or we can terminate these agreements, historically almost all support and maintenance agreements are automatically renewed annually. Contracts for appraisal outsourcing services are generally one to three years in duration. During 2006, approximately 38% of our revenue was attributable to ongoing support and maintenance agreements.

COMPETITION

We compete with numerous local, regional, and national firms that provide or offer some or many of the same products and services that we provide. Most of these competitors are smaller companies that may be able to offer less expensive solutions than ours. Many of these firms operate within a specific geographic area and/or in a narrow product or service niche. We also compete with national firms, some of which have greater financial and technical resources than we do, including Oracle Corporation, Lawson Software, Inc., SAP AG, MAXIMUS, Inc., Affiliated Computer Services, Inc., SunGard Data Systems, Inc., New World Systems and Manatron, Inc. In addition, we sometimes compete with consulting and systems integration firms, such as BearingPoint, Inc., which develop custom systems, primarily for larger governments. We also occasionally compete with central internal information service departments of local governments, which require us to persuade the end-user department to discontinue service by its own personnel and outsource the service to us. We compete on a variety of factors, including price, service, name recognition, reputation, technological capabilities, and the ability to modify existing products and services to accommodate the individual requirements of the customer. Our ability to offer an integrated system of applications for several offices or departments is often a competitive strength. Local governmental units often are required to seek competitive proposals through a request for proposal process.

SUPPLIERS

All computers, peripherals, printers, scanners, operating system software, office automation software, and other equipment necessary for the implementation and provision of our software systems and services are presently available from several third-party sources. Hardware is purchased on original equipment manufacturer or distributor terms at discounts from retail. We have not experienced any significant supply problems.

BACKLOG

At December 31, 2006, our estimated revenue backlog was approximately $205.9 million, compared to $165.4 million at December 31, 2005. The backlog represents signed contracts under which the products have not been delivered or the services have not been performed as of year-end. Approximately $150.3 million of the backlog is expected to be recognized during 2007.

INTELLECTUAL PROPERTY, PROPRIETARY RIGHTS, AND LICENSES

We regard certain features of our internal operations, software, and documentation as confidential and proprietary and rely on a combination of contractual restrictions, trade secret laws and other measures to protect our proprietary intellectual property. We generally do not rely on patents. We believe that, due to the rapid rate of technological change in the computer software industry, trade secrets and copyright protection are less significant than factors such as knowledge, ability and experience of our employees, frequent product enhancements, and timeliness and quality of support services. We typically license our software products under non-exclusive license agreements which are generally non-transferable and have a perpetual term.

EMPLOYEES

At December 31, 2006, we had approximately 1,530 employees. Appraisal outsourcing projects are cyclical in nature and can be widely dispersed geographically. We often hire temporary employees to assist in these projects whose term of employment generally ends with the project s completion. None of our employees are represented by a labor union or are subject to collective bargaining agreements. We consider our relations with our employees to be positive.

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INTERNET WEBSITE AND AVAILABILITY OF PUBLIC FILINGS

We file annual, quarterly, current and other reports, proxy statements and other information with the Securities and Exchange Commission, or SEC, pursuant to the Securities Exchange Act. You may read and copy any materials we file with the SEC at the SEC s Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an Internet site that contains reports, proxy and other information statements, and other information regarding issuers, including us, that file electronically with the SEC. The address of this site is http://www.sec.gov.

We also maintain an Internet site at www.tylertech.com. We make available free of charge through this site our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Forms 4 and 5, Current Reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC. Our Code of Business Conduct and Ethics is also available on our Web site. We intend to satisfy the disclosure requirements regarding amendments to, or waivers from, a provision of our Code of Business Conduct and Ethics by posting such information on our Web site.

ITEM 1A. RISK FACTORS

An investment in our common stock involves a high degree of risk. Investors evaluating our company should carefully consider the factors described below and all other information contained in this Annual Report. Any of the following factors could materially harm our business, operating results, and financial condition. Additional factors and uncertainties not currently known to us or that we currently consider immaterial could also harm our business, operating results, and financial condition. This section should be read in conjunction with the Consolidated Financial Statements and related Notes and Management s Discussion and Analysis of Financial Condition and Results of Operations included in this Annual Report. We may make forward-looking statements from time to time, both written and oral. We undertake no obligation to revise or publicly release the results of any revisions to these forward-looking statements. Our actual results may differ materially from those projected in any such forward-looking statements due to a number of factors, including those set forth below and elsewhere in this Annual Report.

A decline in information technology spending may result in a decrease in our revenues or lower our growth rate.

A decline in the demand for information technology among our current and prospective customers may result in decreased revenues or a lower growth rate for us because our sales depend, in part, on our customers level of funding for new or additional information technology systems and services. Moreover, demand for our solutions may be reduced by a decline in overall demand for computer software and services. Accordingly, we cannot assure you that we will be able to increase or maintain our revenues.

Our products are complex and we run the risk of errors or defects with new product introductions or enhancements.

Software products as complex as those developed by us may contain errors or defects, especially when first introduced or when new versions or enhancements are released. Although we have not experienced material adverse effects resulting from any such defects or errors to date, we cannot assure you that material defects and errors will not be found after commencement of product shipments. Any such defects could result in loss of revenues or delay market acceptance.

Our license agreements with our customers typically contain provisions designed to limit our exposure to potential liability claims. It is possible, however, that we may not always be able to negotiate such provisions in our contracts with customers or that the limitation of liability provisions contained in our license agreements may not be effective as a result of existing or future federal, state or local laws, ordinances, or judicial decisions. Although we maintain errors and omissions and general liability insurance, and we try to structure our contracts to include limitations on liability, we cannot assure you that a successful claim could not be made or would not have a material adverse effect on our business, financial condition, and results of operations.

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We may experience fluctuations in quarterly revenue that could adversely impact our stock price and our operating results.

Our actual revenues in a quarter could fall below expectations, which could lead to a decline in our stock price. Our revenues and operating results are difficult to predict and may fluctuate substantially from quarter to quarter. Revenues from license fees in any quarter depend substantially upon our contracting activity and our ability to recognize revenues in that quarter in accordance with our revenue recognition policies. Our quarterly revenue may fluctuate and may be difficult to forecast for a variety of reasons, including the following:

- a significant number of our prospective customers decisions regarding whether to enter into license agreements with us are made within the last few weeks of each quarter;
- the size of license transactions can vary significantly;
- customers may unexpectedly postpone or cancel orders due to changes in their strategic priorities, project objectives, budget or personnel;
- customer purchasing processes vary significantly and a customer s internal approval, expenditure authorization and contract negotiation processes can be difficult and time consuming to complete, even after selection of a vendor;
- the number, timing, and significance of software product enhancements and new software product announcements by us and our competitors may affect purchase decisions; and
- we may have to defer revenues under our revenue recognition policies.

Fluctuation in our quarterly revenues may adversely affect our operating results. In each fiscal quarter our expense levels, operating costs, and hiring plans are based on projections of future revenues and are relatively fixed. If our actual revenues fall below expectations, we could experience a reduction in operating results.

As with other software vendors, we may be required to delay revenue recognition into future periods, which could adversely impact our operating results.

We have in the past had to, and in the future may have to, defer revenue recognition for license fees due to several factors, including whether:

- license agreements include applications that are under development or other undelivered elements;
- we must deliver services that are considered essential to the functionality of the software, including significant modifications, customization, or complex interfaces, which could delay product delivery or acceptance;
- the transaction involves acceptance criteria;
- the transaction involves contingent payment terms or fees;
- we are required to accept a fixed-fee services contract; or
- we are required to accept extended payment terms.

Because of the factors listed above and other specific requirements under generally accepted accounting principles in the United States for software revenue recognition, we must have very precise terms in our license agreements in order to recognize revenue when we initially deliver and install software or perform services. Negotiation of mutually acceptable terms and conditions can extend the sales cycle, and sometimes we do not obtain terms and conditions that permit revenue recognition at the time of delivery or even as work on the project is completed.

Compliance with changing regulation of corporate governance and public disclosure may result in additional expenses.

Changing laws, regulations, and standards relating to corporate governance and public disclosure, including the Sarbanes-Oxley Act of 2002, new Securities and Exchange Commission regulations and New York Stock Exchange rules, are creating uncertainty for companies such as ours. The costs required to comply with such evolving laws are difficult to predict. To maintain high standards of corporate governance and public disclosure, we intend to invest all reasonably necessary resources to comply with evolving standards. This investment may result in an unforeseen increase in general and administrative expenses and a diversion of management time and attention from revenue-generating activities, which may harm our business, financial condition, or results of operations.

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Increases in service revenue as a percentage of total revenues could decrease overall margins and adversely affect our operating results.

We realize lower margins on software and appraisal service revenues than on license revenue. The majority of our contracts include both software licenses and professional services. Therefore, an increase in the percentage of software service and appraisal service revenue compared to license revenue could have a detrimental impact on our overall gross margins and could adversely affect operating results.

Selling products and services into the public sector poses unique challenges.

We derive substantially all of our revenues from sales of software and services to state, county and city governments, other municipal agencies, and other public entities. We expect that sales to public sector customers will continue to account for substantially all of our revenues in the future. We face many risks and challenges associated with contracting with governmental entities, including:

- the sales cycle of governmental agencies may be complex and lengthy;
- payments under some public sector contracts are subject to achieving implementation milestones, and we have had, and may in the future have, differences with customers as to whether milestones have been achieved;
- political resistance to the concept of government agencies contracting with third parties to provide information technology solutions;
- changes in legislation authorizing government s contracting with third parties;
- the internal review process by governmental agencies for bid acceptance;
- changes to the bidding procedures by governmental agencies;
- changes in governmental administrations and personnel;
- limitations on governmental resources placed by budgetary restraints, which in some circumstances, may provide for a termination of executed contracts because of a lack of future funding; and
- the general effect of economic downturns and other changes on local governments ability to spend public funds on outsourcing arrangements.

Each of these risks is outside our control. If we fail to adequately adapt to these risks and uncertainties, our financial performance could be adversely affected.

The open bidding process for governmental contracts creates uncertainty in predicting future contract awards.

Many governmental agencies purchase products and services through an open bidding process. Generally, a governmental entity will publish an established list of requirements requesting potential vendors to propose solutions for the established requirements. To respond successfully to these requests for proposals, we must accurately estimate our cost structure for servicing a proposed contract, the time required to establish operations for the proposed client, and the likely terms of any other third party proposals submitted. We cannot guarantee that we will win any bids in the future through the request for proposal process, or that any winning bids will ultimately result in contracts on favorable terms. Our failure to secure contracts through the open bidding process, or to secure such contracts on favorable terms, may adversely affect our business, financial condition, and results of operations.

Fixed- price contracts may affect our profits.

Some of our present contracts are on a fixed-priced basis, which can lead to various risks, including:

- the failure to accurately estimate the resources and time required for an engagement;
- the failure to effectively manage governmental agencies and other customers expectations regarding the scope of services to be delivered for an estimated price; and

the failure to timely complete fixed-price engagements within budget to the customers satisfaction.

If we do not adequately assess these and other risks, we may be subject to cost overruns and penalties, which may harm our business, financial condition, or results of operations.

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We face significant competition from other vendors and potential new entrants into our markets.

We believe we are a leading provider of integrated solutions for the public sector. However, we face competition from a variety of software vendors that offer products and services similar to those offered by us, as well as from companies offering to develop custom software. We compete on the basis of a number of factors, including:

the attractiveness of the business strategy and services we offer;

the breadth of products and services we offer;

price;

quality of products and service;

technological innovation;

name recognition; and

our ability to modify existing products and services to accommodate the particular needs of our customers.

We believe the market is highly fragmented with a large number of competitors that vary in size, primary computer platforms, and overall product scope. Our competitors include the consulting divisions of national and regional accounting firms, publicly held companies that focus on selected segments of the public sector market, and a significant number of smaller, privately held companies. Certain competitors have greater technical, marketing, and financial resources than we do. We cannot assure you that such competitors will not develop products or offer services that are superior to our products or services or that achieve greater market acceptance.

We also compete with internal, centralized information service departments of governmental entities, which require us to persuade the end-user to stop the internal service and outsource to us. In addition, our customers may elect in the future to provide information management services internally through new or existing departments, which could reduce the market for our services.

We could face additional competition as other established and emerging companies enter the public sector software application market and new products and technologies are introduced. Increased competition could result in price reductions, fewer customer orders, reduced gross margins, and loss of market share. In addition, current and potential competitors may make strategic acquisitions or establish cooperative relationships among themselves or with third-parties, thereby increasing the ability of their products to address the needs of our prospective customers. It is possible that new competitors or alliances among current and new competitors may emerge and rapidly gain significant market share. Further, competitive pressures could require us to reduce the price of our software licenses and related services. We cannot assure you that we will be able to compete successfully against current and future competitors, and the failure to do so would have material adverse effect upon our business, operating results, and financial condition.

We must respond to rapid technological changes to be competitive.

The market for our products is characterized by rapid technological change, evolving industry standards in computer hardware and software technology, changes in customer requirements, and frequent new product introductions and enhancements. The introduction of products embodying new technologies and the emergence of new industry standards can render existing products obsolete and unmarketable. As a result, our future success will depend, in part, upon our ability to continue to enhance existing products and develop and introduce in a timely manner or acquire new products that keep pace with technological developments, satisfy increasingly sophisticated customer requirements, and achieve market acceptance. We cannot assure you that we will successfully identify new product opportunities and develop and bring new products to market in a timely and cost-effective manner. Further, we cannot assure you that the products, capabilities, or technologies developed by others will not render our products or technologies obsolete or noncompetitive. If we are unable to develop or acquire on a timely and cost-effective basis new software products or enhancements to existing products, or if such new products or enhancements do not achieve

market acceptance, our business, operating results, and financial condition may be materially adversely affected.

Our failure to properly manage growth could adversely affect our business.

We have expanded our operations since February 1998, when we entered the business of providing software solutions and services to the public sector. We intend to continue expansion in the foreseeable future to pursue existing and potential market opportunities. This growth places a significant demand on management and operational resources. In order to manage growth effectively, we must implement and improve our operational systems, procedures, and controls on a timely basis. We must also identify, hire, train, and manage key managerial and technical personnel. If we fail to implement these systems or employ and retain such qualified personnel, our business, financial condition, and results of operations may be materially adversely affected.

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We may be unable to hire, integrate, and retain qualified personnel.

Our continued success will depend upon the availability and performance of our key management, sales, marketing, customer support, and product development personnel. The loss of key management or technical personnel could adversely affect us. We believe that our continued success will depend in large part upon our ability to attract, integrate, and retain such personnel. We have at times experienced and continue to experience difficulty in recruiting qualified personnel. Competition for qualified software development, sales, and other personnel is intense, and we cannot assure you that we will be successful in attracting and retaining such personnel.

We may experience difficulties in executing our acquisition strategy.

In addition, a significant portion of our growth has resulted from strategic acquisitions in new product and geographic markets. Although our future focus will be on internal growth, we will continue to identify and pursue strategic acquisitions and alliances with suitable candidates. Our future success will depend, in part, on our ability to successfully integrate future acquisitions and other strategic alliances into our operations. Acquisitions may involve a number of special risks, including diversion of management s attention, failure to retain key acquired personnel, unanticipated events or circumstances, legal liabilities, and amortization of certain acquired intangible assets. Some or all of these risks could have a material adverse effect on our business, financial condition, and results of operations. Although we conduct due diligence reviews of potential acquisition candidates, we may not identify all material liabilities or risks related to acquisition candidates. There can be no assurance that any such strategic acquisitions or alliances will be accomplished on favorable terms or will result in profitable operations.

We may be unable to protect our proprietary rights.

Many of our product and service offerings incorporate proprietary information, trade secrets, know-how, and other intellectual property rights. We rely on a combination of contracts, copyrights, and trade secret laws to establish and protect our proprietary rights in our technology. We cannot be certain that we have taken all appropriate steps to deter misappropriation of our intellectual property. In addition, there has been significant litigation in the United States in recent years involving intellectual property rights. We are not currently involved in any material intellectual property litigation. We may, however, be a party to intellectual property litigation in the future to protect our proprietary information, trade secrets, know-how, and other intellectual property rights. Further, we cannot assure you that third parties will not assert infringement or misappropriation claims against us in the future with respect to current or future products. Any claims or litigation, with or without merit, could be time-consuming and result in costly litigation and diversion of management s attention. Further, any claims and litigation could cause product shipment delays or require us to enter into royalty or licensing arrangements. Such royalty or licensing arrangements, if required, may not be available on terms acceptable to us, if at all. Thus, litigation to defend and enforce our intellectual property rights could have a material adverse effect on our business, financial condition, and results of operations, regardless of the final outcome of such litigation.

Our Application Service Provider strategy has yet to gain widespread acceptance.

Some businesses choose to access enterprise software applications through application service providers, or ASPs, which are businesses that host applications and provide access to software on a subscription basis. The public sector market for ASP solutions is new and unproven. Acceptance of our ASP model depends upon the ability and willingness of different governmental entities to accept and implement ASP solutions. Some prospective clients have expressed security and privacy concerns with the ASP model, including a concern regarding the confidential nature of the information and transactions available from and conducted with governments and concerns regarding off-site storage of such information. We have limited experience selling our solutions through ASPs and may not be successful in generating revenue from this distribution channel.

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Changes in the insurance markets may affect our ability to win some contract awards and may lead to increased expenses.

Some of our customers, primarily those for our property appraisal services, require that we secure performance bonds before they will select us as their vendor. The number of qualified, high-rated insurance companies that offer performance bonds has decreased in recent years, while the costs associated with securing these bonds has increased dramatically. In addition, we are generally required to issue a letter of credit as security for the issuance of a performance bond. We periodically enter into long-term borrowing agreements and each letter of credit we issue without corresponding cash collateral may reduce our borrowing capacity under the borrowing agreement. We cannot guarantee that we will be able to secure such performance bonds in the future on terms that are favorable to us, if at all. Our inability to obtain performance bonds on favorable terms or at all could impact our future ability to win some contract awards, particularly large property appraisal services contracts, which could have a material adverse effect on our business, financial condition, and results of operations.

Recent volatility in the stock markets, increasing shareholder litigation, the adoption of expansive legislation that redefines corporate controls (in particular, legislation adopted to prevent future corporate and accounting scandals), as well as other factors have recently led to significant increases in premiums for directors and officers liability insurance. The number of insurers offering directors and officers insurance at competitive rates has also decreased in recent years. Volatility of the insurance market may result in future increases in our general and administrative expenses, which may adversely affect future operating results.

Our stock price may be volatile.

The market price of our common stock may be volatile and may be significantly affected by many different factors. Some examples of factors that can have a significant impact on our stock price include:

actual or anticipated fluctuations in our operating results;

announcements of technological innovations, new products, or new contracts by us or our competitors;

developments with respect to patents, copyrights, or other proprietary rights;

conditions and trends in the software and other technology industries;

adoption of new accounting standards affecting the software industry;

changes in financial estimates by securities analysts; and

general market conditions and other factors.

In addition, the stock market has from time to time experienced significant price and volume fluctuations that have particularly affected the market prices for the common stock of technology companies. These broad market fluctuations may adversely affect the market price of our common stock. In the past, following periods of volatility in the market price of a particular company s securities, securities class action litigation has often been brought against that company. We cannot assure you that similar litigation will not occur in the future with respect to us. Such litigation could result in substantial costs and a diversion of management s attention and resources, which could have a material adverse effect upon our business, operating results, and financial condition.

Historically, we have not paid dividends on our common stock.

We have not declared or paid a cash dividend since we entered the business of providing software solutions and services to the public sector in February 1998. Additionally, we may enter into credit agreements that could restrict our ability to pay cash dividends. We intend to retain earnings for use in the operation and expansion of our business. We do not anticipate paying any cash dividends on our common stock in the foreseeable future.

Provisions in our certificate of incorporation, bylaws, and Delaware law could deter takeover attempts.

Our board of directors may issue up to 1,000,000 shares of preferred stock and may determine the price, rights, preferences, privileges, and restrictions, including voting and conversion rights, of these shares of preferred stock.

These determinations may be made without any further vote or action by our stockholders. The rights of the holders of our common stock will be subject to, and may be adversely affected by, the rights of the holders of any preferred stock that may be issued in the future. The issuance of preferred stock may make it more difficult for a third party to acquire a majority of our outstanding voting stock. In addition, some provisions of our Certificate of Incorporation, Bylaws, and of the Delaware General Corporation Law could also delay, prevent, or make more difficult a merger, tender offer, or proxy contest involving us.

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Financial Outlook.

From time to time in press releases and otherwise, we may publish forecasts or other forward-looking statements regarding our results, including estimated revenues or net earnings. Any forecast of our future performance reflects various assumptions. These assumptions are subject to significant uncertainties, and as a matter of course, any number of them may prove to be incorrect. Further, the achievement of any forecast depends on numerous risks and other factors (including those described in this discussion), many of which are beyond our control. As a result, we cannot be certain that our performance will be consistent with any management forecasts or that the variation from such forecasts will not be material and adverse. Current and potential stockholders are cautioned not to base their entire analysis of our business and prospects upon isolated predictions, but instead are encouraged to utilize our entire publicly available mix of historical and forward-looking information, as well as other available information regarding us, our products and services, and the software industry when evaluating our prospective results of operations.

ITEM 1B. UNRESOLVED STAFF COMMENTS

Not applicable.

ITEM 2. PROPERTIES.

We occupy a total of approximately 275,000 square feet of office and warehouse space, 27,000 of which we own. We lease our principal executive office located in Dallas, Texas, as well as other offices for our divisions in Colorado, Iowa, Maine, Ohio, Texas and Washington.

ITEM 3. LEGAL PROCEEDINGS.

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

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.

Our common stock is traded on the New York Stock Exchange under the symbol TYL. At December 31, 2006, we had approximately 2,225 stockholders of record. A number of our stockholders hold their shares in street name; therefore, there are substantially more than 2,225 beneficial owners of our common stock.

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

		High	Low
2005:	First Quarter	$ 8.45	$ 6.29
	Second Quarter	7.90	5.25
	Third Quarter	8.69	7.25
	Fourth Quarter	9.15	7.88
2006:	First Quarter	$11.00	$ 8.40
	Second Quarter	11.50	9.80
	Third Quarter	13.36	10.27
	Fourth Quarter	14.99	12.41
2007:	First Quarter (through February 23, 2007)	$14.93	$13.04

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We did not pay any cash dividends in 2006 or 2005. During 2006 our bank credit agreement contained restrictions on the payment of cash dividends. We terminated this credit agreement in January 2007. We intend to retain earnings for use in the operation and expansion of our business, and, therefore, we do not anticipate declaring a cash dividend in the foreseeable future.

The following table summarizes certain information related to our stock option plan and our Employee Stock Purchase Plan (ESPP). There are no warrants or rights related to our equity compensation plans as of December 31, 2006.

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights as of December 31, 2006	Weighted average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in initial column as of December 31, 2006)
Equity compensation plans approved by security shareholders:			
Stock options	4,086,580	$ 5.32	973,671
ESPP	23,639	11.95	659,445
Equity compensation plans not approved by security shareholders:			
	4,110,219	$ 5.36	1,633,116

During 2006, we purchased approximately 1.0 million shares of our common stock for an aggregate cash purchase price of $10.5 million. A summary of the repurchase activity during 2006 is as follows:

Period	Total number of shares repurchased	Average price paid per share	Maximum number of shares that may be repurchased under current authorization
Three months ended March 31	250,000	$ 8.75	1,814,000
Three months ended June 30	583,000	10.42	1,231,000
Three months ended September 30	154,000	10.78	1,077,000
October 1 through October 31	23,000	12.79	1,054,000
November 1 through November 30	23,000	13.60	1,031,000
December 1 through December 31			1,031,000
Total year ended December 31, 2006	1,033,000	$ 10.19	

The repurchase program, which was approved by our board of directors, was announced in October 2002, and was amended in April and July 2003, October 2004 and October 2005. As of December 31, 2006, we had remaining

authorization to repurchase up to 1.0 million additional shares of our common stock. There is no expiration date specified for the authorization and we intend to repurchase stock under the plan from time to time in the future.

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Performance Graph

The following Performance Graph and related information shall not be deemed soliciting material or to be filed with the Securities and Exchange Commission, nor shall such information be incorporated by reference into any future filing under the Securities Act of 1933 or Securities Exchange Act of 1934, each as amended, except to the extent that we specifically incorporate it by reference into such filing.

The following table compares total Shareholder returns for Tyler over the last five years to the Standard and Poor s 500 Stock Index and the Standard and Poor s 600 Information Technology Index assuming a $100 investment made on December 31, 2001. Each of the three measures of cumulative total return assumes reinvestment of dividends. The stock performance shown on the graph below is not necessarily indicative of future price performance.

Company / Index	12/31/2001	12/31/2002	12/31/2003	12/31/2004	12/31/2005	12/31/2006
TYLER TECHNOLOGIES, INC.	**100**	91.65	211.65	183.74	192.97	309.01
S&P 500 INDEX	**100**	77.90	100.25	111.15	116.61	135.03
S&P 600 INFORMATION TECHNOLOGY	**100**	63.58	97.83	104.33	104.08	113.89

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ITEM 6. SELECTED FINANCIAL DATA.
(In thousands, except per share data)

	FOR THE YEARS ENDED DECEMBER 31,				
	2006	2005	2004	2003	2002
STATEMENT OF OPERATIONS DATA[1]:					
Revenues	$ 195,303	$ 170,457	$ 172,270	$ 145,454	$ 133,897
Costs and expenses:					
Cost of revenues [2]	120,499	108,970	108,432	90,627	88,347
Selling, general and administrative expenses [2]	51,711	46,242	45,451	38,390	33,914
Restructuring charge		1,260			
Amortization of customer and trade name intangibles	1,318	1,266	1,267	925	897
Operating income	21,775	12,719	17,120	15,512	10,739
Realized gain on sale of investment in H.T.E., Inc. [3]				23,233	
Other income (expense), net	1,080	906	317	339	(698)
Income from continuing operations before income taxes	22,855	13,625	17,437	39,084	10,041
Income tax provision	8,493	5,432	7,309	13,106	3,869
Income from continuing operations	$ 14,362	$ 8,193	$ 10,128	$ 25,978	$ 6,172
Income from continuing operations per diluted share	$ 0.34	$ 0.19	$ 0.23	$ 0.58	$ 0.12
Weighted average diluted shares	41,868	42,075	44,566	45,035	49,493
STATEMENT OF CASH FLOWS DATA:					
Cash flows provided by operating activities	$ 26,804	$ 21,187	$ 22,159	$ 22,535	$ 19,845
Cash flows (used by) provided by investing activities	(24,326)	1,820	(9,914)	(590)	(7,974)
Cash flows used by financing activities	(5,999)	(14,847)	(9,940)	(25,421)	(3,398)
BALANCE SHEET DATA:					
Total assets	$ 220,276	$ 194,437	$ 190,487	$ 186,396	$ 169,845
Long-term obligations, less current portion					2,550
Shareholders equity	125,875	112,197	118,400	117,907	118,656

(1)

In December 2003, we acquired Eden Systems, Inc. (Eden), a provider of financial, personnel and citizen services software for local governments. These results include the results of the operations of Eden from the date of its acquisition.

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

(3) On March 25, 2003, we received cash proceeds of $39.3 million in connection with a

transaction to sell all of our 5.6 million shares of H.T.E., Inc. (HTE) common stock to SunGard Data Systems Inc. for $7.00 cash per share. Our original cost basis in the HTE shares was $15.8 million. After transaction and other costs, we recorded a gross realized gain of $23.2 million ($16.2 million or $0.36 per diluted share after income taxes of $7.0 million) for the year ended December 31, 2003.

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ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

FORWARD LOOKING STATEMENTS

In addition to historical information, this Annual Report on Form 10-K contains forward-looking statements. The forward-looking statements are made in reliance upon safe harbor provisions of the Private Securities Litigation Reform Act of 1995. The forward-looking statements are subject to certain risks and uncertainties that could cause actual results to differ materially from those reflected in the forward-looking statements. Factors that might cause such a difference include, but are not limited to, those discussed in Item 1A, Risk Factors. Readers are cautioned not to place undue reliance on these forward-looking statements, which reflect management s opinions only as of the date hereof. We undertake no obligation to revise or publicly release the results of any revision to these forward-looking statements. Readers should carefully review the risk factors described in this Annual Report and other documents we file from time to time with the SEC.

When used in this Annual Report, the words believes, plans, estimates, expects, anticipates, intends, continu will, should, projects, forecasts, might, could or the negative of such terms and similar expressions are intend identify forward-looking statements.

OVERVIEW

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

Our products are generally grouped into four major areas:

Financials;

Courts and Justice;

Property Appraisal and Tax; and

Document Management.

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

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

Cost of Revenues and Gross Margins Our primary cost component is personnel expenses in connection with providing software implementation and appraisal services to our customers. We can improve gross margins by controlling headcount and related costs and by expanding our revenue base, especially from those products and services that produce incremental revenue with minimal incremental cost, such as software licenses and maintenance and support. Our appraisal projects are seasonal in nature, and we often employ appraisal personnel on a short-term basis to coincide with the life of a project.

Selling, General and Administrative (SG&A) Expenses The primary components of SG&A expense are administrative and sales personnel salaries and commissions, marketing expense, research and development

costs, rent and professional fees. Sales commissions generally fluctuate with revenues but other administrative expenses tend to grow at a slower rate than revenues; however, these costs have recently grown disproportionately because of the requirements of corporate governance legislation. Research and development costs fluctuate from year-to-year depending on product development activity.

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Liquidity and Cash Flows The primary driver of our cash flows is net income. Uses of cash include acquisitions, capital investments in software development and property and equipment and the discretionary purchases of treasury stock. During 2006 we used cash of $12.2 million to acquire two small companies and certain maintenance and support agreements. In 2006, we also purchased 1.0 million shares of our common stock at an aggregate cash purchase price of $10.5 million. Our working capital needs are fairly stable throughout the year with the significant components of cash outflows being payment of personnel expenses offset by cash inflows representing collection of accounts receivable and cash receipts from customers in advance of revenue being earned.

Balance Sheet Cash, accounts receivable and days sales outstanding and deferred revenue balances are important indicators of our business.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our discussion and analysis of financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States (GAAP). The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets and liabilities at the date of the financial statements, the reported amounts of revenues, cost of revenues and expenses during the reporting period, and related disclosure of contingent assets and liabilities. The Notes to the Consolidated Financial Statements included as part of this Annual Report describe our significant accounting policies used in the preparation of the consolidated financial statements. On an on-going basis, we evaluate our estimates, including, but not limited to, those related to intangible assets, bad debts and our service contracts. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

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

Revenue Recognition. We recognize revenues in accordance with the provisions of Statement of Position (SOP) 97-2, Software Revenue Recognition, as amended by SOP 98-4 and SOP 98-9, as well as Technical Practice Aids issued from time to time by the American Institute of Certified Public Accountants, and in accordance with the Securities and Exchange Commission Staff Accounting Bulletin No. 104 Revenue Recognition. We recognize revenue on our appraisal services contracts using the proportionate performance method of accounting, with considerations for the provisions of Emerging Issue Task Force No. 00-21, Revenue Arrangements with Multiple Deliverables. Our revenues are derived from sale of software licenses, appraisal services, maintenance and support, and services that typically range from installation, training and basic consulting to software modification and customization to meet specific customer needs. For multiple element software arrangements, which do not entail the performance of services that are considered essential to the functionality of the software, we generally record revenue when the delivered products or performed services result in a legally enforceable and non-refundable claim. We maintain allowances for doubtful accounts and sales adjustments, which are provided at the time the revenue is recognized. Because most of our customers are governmental entities, we rarely incur a loss resulting from the inability of a customer to make required payments. In a limited number of cases, we encounter a customer who is dissatisfied with some aspect of the software product or our service, and we may offer a concession to such customer. In those limited situations where we grant a concession, we rarely reduce the contract arrangement fee, but alternatively may perform additional services, such as additional training or programming a minor feature the customer had in their prior software solution. These amounts have historically been considered nominal. In connection with our customer contracts and the adequacy of related allowances and measures of progress towards contract completion, our project managers are charged with the responsibility to continually review the status of each customer on a specific contract basis. Also, we review, on at least a quarterly basis, significant past due accounts receivable and the adequacy of related reserves. Events or changes in circumstances that indicate that the carrying amount for the allowances for doubtful accounts and sales adjustments may require revision, include, but are not limited to, deterioration of a customer s financial condition,

failure to manage our customer s expectations regarding the scope of the services to be delivered, and defects or errors in new versions or enhancements of our software products.

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

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estimates of expected costs or revenues, we revise our cost and revenue estimates, and any revisions are charged to income in the period in which the facts that give rise to that revision first become known.

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

In connection with certain of our contracts, we have recorded retentions receivable or unbilled receivables consisting of costs and estimated profit in excess of billings as of the balance sheet date. Many of the contracts which give rise to unbilled receivables at a given balance sheet date are subject to billings in the subsequent accounting period. Management reviews unbilled receivables and related contract provisions to ensure we are justified in recognizing revenue prior to billing the customer and that we have objective evidence which allows us to recognize such revenue.

In addition, we have a sizable amount of deferred revenue which represents billings in excess of revenue earned. The majority of this liability consists of maintenance billings in which payments are made in advance and the revenue is ratably earned over the maintenance period, generally one year. We also have deferred revenue for those contracts in which we receive a deposit and the conditions in which to record revenue for the service or product has not been met. On a periodic basis, we review by customer the detail components of our deferred revenue to ensure our accounting remains appropriate.

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

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

Share-based Compensation. We have a stock option plan that provides for the grant of stock options to key employees, directors and non-employee consultants. Prior to January 1, 2006, we accounted for share-based compensation utilizing the intrinsic value method in accordance with the provisions of Accounting Principles Board Opinion (APB) No. 25, Accounting for Stock Issued to Employees, and related Interpretations. Accordingly no compensation expense was recorded because the exercise prices of the stock options equaled the market prices of the underlying stock on the dates of grants. However, prior to adoption of Statement of Financial Accounting Standards (SFAS) No. 123R, share-based compensation had been included in pro forma disclosures in the financial statement footnotes for periods prior to 2006.

Effective January 1, 2006, we adopted the provisions of SFAS No. 123R, Share-Based Payment, which establishes accounting for share-based awards exchanged for employee services, using the modified prospective application transition method. Subsequently, we recorded compensation expense in our statement of operations over the service period that the awards are expected to vest. Compensation cost recognized in 2006, includes the applicable amounts of: (a) compensation cost of all share-based payments granted prior to, but not yet vested as of, January 1, 2006 (based on the grant-date fair value estimated in accordance with the original provisions of SFAS No. 123, Accounting for Stock-Based Compensation, and previously presented in the pro forma footnote disclosures), and (b) compensation cost for all share-based payments granted subsequent to January 1, 2006 (based on the grant-date fair value estimated in accordance with the new provisions of SFAS No. 123R).

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We estimate the fair value of share-based awards on the date of grant using the Black-Scholes option valuation model. Share-based compensation expense includes the estimated effects of forfeitures, which will be adjusted over the requisite service period to the extent actual forfeitures differ, or are expected to differ from such estimates. Changes in estimated forfeitures are recognized in the period of change and will also impact the amount of expense to be recognized in future periods. Forfeiture rate assumptions are derived from historical data. We estimate stock price volatility at the date of grant based on the historical volatility of our common stock. Estimated option life is determined using the simplified method in accordance with Staff Accounting Bulletin No. 107. Determining the appropriate fair-value model and calculating the fair value of share-based awards at the grant date requires considerable judgment, including estimating stock price volatility, expected option life and forfeiture rates.

ANALYSIS OF RESULTS OF OPERATIONS AND OTHER

The following discussion compares the historical results of operations on a basis consistent with GAAP for the years ended December 31, 2006, 2005 and 2004.

2006 Compared to 2005

Revenues

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

		% of		% of	Change	
($ in thousands)	2006	Total	2005	Total	$	%
Software licenses	$ 37,414	19%	$ 29,552	17%	$ 7,862	27%
Software services	57,588	29	51,532	30	6,056	12
Maintenance	73,413	38	64,728	38	8,685	13
Appraisal services	19,755	10	18,374	11	1,381	8
Hardware and other	7,133	4	6,271	4	862	14
Total revenues	$ 195,303	100%	$ 170,457	100%	$ 24,846	15%

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

- Software license revenue related to financial products, which comprise over 70% of our software license revenues in the years presented, increased significantly compared to the prior year primarily due to growth from geographic expansion and increased success in winning larger contracts. Third party software revenue also increased over the comparable prior year because we sold more financial software modules that utilize third party software. Also, in late 2005 we simplified the implementation process for one of our financial products, which has enabled us to deliver the product more rapidly. Our financial software products automate accounting systems for cities, counties, school districts, public utilities and not-for-profit organizations.

- In 2006 software license revenue related to our products other than financial systems experienced strong increases in the aggregate compared to 2005. Software license revenues from our Odyssey courts and justice products experienced a substantial increase over the prior year as a result of the product maturing following successful early implementations and leveraging our existing customer base. In addition, licenses of our tax and appraisal products and a document management product were much higher than the prior year due to several new Java based product releases and increased appraisal revaluation activity. Our appraisal software license volume varies from period to period dependent upon the special needs and timing of our customers. Local government taxing entities normally reappraise properties from time to time to update values for tax assessment purposes and to maintain equity in the taxing process. While certain of these taxing jurisdictions contract with our appraisal services division to perform the reappraisals, it is not always necessary for the customer to purchase new software in order to process the appraisals. In some cases, a customer may simply add additional appraisal software modules to enhance the functionality of its existing software.

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

§ Software services revenue related to financial products, which comprise more than half of our software service revenue in the years presented, increased significantly in 2006 compared to the prior year reflecting increased contract volume and additions

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to training staff which enabled us to deliver our backlog at a faster rate. Typically, software contracts include services such as installing the software, converting the customers data to be compatible with the software and training customer personnel to use the software. Our application service provider (ASP) hosting and disaster recovery services also contributed to the increase as a result of geographic expansion, primarily in the South in the aftermath of hurricane Katrina.

Software services revenue related to Odyssey courts and justice products was up moderately in 2006 compared to 2005 reflecting increased contract volume. Since March 31, 2005, we have increased our presence with Odyssey in Texas, Florida and Michigan and added one contract in Nevada. Odyssey software services revenue did not increase as strongly as Odyssey software license revenue because the prior year included a $1.4 million contract for follow-on services to an existing customer that had previously implemented and accepted the software.

Software services revenue related to our document management products experienced strong increases in 2006 due to several new Java based product releases and other related products.

Maintenance. We provide maintenance and support services for our software products and third party software. Maintenance revenues increased due to growth in our installed customer base as evidenced by our software license revenue and slightly higher maintenance rates on most of our product lines.

Appraisal services. The appraisal services business is driven in part by revaluation cycles in various states. Appraisal services revenue increased over the prior year mainly due to activity related to Ohio s revaluation cycle, which occurs every six years as well as the addition of new customers. The Ohio revaluation cycle was nearly complete by the end of 2006. The level of appraisal services revenues in 2007 will depend on our ability to replace appraisal services revenues associated with the Ohio revaluation.

Cost of Revenues and Gross Margins

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

($ in thousands)	2006	% of related revenues	2005	% of related revenues	Change $	Change %
Software licenses	$ 9,980	27%	$ 9,101	31%	$ 879	10%
Acquired software	1,360	4	794	3	566	71
Software services and maintenance	90,330	69	80,347	69	9,983	12
Appraisal services	13,563	69	14,188	77	(625)	(4)
Hardware and other	5,266	74	4,540	72	726	16
Total cost of revenues	$ 120,499	62%	$ 108,970	64%	$ 11,529	11%

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

Gross margin percentages	2006	2005	Change
Software licenses and acquired software	69.7%	66.5%	3.2%
Software services and maintenance	31.0	30.9	0.1
Appraisal services	31.3	22.8	8.5
Hardware	26.2	27.6	(1.4)
Overall gross margin	38.3%	36.1%	2.2%

Cost of software license revenues. Our software license gross margin percentage in 2006 increased due to substantially higher software license revenues and slightly lower amortization expense of software development costs as some products became fully amortized during the first quarter of 2006. Approximately half of our cost of software license revenues is amortization expense for capitalized development costs on certain software products with the remainder consisting of costs related to third-party software.

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Amortization costs are fixed in nature and do not change with revenue changes. Once a product is released, we begin to amortize over the estimated useful life of the product the costs associated with its development. Amortization expense is determined on a product-by-product basis at an annual rate not less than straight-line basis over the product s estimated life, which is generally five years. Development costs consist mainly of personnel costs, such as salary and benefits paid to our developers and rent for related office space.

Cost of software services and maintenance revenues. The software services and maintenance gross margin percentage in 2006 was comparable to the 2005. The cost of software services and maintenance increased because we added to our implementation and support staff to increase our capacity to support new sales growth and deliver sales backlog. Cost of software services and maintenance primarily consists of expenses, such as personnel costs related to installation of our software licenses, conversion of customer data, training customer personnel and support activities and various other services such as ASP and disaster recovery.

Cost of appraisal services revenues. The appraisal services gross margin percentage increased in 2006 compared to 2005 mainly due to significant organizational changes and headcount reductions we made in the second quarter of 2005 to our appraisal services business to bring costs in line with expected levels of revenue. In addition, margins in 2005 were negatively affected by cost inefficiencies associated with one large contract.

The overall gross margin percentage rose mainly due to a revenue mix that included more software license revenues, as well as lower costs as a result of the restructuring of our appraisal services business in the second quarter of 2005. Software license revenue inherently has higher gross margins than other revenues such as software services and hardware.

Selling, General and Administrative Expenses

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

					Change	
($ in thousands)	2006	% of revenues	2005	% of revenues	$	%
Selling, general and administrative expenses	$51,711	26%	$46,242	27%	$5,469	12%

In 2006 SG&A includes a non-cash purchased in-process research and development charge of $140,000 relating to one of our acquisitions in January 2006 and $2.0 million of non-cash share-based compensation expense as a result of implementing SFAS No. 123R in January 2006. Partially offsetting these charges were lower SG&A expenses relating to our appraisal services and appraisal and tax software businesses due to the restructuring of those businesses in the second quarter of 2005.

Restructuring Charge

Because of unsatisfactory financial performance early in 2005, we made significant organizational changes in the second quarter of 2005 to those areas of our business that were not performing to our expectations. Our goal was to bring costs in line with expected levels of revenue while improving the efficiency of our organizational structure to ensure that clients continue to receive superior service.

We reorganized the appraisal services business to eliminate levels of management and reduce overhead expense. We also took actions to reduce headcount and costs in our appraisal and tax software division, and we consolidated certain senior management positions at the corporate office. These cost reductions were made in the second quarter of 2005. As a result, we eliminated approximately 120 positions, including management, staff and project-related personnel. In connection with the reorganization, we incurred certain charges which were primarily comprised of employee severance costs and related fringe benefits, and totaled approximately $1.3 million before income taxes. The related payments were paid in 2005.

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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 and amortizable software, customer and trade name intangibles with the remainder allocated to goodwill that is not subject to amortization. However, amortization expense related to acquired software is included with cost of revenues while amortization expense of customer and trade name intangibles is recorded as other expense. The estimated useful lives of both customer and trade name intangibles are 5 to 25 years. The following table sets forth a comparison of amortization of customer and trade name intangibles for the following years ended December 31:

			Change	
($ in thousands)	2006	2005	$	%
Amortization of customer and trade name intangibles	$1,318	$1,266	$52	4%

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

2007	$1,348
2008	1,323
2009	1,237
2010	1,237
2011	1,221

Other

Interest income is the main component of other income, which also includes non-usage and other fees associated with a credit agreement we terminated in January 2007, gain on sale of certain assets, gains and losses on risk management liabilities and assets associated with a foreign exchange contract and miscellaneous other items. Interest income in 2006 was $1.4 million compared to $900,000 in 2005.

Income Tax Provision

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

			Change	
($ in thousands)	2006	2005	$	%
Income tax provision	$8,493	$5,432	$3,061	56%
Effective income tax rate	37.2%	39.9%		

The effective income tax rates were different from the statutory United States federal income tax rate of 35% primarily due to state income taxes, the qualified manufacturing activities deduction and non-deductible meals and entertainment costs. In 2006 the rate is also impacted by non-deductible share-based compensation expense.

The effective rate for 2006 was lower than the prior year mainly due to changes in the Texas franchise tax law and rates enacted in the second quarter of 2006, favorable state income tax audit results and lower state income taxes as a result of a change in our corporate structure implemented in early 2005.

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

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2005 Compared to 2004

Revenues

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

($ in thousands)	2005	% of Total	2004	% of Total	Change $	Change %
Software licenses	$ 29,552	17%	$ 30,258	18%	$ (706)	(2)%
Software services	51,532	30	49,786	29	1,746	4
Maintenance	64,728	38	57,760	33	6,968	12
Appraisal services	18,374	11	27,394	16	(9,020)	(33)
Hardware and other	6,271	4	7,072	4	(801)	(11)
Total revenues	$ 170,457	100%	$ 172,270	100%	$ (1,813)	(1)%

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

- Software license revenue related to financial products, which comprise approximately 80% of our software license revenues in the years presented, increased slightly compared to the prior year primarily due to third party software products which enhance the functionality of our proprietary software.

- Software license revenue related to our Odyssey courts and justice products declined in 2005 compared to 2004. The prior year was unusually high because it included approximately $900,000 of license fees earned upon final acceptance for two original Odyssey installation sites. In 2005 we had fifteen Odyssey contracts in process compared to seven Odyssey contracts in 2004. The implementation cycle for Odyssey products ranges from nine to thirty-six months depending on the scope of the contract and modification complexity. We have recognized revenue on these contracts using contract accounting.

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

- Software services revenue related to financial products, which comprise more than half of our software service revenue in the years presented, increased moderately in 2005 compared to the prior year. Approximately one-half of our financial software services revenue increase related to training and the remaining increases were due to new customers for our application service provider hosting and disaster recovery services and other miscellaneous services. We increased our training staff in 2005 which enabled us to deliver our backlog at a faster rate.

- Software services revenue related to our Odyssey courts and justice products increased significantly in 2005 compared to the prior year mainly due to a new $1.4 million contract for follow-on services to an existing customer that had previously implemented and accepted the software.

- Software services revenue related to appraisal and tax products declined substantially in 2005. This decline was mainly associated with the completion of several legacy appraisal and tax contracts in 2004 and early 2005.

Maintenance. We provide maintenance and support services for our software products and third party software. Maintenance revenues increased due to growth in our installed customer base as evidenced by our software license revenue and slightly higher maintenance rates on most of our product lines.

Appraisal services. The decrease in appraisal services revenues is due to the completion in 2004 of certain significant appraisal contracts. These larger projects are often relatively discretionary in nature compared to smaller projects which tend to occur on a more consistent basis, and the larger projects we recently completed have not been replaced by similar projects. The appraisal services business is driven in part by revaluation cycles in various states.

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Cost of Revenues and Gross Margins

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

($ in thousands)	2005	% of related revenues	2004	% of related revenues	Change $	Change %
Software licenses	$ 9,101	31%	$ 8,819	29%	$ 282	3%
Acquired software	794	3	1,447	5	(653)	(45)
Software services and maintenance	80,347	69	72,609	68	7,738	11
Appraisal services	14,188	77	20,132	73	(5,944)	(30)
Hardware and other	4,540	72	5,425	77	(885)	(16)
Total cost of revenues	$ 108,970	64%	$ 108,432	63%	$ 538	0%

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

Gross margin percentages	2005	2004	Change
Software licenses and acquired software	66.5%	66.1%	0.4%
Software services and maintenance	30.9	32.5	(1.6)
Appraisal services	22.8	26.5	(3.7)
Hardware	27.6	23.3	4.3
Overall gross margin	36.1%	37.1%	(1.0)%

Cost of software license revenues. Amortization expense for capitalized software products declined from $6.1 million in 2004 to $5.9 million in 2005, because certain software products became fully amortized during 2005, which offset new amortization expense from software products released in 2004.

Cost of acquired software. In 2005 cost of acquired software declined compared to the prior year because certain acquired software assets recorded for previous acquisitions became fully amortized.

Cost of software services and maintenance revenues. In 2005 cost of software services and maintenance grew 11% while the related software services and maintenance revenues increased 8% compared to the prior year period. During 2005, costs increased at a faster rate than related software services and maintenance revenues, which reflects lower utilization of personnel in our appraisal and tax software division, costs to support our recently released Orion products, a shift in the roles of certain of our development personnel whose costs were capitalized in 2004 to projects that were expensed in 2005, and higher health care costs.

Cost of appraisal services revenues. The decline in the cost of appraisal services revenues is the result of lower appraisal services revenues. We often hire temporary employees to assist in appraisal projects whose term of employment generally ends with the projects completion. In addition, in the second quarter of 2005 we made significant organizational changes to our appraisal services division because of the declining gross margins.

Gross margin percentage. The overall gross margin percentage decline was due to cost inefficiencies associated with lower appraisal services revenues and efforts and costs to support our recently released Orion products, as well as a shift in the roles of certain of our development personnel whose costs were capitalized in 2004 to projects that are being expensed in 2005 and higher health care costs.

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Selling, General and Administrative Expenses

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

($ in thousands)	2005	% of revenues	2004	% of revenues	Change $	Change %
Selling, general and administrative expenses	$46,242	27%	$45,451	26%	$791	2%

SG&A increased mainly due to higher health care costs and an increase in the number of marketing personnel. These increases were offset somewhat by lower consulting fees associated with documenting our internal control processes.

Other

Interest income is the main component of other income, which also includes non-usage and other fees associated with a credit agreement we terminated in January 2007, gain on sale of certain assets, gain on risk management assets associated with a foreign exchange contract and miscellaneous other items. Other income increased compared to 2004 mainly due to higher interest rates and a small gain on sale of certain assets.

Income Tax Provision

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

($ in thousands)	2005	2004	Change $	Change %
Income tax provision	$5,432	$7,309	$(1,877)	(26)%
Effective income tax rate	39.9%	41.9%		

The effective income tax rate declined 2% from 2004 due to the qualified manufacturing activities deduction enacted in 2005 and a corporate reorganization in 2005 which favorably impacted our state income tax provision.

FINANCIAL CONDITION AND LIQUIDITY

Historically, we have funded our operations and capital expenditures primarily with cash generated from operating activities. As of December 31, 2006, our combined cash and cash equivalents and short-term investments (including restricted cash equivalents and a restricted certificate of deposit) balance was $41.7 million compared to $37.5 million at December 31, 2005. Cash provided by operating activities was $26.8 million in 2006 compared to $21.2 million in 2005 and $22.2 million in 2004. Cash and short-term investments increased primarily due to continued strong operating performance and higher deferred revenue due to additional maintenance customers and new contract signings.

At December 31, 2006, our days sales outstanding (DSOs) were 102 days compared to DSOs of 101 days at December 31, 2005. DSOs are calculated based on accounts receivable (excluding long-term receivables) divided by the quotient of annualized quarterly revenues divided by 360 days.

Investing activities used cash of $24.3 million in 2006, while investing activities provided cash of $1.8 million in 2005 and used cash of $9.9 million in 2004. In January 2006, we acquired two companies, MazikUSA, Inc. and TACS, Inc. The combined purchase price, including transaction costs, for the two companies was approximately $14.6 million, comprised of approximately $11.7 million in cash and 325,000 shares of Tyler common stock. In September 2006 we also purchased certain maintenance and support agreements associated with one of our financial products for approximately $580,000. Other investing activities during 2006 were capital expenditures of $4.3 million, including $4.1 million for computer hardware and purchased software for internal use, including a new enterprise-wide customer relationship management system, and other asset additions to support internal growth. In 2005 and 2004 investing activities primarily consisted of investments in software development and property and equipment. Investing activities in 2004 also included adjustments to the acquisition of Eden Systems, Inc. (Eden). Pursuant to our purchase

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agreement, two of the shareholders of Eden were granted the right to put their remaining shares to Tyler and we were also granted the right to call the remaining shares. In 2004, we purchased the remaining 2,500 shares for $725,000 in cash.

We purchased $26.8 million of short-term investments during 2006. Proceeds from sales of short-term investments were $19.0 million during 2006. During 2006, the short-term investments earned interest income of $438,000 which was reinvested. We also earned interest income of $962,000 from money market investments and a restricted certificate of deposit.

Financing activities used cash of $6.0 million in 2006 compared to $14.8 million in 2005 and $9.9 million in 2004. Cash used in financing activities was primarily comprised of purchases of treasury shares, net of proceeds from stock option exercises and contributions from our employee stock purchase plan.

During 2006, we purchased approximately 1.0 million shares of our common stock for an aggregate cash purchase price of $10.5 million.

In 2006, we received $2.9 million from the exercise of options to purchase approximately 623,000 shares of our common stock under our employee stock option plan. During 2005 we issued 436,000 shares of common stock and received $1.8 million in aggregate proceeds, upon exercise of stock options and during 2004 we issued 680,000 shares of common stock and received $1.9 million in aggregate proceeds upon exercise of stock options.

In both 2006 and 2005, we received $1.0 million for contributions to the Tyler Technologies, Inc. Employee Stock Purchase Plan (ESPP). The ESPP was adopted by our shareholders in May 2004.

Subsequent to December 31, 2006 and through February 23, 2007 we purchased approximately 188,000 shares of our common stock for an aggregate cash purchase price of $2.6 million.

We maintain a $10.0 million Letter of Credit facility under which the bank will issue cash collateralized letters of credit. As of December 31, 2006 we had outstanding letters of credit totaling $5.0 million to secure surety bonds required by some of our customer contracts.

In the first quarter of 2007 we acquired two small companies and a building for a combined cash purchase price of $5.0 million. We have not finalized the allocation of the excess purchase price over the fair value of the net identifiable assets of the acquired companies but expect this allocation will result in non-cash charges that may have a small dilutive effect on earnings per share in 2007.

Excluding acquisitions, we anticipate that 2007 capital spending will be between $3.5 million and $4.0 million, the majority of which will be related to computer equipment and software for infrastructure expansions. We currently do not expect to capitalize significant amounts related to software development in 2007 but the actual amount and timing of those costs, and whether they are capitalized or expensed may result in additional capitalized software development. Capital spending in 2007 is expected to be funded from existing cash balances and cash flows from operations.

From time to time we engage in discussions with potential acquisition candidates. In order to pursue such opportunities, which could require significant commitments of capital, we may be required to incur debt or to issue additional potentially dilutive securities in the future. No assurance can be given as to our future acquisition opportunities and how such opportunities will be financed. In the absence of future acquisitions of other businesses, we believe our current cash balances and expected future cash flows from operations will be sufficient to meet our anticipated cash needs for working capital, capital expenditures and other activities through the next twelve months. If operating cash flows are not sufficient to meet our needs, we believe that credit would be available to us.

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We lease office facilities, as well as transportation, computer and other equipment used in our operations under non-cancelable operating lease agreements expiring at various dates through 2013. Most leases contain renewal options and some contain purchase options. Following are the future obligations under non-cancelable leases at December 31, 2006 (in thousands):

	2007	2008	2009	2010	2011	Thereafter	Total
Future rental payments under operating leases	$4,591	$4,365	$4,124	$2,843	$2,077	$1,465	$19,465

It is not our usual business practice to enter into off-balance sheet arrangements or to issue guarantees to third parties. As of December 31, 2006 we have no material purchase commitments, except for the operating lease commitments listed above.

CAPITALIZATION

At December 31, 2006, our capitalization consisted of $125.9 million of shareholders equity.

NEW ACCOUNTING PRONOUNCEMENTS

In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 (FIN 48), which clarifies the accounting and disclosure for uncertainty in tax positions, as defined. FIN 48 seeks to reduce the diversity in practice associated with certain aspects of the recognition and measurement related to accounting for income taxes. This interpretation is effective for fiscal years beginning after December 15, 2006. We do not expect the interpretation will have a material impact on our results from operations or financial position.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements . SFAS No. 157 defines fair value, establishes a framework for measuring fair value in accordance with accounting principles generally accepted in the United States, and expands disclosures about fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007, with earlier application encouraged. Any amounts recognized upon adoption as a cumulative effect adjustment will be recorded to the opening balance of retained earnings in the year of adoption. We have not yet determined the impact of SFAS No. 157 on our financial condition and results of operations.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Market risk represents the risk of loss that may affect us due to adverse changes in financial market prices and interest rates. As of December 31, 2006, we had funds invested in auction rate municipal securities and state and municipal bonds, which we accounted for in accordance with SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities. These investments were treated as available-for-sale under SFAS No. 115. The carrying value of these investments approximates fair market value. Due to the nature of this investment, we are not subject to significant market rate risk.

We have no outstanding debt at December 31, 2006, and we therefore are not subject to any interest rate risk.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

The reports of our independent registered public accounting firm and our consolidated financial statements, related notes, and supplementary data are included as part of this Annual Report beginning on page F-1.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.

None.

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ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures Our chief executive officer and our chief financial officer have evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Securities Exchange Act Rules 13a-15(e)) as of December 31, 2006. Based on such evaluation, our chief executive officer and chief financial officer have concluded that as of December 31, 2006 such disclosure controls and procedures were effective and designed to ensure that information required to be disclosed by us in the reports we file or submit under the Securities Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the SEC s rules and forms, and include controls and procedures designed to ensure that information required to be disclosed by us in such reports is accumulated and communicated to our management, including the chief executive officer and chief financial officer, as appropriate to allow timely decisions regarding required disclosure.

Internal Control Over Financial Reporting During the quarter ended December 31, 2006, there were no changes in our internal controls over financial reporting, as defined in Securities Exchange Act Rule 13a-15(f) and 15d-15(f), that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Management s Report on Internal Control Over Financial Reporting Tyler s management is responsible for establishing and maintaining effective internal control over financial reporting as defined in Securities Exchange Act Rule 13a-15(f). Tyler s internal control over financial reporting is designed to provide reasonable assurance to Tyler s management and board of directors regarding the preparation and fair presentation of published financial statements. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

Management assessed the effectiveness of Tyler s internal control over financial reporting as of December 31, 2006. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control Integrated Framework*. Based on our assessment, we believe that, as of December 31, 2006, Tyler s internal control over financial reporting is effective based on those criteria.

Management s assessment of the effectiveness of internal control over financial reporting as of December 31, 2006 has been audited by Ernst & Young, LLP, the independent registered public accounting firm who also audited Tyler s consolidated financial statements. Ernst & Young s attestation report on management s assessment of Tyler s internal control over financial reporting appears on page F-2 hereof.

ITEM 9B. OTHER INFORMATION

None.

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PART III

See the information under the following captions in Tyler s definitive Proxy Statement, which is incorporated herein by reference. Only those sections of the Proxy Statement that specifically address the items set forth herein are incorporated by reference. Such incorporation by reference does not include the Compensation Discussion and Analysis, the Compensation Committee Report or the Audit Committee Report which are included in the Proxy Statement.

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS, AND CORPORATE GOVERNANCE.

ITEM 11. EXECUTIVE COMPENSATION.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES.

Headings in Proxy Statement

Tyler Management and Corporate Governance Principles and Board Matters

Executive Compensation

Security Ownership of Certain Beneficial Owners and Management

Executive Compensation

The information required under this item may be found under the section captioned Proposals For Consideration Proposal Two Ratification of Ernst & Young LLP as Our Independent Auditors for Fiscal Year 2007 in our Proxy Statement and is incorporated herein by reference.

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PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULE.

The following documents are filed as part of this Annual Report:

(a) (1) The consolidated financial statements are filed as part of this Annual Report.

	Page
Reports of Independent Registered Public Accounting Firm	F-1
Consolidated Statements of Operations for the years ended December 31, 2006, 2005, and 2004	F-3
Consolidated Balance Sheets as of December 31, 2006 and 2005	F-4
Consolidated Statements of Shareholders Equity for the years ended December 31, 2006, 2005 and 2004	F-5
Consolidated Statements of Cash Flows for the years ended December 31, 2006, 2005 and 2004	F-6
Notes to Consolidated Financial Statements	F-7

(2) The following financial statement schedule is filed as part of this report.

Schedule II Valuation and Qualifying Accounts for the years ended December 31, 2006, 2005 and 2004	F-23

All other schedules for which provision is made in the applicable accounting regulation of the Securities and Exchange Commission are not required under the related instructions or are inapplicable and, therefore, have been omitted.

(3) Exhibits

Certain of the exhibits to this Annual Report are hereby incorporated by reference, as specified:

Exhibit Number	Description
3.1	Restated Certificate of Incorporation of Tyler Three, as amended through May 14, 1990, and Certificate of Designation of Series A Junior Participating Preferred Stock (filed as Exhibit 3.1 to our Form 10-Q for the quarter ended June 30, 1990, and incorporated by reference herein).
3.2	Certificate of Amendment to the Restated Certificate of Incorporation (filed as Exhibit 3.1 to our Form 8-K, dated February 19, 1998, and incorporated by reference herein).
3.3	Amended and Restated By-Laws of Tyler Corporation, dated November 4, 1997 (filed as Exhibit 3.3 to our Form 10-K for the year ended December 31, 1997, and incorporated by reference herein).

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Exhibit Number	Description
3.4	Certificate of Amendment dated May 19, 1999 to the Restated Certificate of Incorporation (filed as Exhibit 3.4 to our Form 10-K for the year ended December 31, 2000, and incorporated by reference herein).
4.1	Specimen of Common Stock Certificate (filed as Exhibit 4.1 to our registration statement no. 33-33505 and incorporated by reference herein).
10.1	Form of Indemnification Agreement for directors and officers (filed as Exhibit 10.1 to our Form 10-K for the year ended December 31, 2002 and incorporated by reference herein).
10.2	Stock Option Plan amended and restated as of May 12, 2000 (filed as Exhibit 4.1 to our registration statement no. 333-98929 and incorporated by reference herein).
10.3	Purchase Agreement between Tyler Corporation, Richmond Partners, Ltd. and Louis A. Waters, dated August 20, 1997 (filed as Exhibit 10.24 to our Form 8-K, dated September 2, 1997, and incorporated by reference herein).
*10.4	Employment and Non-Competition Agreement between Tyler Technologies, Inc. and H. Lynn Moore dated August 5, 2003.
10.5	Employment and Non-Competition Agreement between Tyler Technologies, Inc. and John S. Marr Jr. dated July 1, 2003 (filed as Exhibit 10.1 to our Form 10-Q for the quarter ended June 30, 2003 and incorporated by reference herein).
10.6	Employment and Non-Competition Agreement between Tyler Technologies, Inc. and John M. Yeaman dated July 1, 2003 (filed as Exhibit 10.2 to our Form 10-Q for the quarter ended July 31, 2003 and incorporated by reference herein).
10.7	Employment and Non-Competition Agreement between Tyler Technologies, Inc. and Dustin R. Womble dated July 1, 2003 (filed as Exhibit 10.8 to our Form 10-K for the year ended December 31, 2003 and incorporated by reference herein).
*10.8	Employment and Non-Competition Agreement between Tyler Technologies, Inc. and Brian K. Miller, dated February 26, 2007.
10.9	Employee Stock Purchase Plan (filed as Exhibit 4.1 to our registration statement 333-116406 dated June 10, 2004 and incorporated by reference herein).
*23	Consent of Independent Registered Public Accounting Firm

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Exhibit Number	Description
*31.1	Rule 13a-14(a) Certification by Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
*31.2	Rule 13a-14(a) Certification by Principal Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
*32.1	Certification by Principal Executive Officer pursuant to 18 U.S.C. Section 1330, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
*32.2	Certification by Principal Financial Officer pursuant to 18 U.S.C. Section 1330, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

* Filed herewith.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

Date: February 26, 2007 By: /s/ John S. Marr

John S. Marr
Chief Executive Officer and President
(principal executive officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Date: February 26, 2007 By: /s/ John S. Marr

John S. Marr
Chief Executive Officer and President
Director
(principal executive officer)

Date: February 26, 2007 By: /s/ John M. Yeaman

John M. Yeaman
Chairman of the Board

Date: February 26, 2007 By: /s/ Brian K. Miller

Brian K. Miller
Senior Vice President and Chief
Financial Officer
(principal financial officer)

Date: February 26, 2007 By: /s/ W. Michael Smith

W. Michael Smith
Vice President and Chief Accounting
Officer
(principal accounting officer)

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Date: February 26, 2007	By: /s/ Donald R. Brattain Donald R. Brattain Director
Date: February 26, 2007	By: /s/ J. Luther King J. Luther King Director
Date: February 26, 2007	By: /s/ G. Stuart Reeves G. Stuart Reeves Director
Date: February 26, 2007	By: /s/ Michael D. Richards Michael D. Richards Director
Date: February 26, 2007	By: /s/ Dustin R. Womble Dustin R. Womble Director

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders
Tyler Technologies, Inc.

We have audited the accompanying consolidated balance sheets of Tyler Technologies, Inc. and subsidiaries as of December 31, 2006 and 2005, and the related consolidated statements of operations, shareholders equity, and cash flows for each of the three years in the period ended December 31, 2006. Our audits also included the financial statement schedule listed in the Index at Item 15(a). These financial statements and schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Tyler Technologies, Inc. and subsidiaries at December 31, 2006 and 2005, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2006, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

As discussed in Note 1 in the Notes to the Consolidated Financial Statements, the Company changed its method of accounting for share-based compensation effective January 1, 2006.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Tyler Technologies, Inc. s internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 20, 2007 expressed an unqualified opinion thereon.

ERNST & YOUNG LLP
Dallas, Texas
February 20, 2007

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders
Tyler Technologies, Inc.

We have audited management s assessment, included in the accompanying Management s Report on Internal Controls over Financial Reporting, that Tyler Technologies, Inc. maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Tyler Technologies, Inc. s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management s assessment and an opinion on the effectiveness of the company s internal control over financial reporting based on our audit.

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

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

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

In our opinion, management s assessment that Tyler Technologies, Inc. maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, Tyler Technologies, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Tyler Technologies, Inc. as of December 31, 2006 and 2005, and the related consolidated statements of operations, shareholders equity, and cash flows for each of the three years in the period ended December 31, 2006 and our report dated February 20, 2007 expressed an unqualified opinion thereon.

ERNST & YOUNG LLP
Dallas, Texas
February 20, 2007

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Tyler Technologies, Inc.
Consolidated Statements of Operations
For the years ended December 31
In thousands, except per share amounts

	2006	2005	2004
Revenues:			
Software licenses	$ 37,414	$ 29,552	$ 30,258
Software services	57,588	51,532	49,786
Maintenance	73,413	64,728	57,760
Appraisal services	19,755	18,374	27,394
Hardware and other	7,133	6,271	7,072
Total revenues	195,303	170,457	172,270
Cost of revenues:			
Software licenses	9,980	9,101	8,819
Acquired software	1,360	794	1,447
Software services and maintenance	90,330	80,347	72,609
Appraisal services	13,563	14,188	20,132
Hardware and other	5,266	4,540	5,425
Total cost of revenues	120,499	108,970	108,432
Gross profit	74,804	61,487	63,838
Selling, general and administrative expenses	51,711	46,242	45,451
Restructuring charge		1,260	
Amortization of customer and trade name intangibles	1,318	1,266	1,267
Operating income	21,775	12,719	17,120
Other income, net	1,080	906	317
Income before income taxes	22,855	13,625	17,437
Income tax provision	8,493	5,432	7,309
Net income	$ 14,362	$ 8,193	$ 10,128
Earnings per common share:			
Basic	$ 0.37	$ 0.21	$ 0.25
Diluted	$ 0.34	$ 0.19	$ 0.23
Basic weighted average common shares outstanding	38,817	39,439	41,288

Diluted weighted average common shares outstanding	41,868	42,075	44,566

See accompanying notes.

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Tyler Technologies, Inc.
Consolidated Balance Sheets
December 31
In thousands, except share and per share amounts

	2006	2005
ASSETS		
Current assets:		
Cash and cash equivalents	$ 17,212	$ 20,733
Restricted cash equivalents	4,962	
Short-term investments available-for-sale	19,543	11,750
Restricted certificate of deposit		4,750
Accounts receivable (less allowance for losses of $2,971 in 2006 and $1,991 in 2005)	58,188	49,644
Prepaid expenses	6,864	5,158
Other current assets	2,326	2,201
Deferred income taxes	2,579	2,128
Total current assets	111,674	96,364
Accounts receivable, long-term portion	1,675	1,547
Property and equipment, net	7,390	5,759
Other assets:		
Goodwill	66,127	53,709
Customer related intangibles, net	17,502	17,696
Software, net	14,554	17,645
Trade name, net	1,188	1,262
Restricted certificate of deposit		250
Sundry	166	205
	$ 220,276	$ 194,437
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 5,063	$ 3,330
Accrued liabilities	17,735	16,027
Deferred revenue	62,387	51,304
Income taxes payable		289
Total current liabilities	85,185	70,950
Deferred income taxes	9,216	11,290
Commitments and contingencies		
Shareholders equity:		
Preferred stock, $10.00 par value; 1,000,000 shares authorized, none issued	481	481

Common stock, $0.01 par value; 100,000,000 shares authorized; 48,147,969 shares issued in 2006 and 2005		
Additional paid-in capital	151,627	151,515
Accumulated other comprehensive loss, net of tax	(10)	
Retained earnings	18,131	3,769
Treasury stock, at cost; 9,255,783 and 9,273,342 shares in 2006 and 2005, respectively	(44,354)	(43,568)
Total shareholders equity	125,875	112,197
	$ 220,276	$ 194,437

See accompanying notes.

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Tyler Technologies, Inc.
Consolidated Statements of Shareholders Equity
For the years ended December 31, 2006, 2005 and 2004
In thousands

	Common Stock		Additional Paid-in	Accumulated Other Comprehensive Income	Retained Earnings	Treasury Stock		Total Shareholders
	Shares	Amount	Capital	(Loss)	(Deficit)	Shares	Amount	Equity
Balance at December 31, 2003	48,148	$ 481	$ 156,201	$ (32)	$ (14,552)	(6,704)	$ (24,191)	$ 117,907
Comprehensive income:								
Net income					10,128			10,128
Unrealized loss on investment securities, net of tax				(37)				(37)
Reclassification adjustment, net of income taxes of $37				69				69
Total comprehensive income								10,160
Issuance of shares pursuant to stock compensation plan			(3,704)			680	5,644	1,940
Treasury stock purchases						(1,459)	(12,518)	(12,518)
Stock warrant exercises			(143)			16	143	
Issuance of shares pursuant to Employee Stock Purchase Plan			(66)			44	395	329
Federal income tax benefit related to exercise of stock options			582					582
Balance at December 31, 2004	48,148	481	152,870		(4,424)	(7,423)	(30,527)	118,400

Comprehensive income:							
Net income				8,193			8,193
Unrealized loss on investment securities, net of tax				(8)			(8)
Reclassification adjustment, net of income taxes of $5				8			8
Total comprehensive income							8,193
Issuance of shares pursuant to stock compensation plan			(1,570)		436	3,370	1,800
Stock compensation			18				18
Treasury stock purchases					(2,457)	(17,683)	(17,683)
Issuance of shares pursuant to Employee Stock Purchase Plan			(116)		171	1,272	1,156
Federal income tax benefit related to exercise of stock options			313				313
Balance at December 31, 2005	48,148	481	151,515	3,769	(9,273)	(43,568)	112,197
Comprehensive income:							
Net income				14,362			14,362
Unrealized loss on investment securities, net of tax				(10)			(10)
Total comprehensive income							14,352
Issuance of shares pursuant to stock compensation plan			(3,158)		623	6,074	2,916
Stock compensation			1,960				1,960

Treasury stock purchases						(1,033)	(10,531)	(10,531)
Issuance of shares pursuant to Employee Stock Purchase Plan			22			102	918	940
Federal income tax benefit related to exercise of stock options			1,150					1,150
Issuance of shares for acquisitions			138			325	2,753	2,891
Balance at December 31, 2006	48,148	$ 481	$ 151,627	$ (10)	$ 18,131	(9,256)	$ (44,354)	$ 125,875

See accompanying notes.

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Tyler Technologies, Inc.
Consolidated Statements of Cash Flows
For the years ended December 31
In thousands

	2006	2005	2004
Cash flows from operating activities:			
Net income	$ 14,362	$ 8,193	$ 10,128
Adjustments to reconcile net income to net cash provided by operations:			
Depreciation and amortization	10,102	10,443	11,386
Share-based compensation expense	1,960		
Realized net losses on sales of investment securities			106
Purchased in-process research and development charge	140		
Non-cash interest and other charges	220	(73)	88
Provision for losses accounts receivable	2,077	1,641	796
Deferred income tax benefit	(2,520)	(2,200)	(300)
Changes in operating assets and liabilities, exclusive of effects of acquired companies:			
Accounts receivable	(10,400)	(7,031)	(3,760)
Income tax payable	(78)	(421)	1,063
Prepaid expenses and other current assets	(1,496)	(2,117)	(1,084)
Accounts payable	1,626	561	511
Accrued liabilities	972	2,428	(961)
Deferred revenue	9,839	9,763	4,186
Net cash provided by operating activities	26,804	21,187	22,159
Cash flows from investing activities:			
Purchases of short-term investments	(26,825)	(16,882)	(12,277)
Proceeds from sales of short-term investments	19,016	18,964	10,055
Cost of acquisitions, net of cash acquired	(12,237)		(946)
Decrease in restricted investments	38	2,500	
Investment in software development costs	(236)	(1,002)	(4,575)
Additions to property and equipment	(4,088)	(1,734)	(2,267)
Other	6	(26)	96
Net cash (used by) provided by investing activities	(24,326)	1,820	(9,914)
Cash flows from financing activities:			
Purchase of treasury shares	(10,531)	(17,683)	(12,518)
Contributions from employee stock purchase plan	1,002	1,036	673
Proceeds from exercise of stock options	2,916	1,800	1,940
Excess tax benefits from share-based compensation expense	614		
Payments on notes payable			(35)
Net cash used by financing activities	(5,999)	(14,847)	(9,940)

Net (decrease) increase in cash and cash equivalents	(3,521)	8,160	2,305
Cash and cash equivalents at beginning of year	20,733	12,573	10,268
Cash and cash equivalents at end of year	$ 17,212	$ 20,733	$ 12,573

See accompanying notes.

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Tyler Technologies, Inc.
Notes to Consolidated Financial Statements
(Tables in thousands, except per share data)
December 31, 2006 and 2005

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

DESCRIPTION OF BUSINESS

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

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

PRINCIPLES OF CONSOLIDATION

In 2005, we merged all of our subsidiaries into the parent company. The consolidated financials as of December 31, 2004 include our parent company and our subsidiaries, all of which were wholly-owned.

CASH, CASH EQUIVALENTS, SHORT-TERM INVESTMENTS AND OTHER

Cash equivalents include items almost as liquid as cash, such as money market investments with insignificant interest rate risk and original maturities of three months or less at the time of purchase. For purposes of the statements of cash flows, we consider all investments with original maturities of three months or less to be cash equivalents.

In accordance with Statement of Financial Accounting Standards (SFAS) No. 115, Accounting for Certain Investments in Debt and Equity Securities, we determine the appropriate classification of debt and equity securities at the time of purchase and re-evaluate the classification as of each balance sheet date. At December 31, 2006 and 2005, we classified our short-term investments as available-for-sale securities pursuant to SFAS No. 115. Investments which are classified as available-for-sale are recorded at fair value as determined by quoted market price and unrealized holding gains and losses, net of the related tax effect, if any, are not reflected in earnings but are reported as a separate component of other comprehensive income until realized. Interest and dividends earned on these securities are reinvested in the securities. The cost basis of securities sold is determined using the average cost method. Following is a summary of short-term investments:

December 31, 2006	Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Auction rate municipal securities	$ 14,875	$	$	$ 14,875
State and municipal bonds	4,684		(16)	4,668
	$ 19,559	$	$ (16)	$ 19,543

December 31, 2005	Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Auction rate municipal securities	$ 11,750	$	$	$ 11,750

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We maintain a $10.0 million Letter of Credit facility under which the bank will issue cash collateralized letters of credit. As of December 31, 2006 approximately $5.0 million of our cash equivalents are restricted and designated as collateral for our letters of credit issued in connection with our surety bond program. These letters of credit expire during 2007.

REVENUE RECOGNITION

We recognize revenue related to our software arrangements pursuant to the provisions of Statement of Position (SOP) 97-2, Software Revenue Recognition, as amended by SOP 98-4 and SOP 98-9, and related interpretations, as well as the Securities and Exchange Commission (SEC) Staff Accounting Bulletin No. 104, Revenue Recognition. We recognize revenue on our appraisal services contracts using the proportionate performance method of accounting, with considerations for the provisions of Emerging Issues Task Force (EITF) No. 00-21, Revenue Arrangements with Multiple Deliverables.

Software Arrangements:

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

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

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

i. persuasive evidence of an arrangement exists;

ii. delivery has occurred;

iii. our fee is fixed or determinable; and

iv. collectibility is probable.

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

does not exist and the only undelivered element is services that do not involve significant modification or customization of the software, the entire fee is recognized over the period during which the services are expected to be performed.

Software Licenses

We recognize the revenue allocable to software licenses and specified upgrades upon delivery of the software product or upgrade to the customer, unless the fee is not fixed or determinable or collectibility is not probable. If the fee is not fixed or determinable,

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including new customers whose payment terms are three months or more from shipment, revenue is generally recognized as payments become due from the customer. If collectibility is not considered probable, revenue is recognized when the fee is collected. Arrangements that include software services, such as training or installation, are evaluated to determine whether those services are essential to the product s functionality.

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

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

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

Software Services

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

Computer Hardware Equipment

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

Postcontract Customer Support

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

Appraisal Services:

For our property appraisal projects, we recognize revenue using the proportionate performance method of revenue recognition since many of these projects are implemented over one to three year periods and consist of various unique activities. Under this method of revenue recognition, we identify each activity for the appraisal project, with a typical project generally calling for bonding, office set up, training, routing of map information, data entry, data collection, data verification, informal hearings, appeals and project management. Each activity or act is specifically identified and assigned an estimated cost. Costs which are considered to be associated with indirect activities, such as bonding costs and office set up, are expensed as incurred. These costs are typically billed as incurred and are recognized as revenue

equal to cost. Direct contract fulfillment activities and related supervisory costs such as data collection, data entry and verification are expensed as incurred. The direct costs for these activities are determined and the total

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contract value is then allocated to each activity based on a consistent profit margin. Each activity is assigned a consistent unit of measure to determine progress towards completion and revenue is recognized for each activity based upon the percentage complete as applied to the estimated revenue for that activity. Progress for the fulfillment activities is typically based on labor hours or an output measure such as the number of parcel counts completed for that activity. Estimated losses on uncompleted contracts are recorded in the period in which we first determine that a loss is apparent.

Other:

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

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

USE OF ESTIMATES

The preparation of our consolidated financial statements in conformity with accounting principles generally accepted in the United States (GAAP) requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant items subject to such estimates and assumptions include the application of the percentage-of-completion and proportionate performance methods of revenue recognition, the carrying amount and estimated useful lives of intangible assets and valuation allowance for receivables. In addition we are primarily self-insured for employee health care and base our self-insurance liability on claims filed and an estimate of claims incurred but not yet reported. Actual results could differ from estimates.

PROPERTY AND EQUIPMENT, NET

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

RESEARCH AND DEVELOPMENT COSTS

Research and development costs are included with selling, general and administrative expenses and are expensed when incurred. We expensed research and development costs of $3.3 million during 2006, $2.4 million during 2005 and $2.5 million during 2004.

INCOME TAXES

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

STOCK COMPENSATION

Prior to January 1, 2006, we accounted for stock options using the intrinsic value method under Accounting Principles Board Opinion (APB) No. 25, Accounting for Stock Issued to Employees and related interpretations, as permitted by SFAS No. 123,

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Accounting for Stock-Based Compensation , under which no compensation expense was recognized for stock option grants.

Accordingly, share-based compensation related to our stock options for periods prior to 2006 are included as a pro forma disclosure in the financial statement footnotes.

Effective January 1, 2006, we adopted the fair value recognition provisions of SFAS No. 123R, Share-Based Payment using the modified-prospective method. Under this transition method, compensation cost recognized in 2006, includes the applicable amounts of: (a) compensation cost of all share-based payments granted prior to, but not yet vested as of, January 1, 2006 (based on the grant-date fair value estimated in accordance with the original provisions of SFAS No. 123, and previously presented in the pro forma footnote disclosures), and (b) compensation cost for all share-based payments granted subsequent to January 1, 2006 (based on the grant-date fair value estimated in accordance with the new provisions of SFAS No. 123R). Results for prior periods have not been restated.

As a result of adopting SFAS No. 123R on January 1, 2006, our earnings before income taxes and net earnings for 2006 were $2.0 million and $1.6 million lower, respectively, than if we had continued to account for share-based compensation under APB No. 25. Basic and diluted earnings per share for 2006 would have been $0.04 higher, had we continued to account for share-based compensation under APB No. 25.

Prior to the adoption of SFAS No. 123R, we presented all tax benefits of deductions resulting from the exercise of options as operating cash flows in the Consolidated Statements of Cash Flows. SFAS No. 123R requires the cash flows resulting from tax deductions in excess of the compensation cost recognized for those options (excess tax benefits) to be classified as financing cash flows. The $614,000 excess tax benefit classified as a financing cash inflow for 2006 would have been classified as an operating cash inflow if we had not adopted SFAS No. 123R.

If compensation expense for our stock-based awards to employees had been recognized using the fair value method of SFAS No. 123R rather than the intrinsic value method under APB No. 25, net income and earnings per share would have been reduced to the pro forma amounts below for 2005 and 2004.

	Years ended December 31,	
	2005	2004
Net income as reported	$ 8,193	$ 10,128
Add stock-based employee compensation cost included in net income, net of related tax benefit		
Deduct total stock-based employee compensation expense determined under fair-value-based method for all awards, net of related tax benefit	(831)	(1,086)
Pro forma net income	$ 7,362	$ 9,042
Basic earnings per share:		
As reported	$ 0.21	$ 0.25
Pro forma	$ 0.19	$ 0.22
Diluted earnings per share:		
As reported	$ 0.19	$ 0.23
Pro forma	$ 0.17	$ 0.20

See Note 9 for further information on our share-based compensation plans.

SEGMENT AND RELATED INFORMATION

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

GOODWILL AND OTHER INTANGIBLE ASSETS

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

Under SFAS No. 142, Goodwill and Other Intangible Assets, we evaluate goodwill for impairment annually as of April 1st, or more frequently if impairment indicators arise. An impairment loss is recognized to the extent that the carrying amount exceeds the asset s

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fair value. In the implementation of SFAS No. 142, we identified two reporting units for impairment testing. The appraisal services and appraisal software stand-alone business unit qualified as a reporting unit since it is one level below an operating segment, discrete financial information exists for the business unit and the executive management group directly reviews this business unit. The other software business units were aggregated into the other single reporting unit. The appraisal services and appraisal software stand-alone business unit is organized in such a manner that both of its revenue sources are tightly integrated with each other and discrete financial information at the operating profit level does not exist for this business unit s respective revenue sources.

IMPAIRMENT OF LONG-LIVED ASSETS

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

COSTS OF COMPUTER SOFTWARE

Software development costs have been accounted for in accordance with SFAS No. 86, Accounting for the Costs of Computer Software to be Sold, Leased, or Otherwise Marketed. Under SFAS No. 86, capitalization of software development costs begins upon the establishment of technological feasibility and prior to the availability of the product for general release to customers. We capitalized software development costs of approximately $236,000 during 2006, $1.0 million during 2005, and $4.6 million during 2004. Software development costs primarily consist of personnel costs and rent for related office space. We begin to amortize capitalized costs when a product is available for general release to customers. Amortization expense is determined on a product-by-product basis at a rate not less than straight-line basis over the product s remaining estimated economic life, but not to exceed five years. Amortization of software development costs was approximately $5.1 million in 2006, $5.9 million in 2005, and $6.1 million in 2004 and is included in cost of software license revenue in the accompanying consolidated statements of operations.

FAIR VALUE OF FINANCIAL INSTRUMENTS

Cash and cash equivalents, accounts receivables, accounts payables, deferred revenues and certain other assets at cost approximate fair value because of the short maturity of these instruments. Our available-for-sale investments are recorded at fair value based on quoted market prices.

CONCENTRATIONS OF CREDIT RISK AND UNBILLED RECEIVABLES

Concentrations of credit risk with respect to receivables are limited due to the size and geographical diversity of our customer base. Historically, our credit losses have not been significant. As a result, we do not believe we have any significant concentrations of credit risk as of December 31, 2006.

We maintain allowances for doubtful accounts and sales adjustments, which are provided at the time the revenue is recognized. Since most of our customers are domestic governmental entities, we rarely incur a loss resulting from the inability of a customer to make required payments. Events or changes in circumstances that indicate that the carrying amount for the allowances for doubtful accounts and sales adjustments may require revision, include, but are not limited to, deterioration of a customer s financial condition, failure to manage our customer s expectations regarding the scope of the services to be delivered, and defects or errors in new versions or enhancements of our software products. The termination clauses in most of our contracts provide for the payment for the fair value of products delivered or services performed in the event of early termination. Our property appraisal outsourcing service contracts can range up to three years and, in one case, as long as six years in duration. In connection with these contracts, as well as certain software service contracts, we may perform work prior to when the software and services are billable and/or payable pursuant to the contract. We have historically recorded such unbilled receivables (costs and estimated profit in excess of billings) in connection with (1) property appraisal services contracts accounted for using proportionate

performance accounting in which the revenue is earned based upon activities performed in one accounting period but the billing normally occurs shortly thereafter and may span another accounting period; (2) software services

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contracts accounted for using the percentage-of-completion method of revenue recognition using labor hours as a measure of progress towards completion in which the services are performed in one accounting period but the billing for the software element of the arrangement may be based upon the specific phase of the implementation; (3) software revenue for which we have objective evidence that the customer-specified objective criteria has been met but the billing has not yet been submitted to the customer; and (4) in a limited number of cases, we may grant extended payment terms generally to existing customers with whom we have a long-term relationship and favorable collection history. In addition, certain of our property appraisal outsourcing contracts are required by law to have an amount withheld from a progress billing (generally a 10% retention) until final and satisfactory project completion is achieved, typically upon the completion of fieldwork or formal hearings.

In connection with this activity, we have recorded unbilled receivables of $10.1 million and $8.6 million at December 31, 2006 and 2005, respectively, with billing primarily dependent on fixed payment schedules based on specific calendar dates. We also have recorded retention receivable of $3.8 million and $1.7 million at December 31, 2006 and 2005, respectively, and these retentions become payable upon the completion of the contract or completion of our field work and formal hearings. Unbilled receivables and retention receivables expected to be collected in excess of one year have been classified as non-current receivables in the accompanying consolidated balance sheets.

INDEMNIFICATION

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

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

NEW ACCOUNTING PRONOUNCEMENTS

In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 (FIN 48), which clarifies the accounting and disclosure for uncertainty in tax positions, as defined. FIN 48 seeks to reduce the diversity in practice associated with certain aspects of the recognition and measurement related to accounting for income taxes. This interpretation is effective for fiscal years beginning after December 15, 2006. We do not expect the interpretation will have a material impact on our results from operations or financial position.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements . SFAS No. 157 defines fair value, establishes a framework for measuring fair value in accordance with accounting principles generally accepted in the United States, and expands disclosures about fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007, with earlier application encouraged. Any amounts recognized upon adoption as a cumulative effect adjustment will be recorded to the opening balance of retained earnings in the year of adoption. We have not yet determined the impact of SFAS No. 157 on our financial condition and results of operations.

(2) ACQUISITIONS

In January 2006, we completed the acquisitions of all of the capital stock of MazikUSA, Inc. (Mazik) and TACS, Inc. (TACS). The total value of these transactions, including transaction costs, was approximately $14.6 million, which was comprised of $11.7 million in cash and 325,000 shares of Tyler common stock valued at $2.9 million.

Mazik provides an integrated software solution for schools that combines the functionalities of student performance monitoring, student tracking, financial accounting, human resources and reporting.

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TACS provides pension and retirement software solutions that assist public and private pension institutions in increasing operational efficiency and accuracy.

We believe the products offered by Mazik and TACS will complement our business model and give us additional opportunities to provide our customers with solutions tailored specifically for local governments.

We acquired assets of approximately $300,000 and assumed liabilities of approximately $1.7 million. We recorded goodwill of $12.4 million, all of which is expected to be deductible for tax purposes, and other intangible assets of $3.3 million. The $3.3 million of intangible assets is attributable to acquired software and customer relationships that will be amortized over a weighted average period of approximately five years, and purchased in-process research and development of $140,000 which we expensed during the first quarter of 2006. Our consolidated balance sheet as of December 31, 2006 reflects the allocation of the purchase price to the assets acquired and liabilities assumed based on their fair values at the date of acquisition. The operating results of the acquired businesses are included in our results of operations since their respective dates of acquisition in late January 2006.

In September 2006, we also purchased certain maintenance and support agreements associated with one of our financial software products for approximately $580,000. These costs have been capitalized and will be amortized over 13 years.

(3) RESTRUCTURING CHARGE

Because of unsatisfactory financial performance early in 2005, we made significant organizational changes in the second quarter of 2005 to those areas of our business that were not performing to our expectations. Our goal was to bring costs in line with expected levels of revenue while improving the efficiency of our organizational structure to ensure that clients continue to receive superior service.

We reorganized the appraisal services business to eliminate levels of management and reduce overhead expense. We also took actions to reduce headcount and costs in our appraisal and tax software division, and we consolidated certain senior management positions at the corporate office. These cost reductions were made in the second quarter of 2005. As a result, we eliminated approximately 120 positions, including management, staff and project-related personnel. In connection with the reorganization, we incurred certain charges which were primarily comprised of employee severance costs and related fringe benefits, and totaled approximately $1.3 million before income taxes. The related payments were paid in 2005.

(4) PROPERTY AND EQUIPMENT, NET

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

	Useful Lives (years)	2006	2005
Land		$ 115	$ 115
Transportation equipment	5	359	389
Computer equipment and purchased software	3-7	15,240	11,722
Furniture and fixtures	5	4,452	4,347
Building and leasehold improvements	5-25	2,426	2,376
		22,592	18,949
Accumulated depreciation and amortization		(15,202)	(13,190)
Property and equipment, net		$ 7,390	$ 5,759

Depreciation expense was $2.4 million during 2006, $2.5 million during 2005, and $2.5 million during 2004.

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(5) GOODWILL AND OTHER INTANGIBLE ASSETS

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

	2006	2005
Gross carrying amount of acquisition intangibles:		
Goodwill	$ 66,127	$ 53,709
Customer related intangibles	25,291	24,278
Software acquired	19,113	16,023
Trade name	1,681	1,643
	112,212	95,653
Accumulated amortization	(23,449)	(20,771)
Acquisition intangibles, net	$ 88,763	$ 74,882
Post acquisition software development costs	$ 36,715	$ 36,478
Accumulated amortization	(26,107)	(21,048)
Post acquisition software costs, net	$ 10,608	$ 15,430

Total amortization expense for acquisition related intangibles and post acquisition software development costs was $7.7 million during 2006, $8.0 million during 2005, and $8.8 million during 2004.

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

	December 31, 2006			December 31, 2005		
	Gross Carrying Amount	Weighted Average Amortization Period	Accumulated Amortization	Gross Carrying Amount	Weighted Average Amortization Period	Accumulated Amortization
Non-amortizable intangibles:						
Goodwill	$ 66,127		$	$ 53,709		$
Amortizable intangibles:						
Customer related intangibles	25,291	21 years	7,789	24,278	22 years	6,582
Software acquired	19,113	5 years	15,167	16,023	5 years	13,808
Trade name	1,681	21 years	493	1,643	21 years	381

The changes in the carrying amount of goodwill for the two years ended December 31, 2006 are as follows:

Balance as of December 31, 2004 and December 31, 2005	$ 53,709
Goodwill acquired during the year related to the purchase of MazikUSA, Inc	10,198
Goodwill acquired during the year related to the purchase of TACS, Inc	2,220
Balance as of December 31, 2006	$ 66,127

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Estimated annual amortization expense relating to acquisition intangibles, including acquired software for which the amortization expense is recorded as cost of revenues, is as follows:

Years ending December 31,	
2007	$ 2,708
2008	2,621
2009	1,855
2010	1,855
2011	1,273

(6) ACCRUED LIABILITIES

Accrued liabilities consist of the following at December 31:

	2006	2005
Accrued wages, bonuses and commissions	$ 10,392	$ 9,381
Other accrued liabilities	4,416	3,907
Accrued health claims	1,302	1,379
Accrued third party contract costs	1,625	1,360
	$ 17,735	$ 16,027

(7) INCOME TAX

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

	Years ended December 31,		
	2006	2005	2004
Current:			
Federal	$ 9,701	$ 6,340	$ 5,978
State	1,312	1,292	1,631
	11,013	7,632	7,609
Deferred	(2,520)	(2,200)	(300)
	$ 8,493	$ 5,432	$ 7,309

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

	Years ended December 31,		
	2006	2005	2004
Income tax expense at statutory rate	$ 7,999	$ 4,769	$ 6,103
State income tax, net of federal income tax benefit	430	778	1,060
Non-deductible business expenses	518	182	195
Qualified manufacturing activities	(263)	(149)	
Other, net	(191)	(148)	(49)
	$ 8,493	$ 5,432	$ 7,309

Slightly more than half of our stock option awards granted qualify as incentive stock options (ISO) for income tax purposes. As such, a tax benefit is not recorded at the time the compensation cost related to the options is recorded for book purposes due to the fact that an ISO does not ordinarily result in a tax benefit unless there is a disqualifying

disposition. Stock option grants of non-qualified options result in the creation of a deferred tax asset, which is a temporary difference, until the time that the option is exercised. Due to the treatment of incentive stock options for tax purposes, our effective tax rate from year to year is subject to variability.

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

	2006	2005
Deferred income tax assets:		
Operating expenses not currently deductible	$ 1,801	$ 1,530
Employee benefit plans	1,224	819
Property and equipment	49	
Total deferred income tax assets	3,074	2,349
Deferred income tax liabilities:		
Property and equipment		(94)
Intangible assets	(9,535)	(11,202)
Other	(176)	(215)
Total deferred income tax liabilities	(9,711)	(11,511)
Net deferred income tax liabilities	$ (6,637)	$ (9,162)

Although realization is not assured, we believe it is more likely than not that all the deferred tax assets at December 31, 2006 and 2005 will be realized. Accordingly, we believe no valuation allowance is required for the deferred tax assets. However, the amount of the deferred tax asset considered realizable could be adjusted in the future if estimates of reversing taxable temporary differences are revised.

We paid income taxes, net of refunds received, of $10.4 million in 2006, $8.1 million in 2005, and $6.5 million in 2004.

(8) SHAREHOLDERS EQUITY

The following table details activity in our common stock:

	Years ended December 31,					
	2006		2005		2004	
	Shares	Amount	Shares	Amount	Shares	Amount
Purchases of common stock	(1,033)	$ (10,531)	(2,457)	$ (17,683)	(1,459)	$ (12,518)
Stock option exercises	623	2,916	436	1,800	680	1,940
Employee stock plan purchases	102	940	171	1,156	44	329
Shares issued for acquisitions	325	2,891				

Subsequent to December 31, 2006 and through February 23, 2007, we repurchased 188,000 shares for an aggregate purchase price of $2.6 million. As of February 23, 2007 we had authorization from our board of directors to repurchase up to 843,000 additional shares of our common stock.

As of December 31, 2006, we had warrants outstanding to purchase 1.6 million shares of common stock at $2.50 per share. These warrants expire in September 2007.

(9) SHARE-BASED COMPENSATION

Share-based compensation plan

We have a stock option plan that provides for the grant of stock options to key employees, directors and non-employee consultants. Options become fully exercisable after three to five years of continuous employment and expire ten years after the grant date. Once options become exercisable, the employee can purchase shares of our common stock at the market price on the date we granted the option. Effective January 1, 2006, we adopted the provisions of SFAS No. 123R, Share-Based Payment, which establishes accounting for share-based awards exchanged for employee services, using the modified prospective application transition method. Under this transition method,

compensation cost recognized in 2006, includes the applicable amounts of: (a) compensation cost of all share-based payments granted prior to, but not yet vested as of, January 1, 2006 (based on the grant-date fair value estimated in

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accordance with the original provisions of SFAS No. 123, Accounting for Stock-Based Compensation, and previously presented in the pro forma footnote disclosures), and (b) compensation cost for all share-based payments granted subsequent to January 1, 2006 (based on the grant-date fair value estimated in accordance with the new provisions of SFAS No. 123R). Results for prior periods have not been restated. For prior periods we applied APB No. 25, Accounting for Stock Issued to Employees, and related Interpretations, and provided the required pro forma disclosures under SFAS No. 123.

As of December 31, 2006, there were 974,000 shares available for future grants under the plan from the 8.5 million shares previously approved by the stockholders.

Determining Fair Value Under SFAS No. 123R

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

Expected Life. The expected life of awards granted represents the period of time that they are expected to be outstanding. We determine the expected life using the simplified method in accordance with Staff Accounting Bulletin No. 107.

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

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

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

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

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option valuation model. The following weighted average assumptions were used for options granted:

	Years ended December 31,		
	2006	2005	2004
Expected life (in years)	6	5	5
Expected volatility	45.0%	48.4%	79.1%
Risk-free interest rate	4.9%	4.1%	3.7%
Expected forfeiture rate	3%	0%	0%

Share-Based Compensation Under SFAS No. 123R

The following table summarizes share-based compensation expense related to share-based awards under SFAS No. 123R which is recorded in the statement of operations for year ending December 31, 2006:

Cost of software services and maintenance	$ 147
Selling, general and administrative expense	1,813
Total share-based compensation expense	1,960
Tax benefit	(336)
Net decrease in net income	$ 1,624

Share-based compensation expense recorded in the statement of operations for 2005 and 2004 was zero.

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At December 31, 2006 we had unvested options to purchase 1.4 million shares with a weighted average grant date fair value of $4.08. As of December 31, 2006, we had $4.6 million of total unrecognized compensation cost related to unvested options, net of expected forfeitures, which is expected to be amortized over a weighted average amortization period of 2.2 years.

Stock Option Activity

Options granted, exercised, forfeited and expired are summarized as follows:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value
Options outstanding at December 31, 2003	4,630	$ 3.94		
Granted	62	9.18		
Exercised	(680)	2.85		
Forfeited	(48)	3.18		
Options outstanding at December 31, 2004	3,964	4.21		
Granted	1,135	7.49		
Exercised	(436)	4.12		
Forfeited	(55)	7.49		
Options outstanding at December 31, 2005	4,608	4.99		
Granted	237	10.76		
Exercised	(623)	4.68		
Forfeited	(127)	6.42		
Expired	(8)	5.21		
Options outstanding at December 31, 2006	4,087	5.32	6	$ 35,703
Options exercisable at December 31, 2006	2,727	$ 4.25	5	$ 26,760

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

	2006	2005	2004
Weighted average grant-date fair value of stock options granted	$ 6.13	$ 3.47	$ 6.03
Total fair value of stock options vested	1,757	1,519	2,719
Total intrinsic value of stock options exercised	4,227	1,753	4,362

Employee Stock Purchase Plan

Under our Employee Stock Purchase Plan (ESPP) participants may contribute up to 15% of their annual compensation to purchase common shares of Tyler. The purchase price of the shares is equal to 85% of the closing price of Tyler shares on the last day of each quarterly offering period. As of December 31, 2006, there were 683,000 shares available

for future grants under the ESPP from the 1.0 million shares originally reserved for issuance.

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(10) EARNINGS PER SHARE

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

	Years Ended December 31,		
	2006	2005	2004
Numerator:			
Net income for basic and diluted earnings per share	$ 14,362	$ 8,193	$ 10,128
Denominator:			
Denominator for basic earnings per share Weighted-average shares	38,817	39,439	41,288
Effect of dilutive securities:			
Employee stock options	1,799	1,561	2,114
Warrants	1,252	1,075	1,164
Potentially dilutive shares	3,051	2,636	3,278
Denominator for diluted earnings per share Adjusted weighted-average shares	41,868	42,075	44,566
Basic earnings per share	$ 0.37	$ 0.21	$ 0.25
Diluted earnings per share	$ 0.34	$ 0.19	$ 0.23

Stock options representing the right to purchase common stock of 13,000 shares in 2006, 229,000 shares in 2005, and 110,000 shares in 2004, had exercise prices greater than the average quoted market price of our common stock. These options were outstanding during 2006, 2005 and 2004, but were not included in the computation of diluted earnings per share because their inclusion would have had an antidilutive effect.

(11) LEASES

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

Rent expense was approximately $4.9 million in 2006, $4.6 million in 2005, and $4.6 million in 2004, which included rent expense associated with related party lease agreements of $1.7 million in 2006, $1.5 million in 2005, and $1.4 million in 2004.

Future minimum lease payments under all noncancelable leases at December 31, 2006 are as follows:

Years ending December 31,	
2007	$ 4,591
2008	4,365
2009	4,124
2010	2,843
2011	2,077
Thereafter	1,465
	$ 19,465

Included in future minimum lease payments are noncancelable payments due to related parties of $1.7 million each in 2007, 2008 and 2009; $552,000 in 2010 and none thereafter.

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(12) EMPLOYEE BENEFIT PLANS

We provide a defined contribution plan for the majority of our employees meeting minimum service requirements. The employees can contribute up to 30% of their current compensation to the plan subject to certain statutory limitations. We contribute up to a maximum of 2.5% of an employee s compensation to the plan. We made contributions to the plan and charged operations $1.6 million during 2006, $1.0 million during 2005, and $801,000 during 2004.

(13) COMMITMENTS AND CONTINGENCIES

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

(14) SUBSEQUENT EVENTS

In the first quarter of 2007 we acquired two small companies and a building for a combined cash purchase price of $5.0 million. We have not finalized the allocation of the excess purchase price over the fair value of the net identifiable assets of the acquired companies but expect this allocation will result in non-cash charges that may have a small dilutive effect on earnings per share in 2007.

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(15) QUARTERLY FINANCIAL INFORMATION (unaudited)

The following tables contain selected financial information from unaudited consolidated statements of operations for each quarter of 2006 and 2005.

	Quarter Ended							
	2006 (B)				2005 (C)			
	Dec. 31	Sept. 30	June 30	Mar. 31	Dec. 31	Sept. 30	June 30	Mar. 31
Revenues	$ 51,155	$ 50,139	$ 49,151	$ 44,858	$ 44,307	$ 42,306	$ 43,185	$ 40,659
Gross profit (A)	20,239	20,157	18,946	15,462	16,700	15,822	16,050	12,915
Income before income taxes	6,732	6,936	5,828	3,359	5,097	4,284	3,444	800
Net income	4,177	4,413	3,760	2,012	3,121	2,581	2,021	470
Earnings per diluted share	0.10	0.11	0.09	0.05	0.07	0.06	0.05	0.01
Shares used in computing diluted earnings per share	42,163	41,898	41,946	41,894	41,869	41,771	41,943	42,735

(A) In the fourth quarter of 2005 we reclassified amortization cost of acquired software from amortization of acquisition intangibles to cost of revenues. The reconciliation of gross profit to the 2005 Form 10-Qs is as follows:

	2005			
	Dec. 31	Sept. 30	June 30	Mar. 31
Gross profit per Form 10-Q	$ 16,700	$ 16,020	$ 16,249	$ 13,113
Reclassify acquired software amortization expense		(198)	(199)	(198)
Adjusted gross profit	$ 16,700	$ 15,822	$ 16,050	$ 12,915

(B) As a result of adopting SFAS No. 123R on January 1, 2006, our earnings before income taxes and net earnings for 2006 were $2.0 million and $1.6 million lower, respectively, than if we had continued to account for share-based compensation under APB No. 25. Basic and diluted earnings per share for 2006 would have been $0.04 higher, had we continued to account for share-based compensation under APB No. 25.

(C) We made significant organizational changes in the second quarter of 2005 to areas of our business that were not performing to our expectations. In connection with the reorganization we recorded a restructuring charge of $1.3 million.

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TYLER TECHNOLOGIES, INC.
SCHEDULE II VALUATION AND QUALIFYING ACCOUNTS
(IN THOUSANDS)

	Years ended December 31,		
Allowance For Losses Accounts Receivable	2006	2005	2004
Balance at beginning of year	$ 1,991	$ 986	$ 1,094
Additions charged to costs and expenses	2,077	1,641	796
Collection of accounts previously written off	11		(271)
Deductions for accounts charged off or credits issued	(1,108)	(636)	(633)
Balance at end of year	$ 2,971	$ 1,991	$ 986