

TYLER TECHNOLOGIES INC

Form 10-K

February 25, 2010

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

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES AND EXCHANGE ACT OF 1934
For the Fiscal Year Ended December 31, 2009

OR

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

**Commission File Number 1-10485
TYLER TECHNOLOGIES, INC.**

(Exact name of registrant as specified in its charter)

DELAWARE
(State or other jurisdiction
of incorporation or
organization)

75-2303920
(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 NO

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES NO
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such

files). Yes No

Indicate by check mark 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 incorporated by reference in Part III of the Form 10-K or any amendment to the Form 10-K. YES NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting company)

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

The aggregate market value of the voting stock held by non-affiliates of the registrant was \$520,593,000 based on the reported last sale price of common stock on June 30, 2009, 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 22, 2010 was 35,085,970.

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 13, 2010.

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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 the public sector, with a focus on 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 solutions 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 our data centers through an applications service provider (ASP) arrangement through our subscription-based services. 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 divested. 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 entered the local government IT market through 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 3,000 counties, 36,000 cities and towns and 13,900 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 billings, 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.

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Gartner estimates that state and local government IT spending will grow from \$54.1 billion in 2010 to \$62.8 billion in 2013, with local government accounting for \$28.1 billion of IT spending in 2010 and \$31.8 billion in 2013. The external services and software segments of the market, where our business is primarily focused, is expected to expand from \$15.3 billion in 2010 to \$18.5 billion in 2013.

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 five primary sources:

sales of software licenses;

subscription-based arrangements;

software services;

maintenance and support; and

appraisal services.

We design, develop and market a broad range of software solutions 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 solutions and services are generally grouped in three major areas:

Financial Management and Education;

Courts and Justice; and

Property Appraisal and Tax and Other.

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 perpetual 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 financial management and education and property appraisal and tax, we offer multiple solutions designed to meet the needs of different sized governments.

We also offer certain software solutions on a software as a service 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 our data centers. Customers typically pay monthly fees under multi-year contracts for these subscription-based 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 suites of products and services follows:

Software Licenses

Financial Management and Education

Our financial management and education solutions are Enterprise Resource Planning systems for local governments, which integrate information across all facets of a client organization. Our financial management solutions 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 management 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 management systems are intended to conform to government auditing and financial reporting requirements and generally accepted accounting principles.

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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.

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 addition to providing financial management systems to K-12 schools, in 2006 we began offering a student information system for K-12 schools, which manages such applications as scheduling, grades and attendance. We also offer student transportation solutions to manage school bus routing optimization, fleet management, field trips and other related functions. We also added software applications to manage public sector pension funds.

Tyler's financial management and education solutions 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, fully integrated suite of judicial solutions designed to handle complex, multi-jurisdictional county or statewide implementations as well as single county systems. Our solutions help eliminate duplicate data entry, promote more effective business procedures and improve efficiency across the entire justice process.

Our unified court case management system is designed to automate the tracking and management of information involved in all case types, including criminal, traffic, civil, family, probate and juvenile courts. It also tracks the status of cases, processes fines and fees and generates the specialized judgment and sentencing documents, notices and forms required in the court process. Documents received by the court can be scanned into the electronic case file and easily retrieved for viewing. Documents generated by the court can be electronically signed and automatically attached to the electronic case file. Additional modules automate the management of court calendars, coordinate judge's schedules and generate court dockets. Our targeted courtroom technologies allow courts to rapidly review calendars, cases and view documents in the courtroom. Courts may also take advantage of our related jury management system.

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, including digital mug shots. Our 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 assists dispatchers with processing emergency situations. The law enforcement and jail management systems are fully integrated with prosecution and other court products that manage the entire judicial process.

Our court and law enforcement systems allow the public to access, via the Internet, a variety of information, including non-confidential 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.

Our prosecutor system enables state attorney offices to track and manage criminal cases, including detailed victim information and private case notes. Investigative reports and charging instrument documents can be generated and stored for later viewing. Prosecutors can schedule and record the outcome of grand jury hearings. When integrated with the court system, prosecutors can view the electronic case file and related documents, as well as manage witness lists and subpoenas needed for court hearings.

Our supervision system allows pre-trial and probation offices to manage offender caseloads. Supervision officers can track busy contact schedules, risk/needs assessments and reassessments, detailed drug test results, employment histories, compliance with conditions and payments of fees and restitution. Documents and forms, like pre-sentence investigations or revocation orders, can be generated and stored for easy viewing. When integrated with the jail and

court systems, supervision officers can have easy access and quick notification of offenders that have court hearings scheduled, are arrested locally and have new warrants issued.

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We also offer a court case management solution that automates and tracks all aspects of municipal courts and offices. It is a fully integrated, graphical application that provides effective case management, document processing and cash/bond management. This system complies with all state reporting and conviction reports and includes electronic reporting and also integrates with certain of our financial management solutions and public safety solutions. Our public safety solution for municipalities includes more than thirty essential law enforcement, criminal investigation, and administration record management modules. The public safety solution manages information such as arrests and field interviews, traffic reports and citations, and incident and offense reports. It also supports multimedia files, photo lineups, multi-agency security and incident workflow and streamlines mandatory reporting to local, state and federal offices.

Property Appraisal and Tax and Other

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.

We also offer a number of specialized software applications designed to help county governments enhance and automate courthouse operations. These systems record, scan 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). These applications include fully integrated imaging systems with batch and scan processing capabilities and fully integrated receipting and cashiering systems as well as Web-enabled public access.

Subscription-Based Services

Subscription-based services revenue primarily consists of revenues derived from application service provider (ASP) arrangements and other hosted service offerings, software subscriptions and disaster recovery services. Our ASP arrangements and other hosted service offerings, provide certain software solutions on a software as a service 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.

ASP arrangements and other hosting services are typically for a period of three to six years and automatically renew unless either party cancels the agreement. Other software subscriptions and disaster recovery service arrangements are typically under annual contracts. The majority of the ASP and other hosting services and software subscriptions also include professional services and maintenance and support services. In certain ASP arrangements, the customer also acquires a license to the software.

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 solutions. 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 connections 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

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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 products 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 which are classified as subscription-based revenues.

Appraisal Services

We are the nations 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 authorities 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 appraisal services business unit 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, and filing court documents 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 many of our software products under an ASP or other software as a subscription-based service model which 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.

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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 solutions have achieved nationwide geographic penetration. We intend to continue to expand into new geographic markets by adding sales staff and targeting marketing efforts by solutions in those areas. We also intend to continue to expand our customer base to include more large 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 solutions, 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 solutions 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 revenues. We have a large recurring revenue base from maintenance and support and subscription-based services, which had revenues of \$141.7 million in 2009. We have historically experienced very low customer turnover (approximately 2% annually) and recurring revenues continue to grow as the installed customer base increases.

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 solutions 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, from time to time we selectively pursue strategic acquisitions that provide us with one or more of the following:

- o products and services to complement our existing offerings;
- o entry into new markets related to local governments; and
- o 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 are enhancing 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. In the fourth quarter of 2009 we expanded our co-development effort with Microsoft to include payroll, human resource and budget functionality. 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 released in 2011. 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 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 sales 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

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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.

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 2009, approximately 43% 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 solutions 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, Affiliated Computer Services, Inc., SunGard Data Systems, Inc., New World Systems, Constellation Software, Inc. 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

Substantially all of the 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, 2009, our estimated revenue backlog was approximately \$233.1 million, compared to \$249.8 million at December 31, 2008. 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 \$169.9 million of the backlog is expected to be recognized during 2010.

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, 2009, we had 2,018 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

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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.

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. In addition, copies of our annual report will be made available, free of charge upon written request.

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 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.

Declining general economic conditions and uncertainties in the global credit crisis and equity markets may adversely affect our operating results and financial condition.

The financial market crisis has continued to disrupt credit and equity markets worldwide. Local and state governments may face financial pressures that could in turn affect our growth rate in 2010. We cannot assure you local and state spending levels will be unaffected by the global credit crisis and if budget shortfalls occur they may negatively impact local and state information technology spending and could have a material adverse effect upon our business, operating results, and financial condition.

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.

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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.

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.

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 focus is 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

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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 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;

features and functionality of our software;

price;

quality of products and service;

technological innovation;

name recognition;

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

our financial strength and stability.

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 consulting 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 pricing pressure, 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.

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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.

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.

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 may be 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 to some extent 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.

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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.

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.

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.

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.

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.

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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, our bank credit agreement contains restrictions on the payment of cash dividends. We intend to retain earnings for use in the operation and expansion of our business. 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 514,330 square feet of office space, 201,507 square feet of which we own. One of the office buildings we own (approximately 84,000 square feet) has been leased to third-party tenants. The lease agreements with respect to approximately 70% of this leased space expire in July 2011 and the remaining agreement expires in June 2013. Upon expiration of these agreements we expect to begin occupying the facility. We lease our principal executive office located in Dallas, Texas, as well as other offices for our operations in Colorado, Iowa, Maine, Ohio, Texas and Washington.

ITEM 3. LEGAL PROCEEDINGS.

On November 3, 2008, a putative collective action complaint was filed against us in the United States District Court for the Eastern District of Texas (the Court) on behalf of current and former telephone and remote customer support personnel (Category 1), computer hardware and software set up and maintenance personnel (Category 2), implementation personnel (Category 3), sales support personnel (Category 4), and quality assurance analysts (Category 5). The petition alleges that we misclassified these groups of employees as exempt rather than non-exempt under the Fair Labor Standards Act and that we therefore failed to properly pay overtime wages. The suit was initiated by six former employees working out of our Longview, Texas, office and seeks to recover damages in the form of lost overtime pay, liquidated damages equal to the amount of lost overtime pay, interest, costs, and attorneys' fees.

On June 23, 2009, the Court issued an Order granting Plaintiffs' motion for conditional certification for the purpose of providing notice to potential plaintiffs about the litigation. Accordingly, the plaintiffs sent the court ordered notice to all current and former employees who worked in the foregoing job classifications at any time from June 23, 2006 until June 23, 2009. On October 26, 2009, the opt in period for plaintiffs and potential plaintiffs closed. There are a total of 78 plaintiffs in the litigation consisting of the following: 31 in Category 1; 4 in Category 2; 39 in Category 3; 2 in Category 4; and 2 in Category 5.

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.

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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, 2009, we had approximately 2,115 stockholders of record. A number of our stockholders hold their shares in street name; therefore, there are substantially more than 2,115 beneficial owners of our common stock.

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

	High	Low
2008:		
First Quarter	\$ 14.70	\$ 12.29
Second Quarter	15.97	13.33
Third Quarter	18.47	13.29
Fourth Quarter	15.17	9.79
2009:		
First Quarter	\$ 14.79	\$ 11.35
Second Quarter	17.76	14.17
Third Quarter	17.62	14.51
Fourth Quarter	21.09	16.76

2010:

First Quarter (through February 22, 2010)	\$ 21.52	\$ 18.32
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We did not pay any cash dividends in 2009 or 2008. Our bank credit agreement contains restrictions on the payment of cash dividends. We intend to retain earnings for use in the operation and expansion of our business, and, therefore, we do not anticipate declaring a cash dividend in the foreseeable future.

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, 2009.

Plan Category	Number of securities to be issued upon exercise of	Weighted average exercise price of	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in initial column as of December 31, 2009)
Equity compensation plans approved by security shareholders:			
Stock options	5,703,430	\$ 11.12	176,378
ESPP	25,072	16.92	341,306
Equity compensation plans not approved by security shareholders			

5,728,502

\$ 11.15

517,684

17

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During 2009, we purchased approximately \$1.2 million shares of our common stock for an aggregate purchase price of \$17.0 million. A summary of the repurchase activity during 2009 is as follows:

Period	Total number of shares repurchased	Additional number of shares authorized that may be repurchased	Average price paid per share	Maximum number of shares that may be repurchased under current authorization
Three months ended March 31	707,000		\$12.49	791,000
Additional authorization by the board of directors		2,000,000		2,791,000
Three months ended June 30	8,000		15.28	2,783,000
Three months ended September 30	520,000		15.49	2,263,000
October 1 through October 31				2,263,000
November 1 through November 30				2,263,000
December 1 through December 31				2,263,000
Total year ended December 31, 2009	1,235,000	2,000,000	\$13.77	

The repurchase program, which was approved by our board of directors, was announced in October 2002, and was amended in April and July 2003, October 2004, October 2005, May 2007, May 2008, October 2008 and May 2009. Our board of directors authorized the repurchase of an additional 2.0 million shares on May 14, 2009. As of December 31, 2009, we had remaining authorization to repurchase up to 2.3 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. Our bank credit agreement contains restrictions on the amount of common stock we may purchase.

Table of Contents**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, 2004. 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	12/31/04	12/31/05	12/31/06	12/31/07	12/31/08	12/31/09
Tyler Technologies, Inc.	100	105.02	168.18	154.19	143.30	238.16
S&P 500 Index	100	104.91	121.48	128.16	80.74	102.11
S&P 600 Information Technology Index	100	99.76	109.17	119.32	71.15	105.41

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ITEM 6. SELECTED FINANCIAL DATA.

(In thousands, except per share data)

	FOR THE YEARS ENDED DECEMBER 31,				
	2009	2008	2007	2006	2005
STATEMENT OF OPERATIONS DATA:					
Revenues	\$ 290,286	\$ 265,101	\$ 219,796	\$ 195,303	\$ 170,457
Costs and expenses:					
Cost of revenues ⁽¹⁾	161,523	155,314	135,371	120,499	108,970
Selling, general and administrative expenses ⁽¹⁾	70,115	62,923	51,724	48,389	43,821
Research and development expense	11,159	7,286	4,443	3,322	2,421
Restructuring charge					1,260
Amortization of customer and trade name intangibles	2,705	2,438	1,478	1,318	1,266
Non-cash legal settlement related to warrants ⁽²⁾		9,045			
Operating income	44,784	28,095	26,780	21,775	12,719
Other (expense) income, net	(146)	1,181	1,800	1,080	906
Income from operations before income taxes	44,638	29,276	28,580	22,855	13,625
Income tax provision	17,628	14,414	11,079	8,493	5,432
Net income	\$ 27,010	\$ 14,862	\$ 17,501	\$ 14,362	\$ 8,193
Net income per diluted share	\$ 0.74	\$ 0.38	\$ 0.42	\$ 0.34	\$ 0.19
Weighted average diluted shares	36,624	39,184	41,352	41,868	42,075
STATEMENT OF CASH FLOWS DATA:					
Cash flows provided by operating activities	\$ 42,941	\$ 47,802	\$ 34,111	\$ 26,804	\$ 21,187
Cash flows (used by) provided by investing activities	(13,658)	(9,554)	(34,275)	(24,326)	1,820
Cash flows used by financing activities	(21,349)	(46,128)	(7,406)	(5,999)	(14,847)
BALANCE SHEET DATA:					
Total assets	\$ 270,670	\$ 251,761	\$ 241,508	\$ 220,276	\$ 194,437
Shareholders' equity	134,358	114,262	137,211	125,875	112,197

⁽¹⁾ Effective January 1, 2006, we adopted the fair value recognition

provisions of Accounting Standards Codification 718, Stock Compensation, using the modified-prospective method. In 2009, 2008, 2007 and 2006, respectively, cost of revenues included \$540,000, \$364,000, \$227,000 and \$147,000 share-based compensation expense. Selling, general and administrative expenses in 2009, 2008, 2007 and 2006, respectively, included \$4.5 million, \$3.5 million, \$2.1 million and \$1.8 million share-based compensation expense. In accordance with the standard, results of operations for the year 2005 are reported under the previous accounting standard and no expense was recorded.

- (2) On June 27, 2008, we settled outstanding litigation related to two Stock Purchase Warrants (the Warrants) owned by Bank of America, N. A. (BANA). The Warrants entitled BANA to acquire 1.6 million shares of Tyler common stock at an exercise price of \$2.50 per share.

Following court-ordered mediation, in July 2008, BANA paid us \$2.0 million and we issued to BANA 801,883 restricted shares of Tyler common stock. Accordingly, we recorded a non-cash legal settlement related to warrants charge of \$9.0 million, which was not tax deductible.

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

FORWARD-LOOKING STATEMENTS

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

OVERVIEW

General

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

Our products generally automate three major functional areas:

Financial Management and Education;

Courts and Justice; and

Property Appraisal and Tax and Other.

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

Revenues We derive our revenues from five primary sources: sale of software licenses; subscription-based services; software services; maintenance and support; and appraisal services. 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 are a recurring revenue source. We also monitor our customer base and churn since our maintenance and support revenue should increase

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due to our historically low customer turnover. During 2009, approximately 43% of our revenue was attributable to ongoing support and maintenance agreements and our customer turnover was approximately 2%.

Cost of Revenues and Gross Margins Our primary cost component is personnel expenses in connection with providing software implementation, subscription-based services, maintenance and support, and appraisal services to our customers. We can improve gross margins by controlling headcount and related costs and by expanding our revenue base, especially from those products and services that produce incremental revenue with minimal incremental cost, such as software licenses, subscription-based services, and maintenance and support. Our appraisal projects are seasonal in nature, and we often employ appraisal personnel on a short-term basis to coincide with the life of a project. As of December 31, 2009, our total employee count increased to 2,018 from 1,940 at December 31, 2008. Approximately a third of these additions were to our implementation and support staff, including additions that increased our capacity to deliver our backlog.

Selling, General and Administrative (SG&A) Expenses The primary components of SG&A expense are administrative and sales personnel salaries and commissions, marketing expense, share-based compensation expense, rent and professional fees. Sales commissions generally fluctuate with revenues but other administrative expenses tend to grow at a slower rate than revenues.

Liquidity and Cash Flows The primary driver of our cash flows is net income. Uses of cash include acquisitions, capital investments in property and equipment and the discretionary purchases of treasury stock. In 2009, we purchased 1.2 million shares of our common stock for an aggregate purchase price of \$17.0 million. We also paid \$1.3 million for common stock repurchases accrued as of December 31, 2008. During 2009 we used cash of \$2.9 million to acquire two companies and invested \$12.4 million in property and equipment. Our investment in property and equipment included \$9.4 million for an office building and we expect to pay the final retainage payment of \$1.8 million for this office building by mid-2010. We also paid-down \$8.0 million on our short-term revolving line of credit. Our working capital needs are fairly stable throughout the year with the significant components of cash outflows being payment of personnel expenses offset by cash inflows representing collection of accounts receivable and cash receipts from customers in advance of revenue being earned.

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

Acquisitions

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

On April 3, 2009, we completed the acquisition of all of the capital stock of Assessment Evaluation Services, Inc. (AES). AES develops integrated property appraisal solutions and specializes in applications that deal with the unique provisions of the California Revenue and Taxation Code. The purchase price was approximately \$1.1 million in cash. In connection with these transactions we acquired total tangible assets of approximately \$480,000 and assumed total liabilities of approximately \$835,000, including \$450,000 for contingent consideration for which we have paid \$38,000 as of December 31, 2009. We recorded goodwill of approximately \$1.3 million, all of which is expected to be deductible for tax purposes, and other intangible assets of approximately \$820,000. The \$820,000 of intangible assets is attributable to acquired software and customer relationships that will be amortized over a weighted average period of approximately 9 years. Our balance sheet as of December 31, 2009 reflects the allocation of the purchase price to the assets acquired and liabilities assumed based on their estimated fair values at the dates of acquisition.

The operating results of these acquisitions are included in our results of operations since the date of acquisition. We believe these acquisitions will complement our business by expanding our presence in certain geographic areas and

adding to our customer base.

In the twelve months ended December 31, 2009, we also paid approximately \$1.1 million for certain software assets to complement our tax and appraisal solutions and our student information management solutions.

Outlook

The financial market crisis has continued to disrupt credit and equity markets worldwide. Broad economic conditions remain uncertain and public sector entities continue to experience pressures that are reflected in longer than normal decision processes. Local and state governments may face financial pressures that could in turn affect our growth rate in the first quarter of 2010 and for the calendar year. While market conditions are not robust, we have great stability from the foundation of recurring revenues and high customer retention. Our base of recurring revenues from maintenance and support and subscription-based services is approximately

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49% of total revenues. Consistent with our historical trends, we expect that first quarter 2010 earnings will not reach the level achieved in the fourth quarter of 2009, and will likely be below last years first quarter earnings. We also expect that in excess of 60% of our annual earnings will occur in the second half of 2010.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our discussion and analysis of financial condition and results of operations is based upon our financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States (GAAP). The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets and liabilities at the date of the financial statements, the reported amounts of revenues, cost of revenues and expenses during the reporting period, and related disclosure of contingencies. The Notes to the Financial Statements included as part of this Annual Report describe our significant accounting policies used in the preparation of the financial statements. Significant items subject to such estimates and assumptions include the application of the percentage-of-completion and proportionate performance methods of revenue recognition, the carrying amount and estimated useful lives of intangible assets, determination of share-based compensation expense and valuation allowance for receivables. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

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

Revenue Recognition. We recognize revenues in accordance with the provisions of Accounting Standards Codification (ASC) 605, Revenue Recognition and ASC 985-605, Software Revenue Recognition. Our revenues are derived from sales of software licenses, subscription-based services, appraisal services, maintenance and support, and services that typically range from installation, training and basic consulting to software modification and customization to meet specific customer needs. For multiple element software arrangements, which do not entail the performance of services that are considered essential to the functionality of the software, we generally record revenue when the delivered products or performed services result in a legally enforceable and non-refundable claim. We maintain allowances for doubtful accounts and sales adjustments, which are provided at the time the revenue is recognized. Because most of our customers are governmental entities, we rarely incur a loss resulting from the inability of a customer to make required payments. In a limited number of cases, we encounter a customer who is dissatisfied with some aspect of the software product or our service, and we may offer a concession to such customer. In those limited situations where we grant a concession, we rarely reduce the contract arrangement fee, but alternatively may perform additional services, such as additional training or programming a minor feature the customer had in their prior software solution. These amounts have historically been nominal. In connection with our customer contracts and the adequacy of related allowances and measures of progress towards contract completion, our project managers are charged with the responsibility to continually review the status of each customer on a specific contract basis. Also, we review, on at least a quarterly basis, significant past due accounts receivable and the adequacy of related reserves. Events or changes in circumstances that indicate that the carrying amount for the allowances for doubtful accounts and sales adjustments may require revision, include, but are not limited to, deterioration of a customer s financial condition, failure to manage our customer s expectations regarding the scope of the services to be delivered, and defects or errors in new versions or enhancements of our software products.

We use contract accounting, primarily the percentage-of-completion method, as discussed in ASC 605-35, Construction Type and Certain Production Type Contracts, for those software arrangements that involve significant production, modification or customization of the software, or where our software services are otherwise considered essential to the functionality of the software. We measure progress-to-completion primarily using labor hours incurred, or value added. In addition, we recognize revenue using the proportionate performance method of revenue recognition for our property appraisal projects, some of which can range up to five years. These methods rely on estimates of total expected contract revenue, billings and collections and expected contract costs, as well as measures of progress toward completion. We believe reasonably dependable estimates of revenue and costs and progress applicable to various stages of a contract can be made. At times, we perform additional and/or non-contractual

services for little to no incremental fee to satisfy customer expectations. If changes occur in delivery, productivity or other factors used in developing our estimates of expected costs or revenues, we revise our cost and revenue estimates, and any revisions are charged to income in the period in which the facts that give rise to that revision first become known. In connection with these and certain other contracts, we may perform the work prior to when the services are billable and/or payable pursuant to the contract. The termination clauses in most of our contracts provide for the payment for the fair value of products delivered and services performed in the event of an early termination.

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For subscription-based services such as application service provider arrangements and other hosting arrangements, we evaluate whether each of the elements in these arrangements represents a separate unit of accounting, as defined by ASC 605-25, Multiple Element Arrangements, using all applicable facts and circumstances, including whether (i) we sell or could readily sell the element unaccompanied by the other elements, (ii) the element has stand-alone value to the customer, (iii) there is objective reliable evidence of the fair value of the undelivered item, and (iv) there is a general right of return. We consider the applicability of ASC 605-55-121 and 122 with respect to arrangements that include the right to use software stored on another entity's hardware on a contract-by-contract basis. In hosted term-based agreements, where the customer does not have the contractual right to take possession of the software, hosting fees are recognized on a monthly basis over the term of the contract commencing when the customer has access to the software. For professional services associated with hosting arrangements that we determine do not have stand-alone value to the customer, we recognize the services revenue ratably over the remaining contractual period once hosting has gone live and we may begin billing for the hosting services. We record amounts that have been invoiced in accounts receivable and in deferred revenue or revenues, depending on whether the revenue recognition criteria have been met.

In connection with certain of our contracts, we have recorded retentions receivable or unbilled receivables consisting of costs and estimated profit in excess of billings as of the balance sheet date. Many of the contracts which give rise to unbilled receivables at a given balance sheet date are subject to billings in the subsequent accounting period.

Management reviews unbilled receivables and related contract provisions to ensure we are justified in recognizing revenue prior to billing the customer and that we have objective evidence which allows us to recognize such revenue. In addition, we have a sizable amount of deferred revenue which represents billings in excess of revenue earned. The majority of this liability consists of maintenance billings for which payments are made in advance and the revenue is ratably earned over the maintenance period, generally one year. We also have deferred revenue for those contracts in which we receive a deposit and the conditions in which to record revenue for the service or product has not been met. On a periodic basis, we review by customer the detail components of our deferred revenue to ensure our accounting remains appropriate.

Intangible Assets and Goodwill. Our business acquisitions typically result in the creation of goodwill and other intangible asset balances, and these balances affect the amount and timing of future period amortization expense, as well as expense we could possibly incur as a result of an impairment charge. The cost of acquired companies is allocated to identifiable tangible and intangible assets based on estimated fair value, with the excess allocated to goodwill. Accordingly, we have a significant balance of acquisition date intangible assets, including software, customer related intangibles, trade name and goodwill. In addition, we capitalize software development costs incurred subsequent to the establishment of technological feasibility. These intangible assets 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. We evaluate goodwill for impairment annually as of April, or more frequently if impairment indicators arise. An impairment loss is recognized to the extent that the carrying amount exceeds the asset's fair value. The fair values calculated in our impairment tests are determined using discounted cash flow models involving several assumptions. These assumptions include, but are not limited to, anticipated operating income growth rates, our long-term anticipated operating income growth rate and the discount rate. Our cash flow forecasts are based on assumptions that are consistent with the plans and estimates we are using to manage the underlying businesses. The assumptions that are used are based upon what we believe a hypothetical marketplace participant would use in estimating fair value. We have identified two reporting units for impairment testing. Our reporting units are the same as our reportable segments and consistent with the reporting units tested for impairment in prior years. Assets, liabilities and goodwill have been assigned to reporting units based on assets acquired and liabilities assumed as of the date of acquisition. We evaluate the reasonableness of the fair value calculations of our reporting units by comparing the total of the fair value of all of our reporting units to our total market capitalization. We base our fair value estimates on assumptions we believe to be reasonable but that are unpredictable and inherently uncertain.

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

Our annual goodwill impairment analysis, which we performed during the second quarter of 2009, did not result in an impairment charge. During 2009 we did not identify any triggering events which would require an update to our annual impairment. A

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hypothetical 10% decrease in the fair value of either of our reporting units as of December 31, 2009 would have had no impact on the carrying value of our goodwill.

Share-Based Compensation. We have a stock option plan that provides for the grant of stock options to key employees, directors and non-employee consultants. We estimate the fair value of share-based awards on the date of grant using the Black-Scholes option valuation model. Share-based compensation expense includes the estimated effects of forfeitures, which will be adjusted over the requisite service period to the extent actual forfeitures differ, or are expected to differ from such estimates. Changes in estimated forfeitures are recognized in the period of change and will also impact the amount of expense to be recognized in future periods. Forfeiture rate assumptions are derived from historical data. We estimate stock price volatility at the date of grant based on the historical volatility of our common stock. Estimated option life is determined using the simplified method in accordance with Staff Accounting Bulletin No. 110. 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, 2009, 2008 and 2007.

2009 Compared to 2008Revenues

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

(\$in thousands)	2009	% of Total	2008	% of Total	Change	
					\$	%
Software licenses	\$ 42,131	15%	\$ 41,490	16%	\$ 641	2%
Subscriptions	17,181	6	14,374	5	2,807	20
Software services	80,405	28	74,997	28	5,408	7
Maintenance	124,512	43	107,458	41	17,054	16
Appraisal services	18,740	6	19,098	7	(358)	(2)
Hardware and other	7,317	2	7,684	3	(367)	(5)
Total revenues	\$ 290,286	100%	\$ 265,101	100%	\$ 25,185	10%

Software licenses. Software license revenues consist of the following components for the following years ended December 31:

(\$in thousands)	2009	% of Total	2008	% of Total	Change	
					\$	%
Financial management and education	\$ 25,708	61%	\$ 29,124	70%	\$ (3,416)	(12)%
Courts and justice	13,801	33	10,128	24	3,673	36
Appraisal and tax and other	2,622	6	2,238	6	384	17
Total software license revenues	\$ 42,131	100%	\$ 41,490	100%	\$ 641	2%

In 2009 we signed 74 large new contracts with average software license fees of approximately \$307,000, compared to 72 large new contracts signed in 2008 with average software license fees of approximately \$311,000. We consider contracts with a license fee component of \$100,000 or more to be large. Although a contract is signed in a particular year, the year in which the revenue is recognized may be different because we recognize revenue according to our

revenue recognition policy as described in Note 1 in the Notes to Financial Statements.

Changes in software license revenues consist of the following components:

Software license revenue related to our financial management and education solutions declined \$3.4 million compared to the prior year. We acquired several student information and financial management solutions for K-12 schools from January through August 2008. Excluding the impact of these acquisitions software license revenue would have declined \$4.3 million. The decline was due to several factors. In 2009 our sales cycle to negotiate and close contracts which have reached the

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request for proposal phase lengthened slightly mainly due to budgetary constraints related to declining economic conditions. As a result the purchasing processes for some of our customers have been extended to include more approval and documentation requirements. The software installation period for most of our financial management and education solutions is relatively short and delays in the timing of signing new contracts will impact our results in the short term. In addition, a few contracts have included requirements to construct interfaces to existing systems or other essential functionality which results in recognizing revenue over a longer period of time. While we expect to continue to experience longer than normal sales cycles in 2010 and continued weakness through mid-2010, we currently expect financial management and education solutions software license revenues for 2010 to be slightly higher than 2009.

Software license revenue related to our courts and justice software solutions increased \$3.7 million in 2009 compared to 2008. Both 2009 and 2008 included approximately \$1.7 million of revenue from contracts which had been deferred in accordance with the terms of these contracts. Courts and justice software license revenues were higher in 2009 due to contract arrangements that included more software license revenue than in the comparable prior year periods, slight price increases and improved installation processes as our primary courts and justice solution matures. In addition approximately \$1.0 million of the increase related to achieving certain milestones for several contracts. We do not expect similar large adjustments to courts and justice software solutions revenue in 2010 due to recognition of revenue previously deferred in accordance with contract language. Therefore we currently expect courts and justice software solutions software license revenue in 2010 to increase at a much slower rate compared to 2009.

Subscriptions. Subscription-based services revenue primarily consists of revenues derived from application service provider (ASP) arrangements and other hosted service offerings, software subscriptions and disaster recovery services. ASP and other software subscription agreements are typically for periods of three to six years and automatically renew unless either party cancels the agreement. Disaster recovery and miscellaneous other hosted service agreements are typically renewable annually. New customers for ASP and other hosted service offerings as well as existing customers who converted to our ASP model provided the majority of the subscription revenue increase with the remaining increase due to slightly higher rates for disaster recovery services. In June 2008, as a result of changes in its technology organization, one customer terminated its ASP arrangement with us and elected, as provided in the ASP contract, to purchase the software instead. This contract contributed approximately \$450,000 of subscription revenue in each of the first two quarters of 2008.

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

Software services revenue related to financial management and education solutions, which comprise approximately 60% of our software services revenue in the periods presented, increased 5% compared to 2008. We acquired several student information and financial management solutions for K-12 schools from January through August 2008. Excluding the impact of these acquisitions, software services revenue increased 3%, which was mainly due to additions to our implementation and support staff as well as leverage in the utilization of our implementation and support staff.

Software services revenue related to courts and justice solutions comprise approximately 30% of our software services revenues in the periods presented and increased 21% compared to 2008. These increases reflect our increased capacity to deliver backlog following additions to our implementation and support staff and slightly higher rates on some arrangements. Also, increased contract volume in our municipal courts software solutions, primarily in Texas, generated higher related services revenue.

Maintenance. We provide maintenance and support services for our software products and third party software. Maintenance revenues increased 16% in 2009 compared to 2008. Maintenance and support services grew 14% in 2009, excluding the impact of acquisitions. This increase was due to growth in our installed customer base and slightly higher maintenance rates on most of our product lines.

Appraisal services. Appraisal services revenue declined 2% in 2009 compared to 2008. The appraisal services business is somewhat cyclical and driven in part by statutory revaluation cycles in various states. We substantially completed several large appraisal projects mid-2009. We began several new revaluation contracts late 2009 and as a result currently expect appraisal revenues to increase slightly in 2010.

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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)	2009	% of related revenues	2008	% of related revenues	Change	
					\$	%
Software licenses	\$ 5,440	13%	\$ 9,224	22%	\$ (3,784)	(41)%
Acquired software	1,411	3	1,799	4	(388)	(22)
Software services, maintenance and subscriptions	137,199	62	126,247	64	10,952	9
Appraisal services	11,518	61	12,251	64	(733)	(6)
Hardware and other	5,955	81	5,793	75	162	3
Total cost of revenues	\$ 161,523	56%	\$ 155,314	59%	\$ 6,209	4%

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:

	2009	2008	Change
Gross margin percentages			
Software licenses and acquired software	83.7%	73.4%	10.3%
Software services, maintenance and subscriptions	38.2	35.9	2.3
Appraisal services	38.5	35.9	2.6
Hardware and other	18.6	24.6	(6.0)
Overall gross margin	44.4%	41.4%	3.0%

Software license and acquired software. Amortization expense for capitalized development costs on certain software products comprised approximately 15% of our cost of software license revenues in 2009 compared to approximately 50% of our cost of software license in 2008. The remaining balance is made up of third party software costs. Once a product is released, we begin to amortize, over the estimated useful life of the product, any capitalized 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 acquired software includes amortization expense for software acquired through acquisitions. We completed several acquisitions in the period 2007 through 2009 and these costs are being amortized over a weighted average period of approximately 5 years. In late 2008 software associated with one significant acquisition completed in December 2003 became fully amortized.

In 2009, our software license gross margin percentage rose significantly compared to the prior year periods because several products became fully amortized in late 2008, as did software acquired related to a significant acquisition in December 2003. We did not capitalize any internal software development costs in 2009 or 2008.

Software services, maintenance and subscription-based services. Cost of software services, maintenance and subscriptions primarily consists of personnel costs related to installation of our software, conversion of customer data, training customer personnel and support activities and various other services such as ASP and disaster recovery. In 2009, the software services, maintenance and subscriptions gross margin increased compared to the prior year partly because maintenance and various other services such as ASP and disaster recovery costs typically grow at a slower rate than related revenues due to leverage in the utilization of our support and maintenance staff and economies of scale. We have increased our implementation and support staff for both the financial management and education solutions and courts and justice solutions by 51 employees since 2008 in order to expand our capacity to implement

our contract backlog. This increase was offset somewhat by 24 fewer employees for appraisal and tax solutions. The

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software services, maintenance and subscription-based services gross margin also benefited from slightly higher rates for certain services.

Appraisal services. Our appraisal gross margin increased compared to 2008 as the result of cost savings and operational efficiencies experienced on an unusually complex project. A high proportion of the costs of appraisal services revenue are variable, as we often hire temporary employees to assist in appraisal projects whose term of employment generally ends with the projects' completion.

Our blended gross margin for 2009 was higher than 2008 due to lower amortization expense of software development costs described above. The gross margin also benefited from leverage in the utilization of our support and maintenance staff and economies of scale and slightly higher rates on certain services.

Selling, General and Administrative Expenses

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

(\$in thousands)	2009	% of revenues	2008	% of revenues	Change \$	%
Selling, general and administrative expenses	\$70,115	24%	\$62,923	24%	\$7,192	11%

The increase in SG&A expenses included higher share-based compensation expense, commission costs and marketing expenses. Marketing expenses in 2009 include costs associated with the launch of a new corporate branding initiative. Our SG&A employee count increased 4% from 2008.

Research and Development Expense

Research and development expenses consist primarily of salaries, employee benefits and related overhead costs associated with product development and enhancements and upgrades provided to existing customers under maintenance plans. The following table sets forth a comparison of our research and development expense for the following years ended December 31:

(\$in thousands)	2009	% of revenues	2008	% of revenues	Change \$	%
Research and development expense	\$11,159	4%	\$7,286	3%	\$3,873	53%

Research and development expense consist mainly of costs associated with the Microsoft Dynamics AX project, in addition to costs associated with other new product development efforts. We have increased our research and development staff by 72 employees since 2008. In January 2007, we entered into a Software Development and License Agreement, which provided for a strategic alliance with Microsoft Corporation (Microsoft) to jointly develop core public sector functionality for Microsoft Dynamics AX to address the accounting needs of public sector organizations worldwide. In September 2007, Tyler and Microsoft signed an amendment to the Software Development and License Agreement, which grants Microsoft intellectual property rights in and to certain portions of the software code provided and developed by Tyler into Microsoft Dynamics AX products to be marketed and sold outside of the public sector in exchange for reimbursement payments to partially offset the research and development costs.

In 2009 and 2008, we offset our research and development expense by \$3.5 million and \$1.8 million, respectively, which were the amounts earned under the terms of our agreement with Microsoft. In September 2008, Tyler and Microsoft signed a statement of work under the Amended Software Development and License Agreement for which we currently expect to recognize offsets to our research and development expense by approximately \$850,000 each quarter through the end of 2010. In addition, in October 2009, the scope of the project was further expanded that will result in additional offsets to research and development expense, varying in amount from quarter to quarter, with the first payment to be invoiced on August 31, 2010 and invoiced quarterly through March 31, 2012 for a total of

approximately \$6.2 million. The actual amount and timing of future research and development costs and related reimbursements and whether they are capitalized or expensed may vary.

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On June 27, 2008, we settled outstanding litigation related to the Warrants owned by Bank of America, N. A. (BANA). As disclosed in prior SEC filings, the Warrants entitled BANA to acquire 1.6 million shares of Tyler common stock at an exercise price of \$2.50 per share. Following court-ordered mediation, in July 2008, BANA paid us \$2.0 million and we issued to BANA 801,883 restricted shares of Tyler common stock. Accordingly, we recorded a non-cash legal settlement related to warrants charge of \$9.0 million, which was not tax deductible.

Amortization of Customer and Trade Name Intangibles

Acquisition intangibles are comprised of the excess of the purchase price over the fair value of net tangible assets acquired that is allocated to acquired software and customer and trade name intangibles. The remaining excess purchase price is allocated to goodwill that is not subject to amortization. Amortization expense related to acquired software is included with cost of revenues, while amortization expense of customer and trade name intangibles is recorded as other operating expense. The estimated useful lives of both customer and trade name intangibles are 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:

(\$in thousands)	2009	2008	Change	
			\$	%
Amortization of customer and trade name intangibles	\$2,705	\$2,438	\$267	11%

In 2009 we completed several acquisitions and purchased certain software assets to complement our tax and appraisal solutions and our student information management solutions. These transactions increased amortizable customer and trade name intangibles by approximately \$625,000. This amount will be amortized over approximately 10 years.

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

2010	\$2,654
2011	2,638
2012	2,586
2013	2,427
2014	2,426

Other

Other (expense) income in 2009 and 2008 includes non-usage and other fees associated with a credit agreement entered into in October 2008. Other income in 2008 also included \$1.1 million of interest income which declined due to significantly lower invested cash balances in 2009. Our invested cash balances declined due to purchases of treasury stock and investments in office facilities in late 2008 and 2009.

Income Tax Provision

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

(\$in thousands)	2009	2008	Change	
			\$	%
Income tax provision	\$17,628	\$14,414	\$3,214	22%
Effective income tax rate	39.5%	49.2%		

Our effective income tax rate declined compared to 2008 mainly due to a non-cash legal settlement related to warrants charge of \$9.0 million in 2008, which was not deductible. In addition to the impact of the non-deductible non-cash legal settlement charge in 2008,

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

Approximately 40% of our stock option awards qualify as incentive stock options (ISOs) 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. Non-qualified stock options result in the creation of a deferred tax asset, which is a temporary difference, until the time that the option is exercised. Due to the treatment of ISOs for tax purposes, our effective tax rate from year to year is subject to variability.

2008 Compared to 2007**Revenues**

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

(\$in thousands)	2008	% of Total	2007	% of Total	Change	
					\$	%
Software licenses	\$ 41,490	16%	\$ 35,063	16%	\$ 6,427	18%
Subscriptions	14,374	5	10,406	5	3,968	38
Software services	74,997	28	60,283	27	14,714	24
Maintenance	107,458	41	85,411	39	22,047	26
Appraisal services	19,098	7	21,318	10	(2,220)	(10)
Hardware and other	7,684	3	7,315	3	369	5
Total revenues	\$ 265,101	100%	\$ 219,796	100%	\$ 45,305	21%

Software licenses. Software license revenues consist of the following components for the following years ended December 31:

(\$in thousands)	2008	% of Total	2007	% of Total	Change	
					\$	%
Financial management and education	\$ 29,124	70%	\$ 27,236	78%	\$ 1,888	7%
Courts and justice	10,128	24	5,987	17	4,141	69
Appraisal and tax and other	2,238	6	1,840	5	398	22
Total software license revenues	\$ 41,490	100%	\$ 35,063	100%	\$ 6,427	18%

Changes in software license revenues consist of the following components:

Software license revenue related to our financial management and education solutions for 2008 increased 7% compared to the prior year. Revenue from student information management solutions as well as student transportation management solutions acquired in the last twelve months contributed substantially to the increase. The remaining increase was mainly due to contract arrangements that included more software license revenue than in the past.

Software license revenue related to our courts and justice software solutions increased 69% for 2008 compared to the prior year. New statewide contracts in Indiana and New Mexico contributed approximately two-thirds of the increase. The remaining increase was primarily due to an expanded presence in the markets for municipal courts software solutions and public safety software solutions.

Subscriptions. New ASP customers and existing customers converting to ASP arrangements provided the majority of the subscription revenue increase with the remaining increase due to new disaster recovery customers and slightly higher rates for disaster recovery services.

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

Software services revenue related to financial management and education solutions, which comprises slightly more than half of our software services revenue in the years presented, increased substantially compared to 2007. This increase was driven in part by increased capacity to deliver backlog following additions to our implementation and support staff since 2007 and due to larger and more complex contracts, which include more programming and project management services. In addition, we acquired a student transportation management solution in January 2008 which contributed approximately \$3.9 million to software service revenues in 2008. Excluding the impact of acquisitions, we added approximately 95 employees to our financial management and education implementation and training staff during 2008.

Software services revenue related to our courts and justice solutions experienced strong increases compared to 2007, reflecting increased capacity to deliver backlog following additions to our implementation and support staff since mid-2007. In addition, increased contract volume for municipal courts software solutions and public safety software solutions also generated higher related services revenue. We added approximately 12 employees to our courts and justice implementation and training staff during 2008.

Maintenance. Maintenance revenues increased 26% in 2008 compared to 2007. Excluding the impact of acquisitions, maintenance and support services grew 16% in 2008. This increase was due to growth in our installed customer base and slightly higher maintenance rates on most of our product lines.

Appraisal services. Appraisal services revenue declined 10% in 2008 compared to 2007. In late 2007, we substantially completed several projects related to the Ohio revaluation cycle, which occurs every six years, as well as a few other large contracts. Appraisal revenues for the first six months of 2008 were down 23% compared to the first six months of 2007. In mid-2008 we began a complete reappraisal of real property in Orleans Parish, Louisiana. As a result of this contract and an overall increase in contract volume, appraisal revenues for the last six months of 2008 increased 4% over the last six months of 2007.

Table of Contents*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)	2008	% of related revenues	2007	% of related revenues	Change	
					\$	%
Software licenses	\$ 9,224	22%	\$ 7,953	23%	\$ 1,271	16%
Acquired software	1,799	4	2,279	7	(480)	(21)
Software services, maintenance and subscriptions	126,247	64	104,993	67	21,254	20
Appraisal services	12,251	64	14,467	68	(2,216)	(15)
Hardware and other	5,793	75	5,679	78	114	2
Total cost of revenues	\$ 155,314	59%	\$ 135,371	62%	\$ 19,943	15%

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	2008	2007	Change
Software licenses and acquired software	73.4%	70.8%	2.6%
Software services, maintenance and subscriptions	35.9	32.7	3.2
Appraisal services	35.9	32.1	3.8
Hardware and other	24.6	22.4	2.2
Overall gross margin	41.4%	38.4%	3.0%

Software license. In 2008, our software license gross margin percentage rose compared to the prior year mainly due to strong license fee revenue increases. Because approximately one-half of our cost of software license revenues in both periods is comprised of amortization of capitalized development costs, increased license fee revenues inherently result in higher gross margins.

Software services, maintenance and subscription-based services. In 2008, the software services, maintenance and subscriptions gross margin increased compared to the prior year partly because maintenance and various other services such as ASP and disaster recovery costs typically grow at a slower rate than related revenues due to leverage in the utilization of our support and maintenance staff and economies of scale. We have increased our implementation and support staff by 215 employees during 2008 in order to expand our capacity to implement our contract backlog. This increase includes 102 employees related to acquisitions completed in 2008.

Appraisal services. Our appraisal gross margin for 2008 is higher than the prior year due to cost savings associated with a significant complex reappraisal project.

Our blended gross margin in 2008 was higher than the prior year in large part due to leverage in the utilization of our support and maintenance staff and economies of scale, with resulting increases in gross margin for each revenue category.

Table of ContentsSelling, General and Administrative Expenses

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

(\$in thousands)	2008	% of revenues	2007	% of revenues	Change \$	%
Selling, general and administrative expenses	\$62,923	24%	\$51,724	24%	\$11,199	22%

Excluding the impact of acquisitions, our SG&A employee count increased 9% during 2008.

Research and Development Expense

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

(\$in thousands)	2008	% of revenues	2007	% of revenues	Change \$	%
Research and development expense	\$7,286	3%	\$4,443	2%	\$2,843	64%

Research and development expense consist mainly of costs associated with the Microsoft Dynamics AX project, in addition to costs associated with other new product development efforts. In 2008 and 2007, we offset our research and development expense by \$1.8 million and \$1.6 million, respectively, which were the amounts earned under the terms of our research and development agreement with Microsoft.

Non-Cash Legal Settlement Related to Warrants

On June 27, 2008, we settled outstanding litigation related to the Warrants owned by BANA. The Warrants entitled BANA to acquire 1.6 million shares of Tyler common stock at an exercise price of \$2.50 per share. Following court-ordered mediation, in July 2008, BANA paid us \$2.0 million and we issued to BANA 801,883 restricted shares of Tyler common stock. Accordingly, we recorded a non-cash legal settlement related to warrants charge of \$9.0 million, which was not tax deductible.

Amortization of Customer and Trade Name Intangibles

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

(\$in thousands)	2008	2007	Change \$	%
Amortization of customer and trade name intangibles	\$2,438	\$1,478	\$960	65%

In 2008, we completed three acquisitions, which increased amortizable customer and trade name intangibles by \$12.3 million.

Other

Interest income was the main component of other income in both 2008 and 2007. Other income in 2008 also includes non-usage and other fees associated with a credit agreement entered into in October 2008. Interest income in 2008 was \$1.1 million compared to \$1.8 million in 2007. Interest income declined due to lower invested cash balances and slightly lower interest rates. Our invested cash balances declined due to purchases of treasury stock and investments in office facilities in 2008.

Table of ContentsIncome Tax Provision

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

(\$in thousands)	2008	2007	Change	
			\$	%
Income Tax Provision	\$14,414	\$11,079	\$3,335	30%
Effective income tax rate	49.2%	38.8%		

Our effective income tax rate increased approximately twelve points compared to the prior year due to a non-cash legal settlement related to warrants charge of \$9.0 million, which was not deductible. The effective income tax rates were different from the statutory United States federal income tax rate of 35% primarily due to non-cash legal settlement related to warrants charge which was not deductible, as well as state income taxes, non-deductible share-based compensation expense, the qualified manufacturing activities deduction, and non-deductible meals and entertainment costs.

BUSINESS SEGMENT DISCUSSION*Enterprise Software Solutions*

	2009	% change	2008	% change	2007
Revenue	\$250,059	11%	\$225,887	24%	\$182,065
Gross Margin	\$114,309		\$97,214		\$71,684
Gross Margin percentage	46%		43%		39%
Segment Operating Income	\$55,639	17%	\$47,698	37%	\$34,833

In 2009 software license revenues were flat compared to 2008. Growth in recurring revenues from subscription-based services and maintenance experienced a 14% increase, excluding the impact of acquisitions, and was the primary factor for the increase in overall revenue and segment operating income for the Enterprise Software Solutions segment. This increase was due to growth in our installed customer base and slightly higher maintenance rates on most of our product lines. New customers for ASP and other hosted service offerings as well as existing customers converting to ASP arrangements and slightly higher rates for disaster recovery services also contributed to this increase. The gross margin and segment operating income rose in 2009 due to lower amortization expense of software development costs. The gross margin and segment operating income also benefited from leverage in the utilization of our support and maintenance staff and economies of scale and slightly higher rates on certain services.

In 2008 software license revenues were 18% higher than 2007 mainly due to higher courts and justice contract volume as a result of an expanded presence in Indiana and New Mexico. 2008 software license revenue also benefitted from student information management solutions and transportation solutions acquired in early 2008. Excluding the impact of acquisitions in 2008, revenues from subscription-based arrangements and maintenance grew by 19% compared to 2007 primarily due to growth in our customer base. Our gross margin and segment operating income in 2008 was higher than 2007 in large part due to leverage in the utilization of our support and maintenance staff and economies of scale and higher software license revenues.

Appraisal and Tax Software Solutions and Services

	2009	% change	2008	% change	2007
Revenue	\$40,776	5%	\$38,868	1%	\$38,649
Gross Margin	\$15,489		\$13,231		\$12,966
Gross Margin percentage	38%		34%		34%
Segment Operating Income	\$6,949	28%	\$5,448	8%	\$5,040

In 2009 overall revenues for the Appraisal and Tax Software Solutions and Services segment increased compared to 2008 mainly due to a 16% increase in subscription-based arrangements and maintenance due to growth in our

customer base and slightly higher rates. Excluding the results of acquisitions, subscription-based arrangements and maintenance increased 15% compared to 2008. This

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increase was offset slightly by 2% lower appraisal services. The appraisal services business is somewhat cyclical and driven in part by scheduled revaluation cycles in various states. We substantially completed several large appraisal projects mid-2009. Our appraisal gross margin and segment operating income increased compared to 2008 as the result of cost savings and operational efficiencies experienced on an unusually complex appraisal project. A high proportion of the costs of appraisal services revenue are variable, as we often hire temporary employees to assist in appraisal projects whose term of employment generally ends with the projects' completion.

Overall appraisal and tax revenues in 2008 were flat compared to 2007. Although maintenance revenues increased 8%, appraisal services revenues declined 10%. In late 2007, we substantially completed several appraisal projects related to the Ohio revaluation cycle, which occurs every six years, as well as a few other large contracts. The gross margin for 2008 was flat compared to 2007 due to cost savings associated with a significant complex reappraisal project which offset declines from lower contract volume.

FINANCIAL CONDITION AND LIQUIDITY

As of December 31, 2009, we had cash and cash equivalents (including restricted cash equivalents) of \$15.7 million and current and non-current investments of \$2.0 million, compared to cash and cash equivalents (including restricted cash equivalents) of \$6.8 million and current and non-current investments of \$4.6 million at December 31, 2008. As of December 31, 2009, we had no outstanding borrowings and outstanding letters of credit totaling \$7.3 million to secure surety bonds required by some of our customer contracts. These letters of credit expire through mid-2010. The following table sets forth a summary of cash flows for the years ended December 31:

(\$in thousands)	2009	2008	2007
Cash flows provided by (used by):			
Operating activities	\$ 42,941	\$ 47,802	\$ 34,111
Investing activities	(13,658)	(9,554)	(34,275)
Financing activities	(21,349)	(46,128)	(7,406)
Net increase (decrease) in cash and cash equivalents	\$ 7,934	\$ (7,880)	\$ (7,570)

Net cash provided by operating activities continues to be our primary source of funds to finance operating needs and capital expenditures. Other capital resources include cash on hand, public and private issuances of debt and equity securities, and bank borrowings. The capital and credit markets have become more volatile and tightened as a result of adverse conditions that have caused the failure and near failure of a number of large financial services companies. It is possible that our ability to access the capital and credit markets may be limited by these or other factors.

Notwithstanding the foregoing, we believe that cash provided by operating activities, cash on hand and our revolving credit agreement are sufficient to fund our working capital requirements, capital expenditures, income tax obligations, and share repurchases for the foreseeable future.

In 2009, operating activities provided net cash of \$42.9 million, primarily generated from net income of \$27.0 million, non-cash depreciation and amortization charges of \$9.5 million, non-cash share-based compensation expense of \$5.0 million and a decrease in working capital of \$2.7 million offset slightly by a \$1.7 million decrease related to deferred income taxes. Working capital declined due to higher accounts payable and accrued liabilities pertaining to timing of payments on vendor invoices and income tax liabilities and an accrued liability of \$1.8 million for a retention payment related to construction of an office building. Other sources of working capital were deferred revenue related to December maintenance billings and a decrease in prepaid expenses. These working capital declines were offset somewhat by an increase in annual software maintenance billings as a result of growth in our installed customer base. The increase in accounts receivable was offset slightly by the collection of several large customer billings, one of which had been outstanding for over twelve months.

Cash flows provided by operating activities in 2008 included several advance payments from customers. In general, changes in the balance of deferred revenue are cyclical and primarily driven by the timing of our maintenance renewal billings. Our renewal dates occur throughout the year but our heaviest renewal cycles occur in the second and fourth quarters.

Non-current investments available-for-sale consist of two auction rate municipal securities (ARS) which are collateralized debt obligations supported by municipal and state agencies and do not include mortgage-backed securities. Short-term investments

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available-for-sale consists of the portion of one of these ARS which was partially redeemed at par during the period January 1, 2010 through February 22, 2010. These ARS are debt instruments with stated maturities ranging from 22 to 33 years, for which the interest rate is designed to be reset through Dutch auctions approximately every 30 days. However, due to events in the credit markets, auctions for these securities have not occurred since February 2008. Both of our ARS have had very small partial redemptions at par in the period from July 2009 through February 2010. As of December 31, 2009 we have continued to earn and collect interest on both of our ARS. Because quoted prices in active markets are no longer available we determined the estimated fair values of these securities utilizing a discounted trinomial model. The model considers the probability of three potential occurrences for each auction event through the maturity date of each ARS. The three potential outcomes for each auction are (i) successful auction/early redemption, (ii) failed auction and (iii) issuer default. Inputs in determining the probabilities of the potential outcomes include but are not limited to, the securities collateral, credit rating, insurance, issuer's financial standing, contractual restrictions on disposition and the liquidity in the market. The fair value of each ARS is determined by summing the present value of the probability-weighted future principal and interest payments determined by the model. Since there can be no assurances that auctions for these securities will be successful in the near future, we have classified our ARS as non-current investments.

In association with this estimate of fair value, we have recorded an after-tax temporary unrealized loss on our non-current ARS of \$18,000, net of related tax effects of \$10,000 in 2009, which is included in accumulated other comprehensive loss on our balance sheet. The unrealized loss includes the impact of adjusting previously recorded unrealized losses of approximately \$120,000, net of related tax effects of \$65,000 as of December 31, 2008 for several ARS which were subsequently redeemed for \$2.5 million at par during 2009.

We consider the impairment in our ARS as temporary because we do not have the intent to sell, nor is it more-likely-than-not that we will be required to sell these securities before recovery of their cost basis. We believe that this temporary decline in fair value is due entirely to liquidity issues, because the underlying assets of these securities are supported by municipal and state agencies and do not include mortgage-backed securities, have redemption features which call for redemption at 100% of par value and have a current credit rating of A or AAA. The ratings on the ARS take into account credit support through insurance policies guaranteeing each of the bonds payment of principal and accrued interest, if it becomes necessary. In addition, both ARS have had very small partial redemptions at par in the period July 2009 through February 2010. Based on our cash and cash equivalents balance of \$15.7 million and expected operating cash flows, we do not believe a lack of liquidity associated with our ARS will adversely affect our ability to conduct business, and believe we have the ability to hold the securities throughout the currently estimated recovery period. We will continue to evaluate any changes in the market value of our ARS and in the future, depending upon existing market conditions, we may be required to record an other-than-temporary decline in market value.

At December 31, 2009, our days sales outstanding (DSOs) were 98 days compared to DSOs of 99 days at December 31, 2008. DSOs are calculated based on accounts receivable (excluding long-term receivables, but including unbilled receivables) divided by the quotient of annualized quarterly revenues divided by 360 days. Investing activities used cash of \$13.7 million in 2009 compared to \$9.6 million in 2008. In connection with plans to consolidate our workforce and support planned long-term growth, we paid \$9.4 million for construction of an office building and expect to pay the final retainage of \$1.8 million by mid-2010. We also liquidated \$2.5 million of investments in ARS for cash at par. In 2009 we completed the acquisition of all of the capital stock of Assessment Evaluation Services, Inc. for \$1.1 million in cash, paid \$700,000 in cash for certain assets of KPL, Inc. d/b/a Parker-Lowe & Associates and acquired various software assets for \$1.1 million in cash. Capital expenditures and acquisitions were funded from cash generated from operations.

In 2008, we liquidated \$36.4 million of ARS investments for cash at par, and we completed the acquisitions of School Information Systems, Inc., VersaTrans Solutions Inc. and certain assets of Olympia Computing Company, Inc. d/b/a Schoolmaster to expand our presence in the education market. The combined purchase price, excluding cash acquired and including transaction costs, was approximately \$23.9 million in cash and approximately 196,000 shares of Tyler common stock valued at \$2.9 million. We paid \$3.3 million, which included \$2.1 million for land, for an office development. We also paid \$12.7 million for an office building, land, and a related tenant lease in Yarmouth, Maine.

Cash used in financing activities was primarily comprised of purchases of treasury shares, net of proceeds from stock option exercises, payments on our revolving credit line and contributions from our employee stock purchase plan. During 2009, we purchased 1.2 million shares of our common stock for an aggregate purchase price of \$17.0 million. We also paid \$1.3 million for common stock repurchases accrued as of December 31, 2008.

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The repurchase program, which was approved by our board of directors, was announced in October 2002, and was amended in April and July 2003, October 2004, October 2005, May 2007, May 2008, October 2008 and May 2009. Our board of directors authorized the repurchase of an additional 2.0 million shares on May 14, 2009. As of December 31, 2009, we had remaining authorization to repurchase up to 2.3 million additional shares of our common stock. Our share repurchase program allows us to repurchase shares at our discretion and market conditions influence the timing of the buybacks and the number of shares repurchased. These share repurchases are funded using our existing cash balances as well as borrowings under our revolving credit agreement and may occur through open market purchase and transactions structured through investment banking institutions, privately negotiated transactions and/or other mechanisms. There is no expiration date specified for the authorization and we intend to repurchase stock under the plan from time to time. Our bank credit agreement contains restrictions on the amount of common stock we may purchase.

During 2008, we purchased 4.3 million shares of our common stock for an aggregate purchase price of \$59.0 million. In 2009 we issued 425,000 shares of common stock and received \$2.3 million in aggregate proceeds upon exercise of stock options. In 2008 we received \$1.8 million from the exercise of options to purchase approximately 379,000 shares of our common stock under our employee stock option plan and during 2007, we received \$3.6 million from the exercise of options to purchase approximately 878,000 shares of our common stock under our employee stock option plan. In 2009 we received \$1.5 million from contributions to the Tyler Technologies, Inc. Employee Stock Purchase Plan (ESPP). In both 2008 and 2007, we received \$1.2 million from contributions to the ESPP.

Subsequent to December 31, 2009 and through February 22, 2010 we purchased approximately 59,000 shares of our common stock for an aggregate cash purchase price of \$1.1 million.

In October 2008, we entered into a revolving bank credit agreement (the Credit Facility) and a related pledge and security agreement which originally matured October 19, 2009. We amended and extended the related pledge and security agreement in October 2009. The Credit Facility matures October 18, 2010 and provides for total borrowings of up to \$25.0 million and a \$10.0 million Letter of Credit facility which can either be cash collateralized or issued using availability under the Credit Facility. The Credit Facility is secured by substantially all of our property. The Credit Facility requires us to maintain certain financial ratios and other financial conditions and prohibits us from making certain investments, advances, cash dividends or loans, restricts the amount of our common stock we may purchase and limits incurrence of additional indebtedness and liens. As of December 31, 2009, we were in compliance with those covenants. We expect borrowings to fund discretionary purchases of our common stock or fund acquisitions.

As of December 31, 2009, we had no outstanding borrowings and unused available borrowing capacity of \$23.7 million under the Credit Facility. In addition, as of December 31, 2009, our bank had issued outstanding letters of credit totaling \$7.3 million to secure surety bonds required by some of our customer contracts. These letters of credit have been collateralized by restricted cash balances of \$6.0 million and \$1.3 million of our available borrowing capacity and expire through mid-2010.

We paid income taxes, net of refunds received, of \$18.1 million in 2009, \$15.7 million in 2008, and \$8.7 million in 2007.

In the first quarter of 2010 we acquired all the assets of Wiznet, Inc. (Wiznet) for a cash purchase price of \$9.5 million. Wiznet provides electronic document filing solutions for courts and law offices throughout the United States and is currently integrated with our primary courts and justice solution. We have not finalized the allocation of the purchase price.

Excluding acquisitions and final retainage payment of \$1.8 million for an office building, we anticipate that 2010 capital spending will be between \$3.7 million and \$4.2 million. We expect the majority of our capital spending in 2010 will consist of computer equipment and software for infrastructure expansion. We currently do not expect to capitalize significant amounts related to software development in 2010, 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 2010 is expected to be funded from existing cash balances and cash flows from operations.

From time to time we engage in discussions with potential acquisition candidates. In order to pursue such opportunities, which could require significant commitments of capital, we may be required to incur debt or to issue

additional potentially dilutive securities in the future. No assurance can be given as to our future acquisition opportunities and how such opportunities will be financed.

We lease office facilities, as well as transportation, computer and other equipment used in our operations under non-cancelable operating lease agreements expiring at various dates through 2014. Most leases contain renewal options and some contain purchase

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options. Following are the future obligations under non-cancelable leases at December 31, 2009 (in thousands):

	2010	2011	2012	2013	2014	Thereafter	Total
Future rental payments under operating leases	\$6,033	\$5,265	\$3,954	\$2,365	\$1,721	\$	\$19,338

As of December 31, 2009, we do not have any off-balance sheet arrangements, guarantees to third parties or material purchase commitments, except for the operating lease commitments listed above.

CAPITALIZATION

At December 31, 2009, our capitalization consisted of \$134.4 million of shareholders' equity.

NEW ACCOUNTING PRONOUNCEMENTS

In September 2009, the Financial Accounting Standards Board issued ASU 2009-13, Multiple Element Arrangements. ASU 2009-13 addresses the determination of when the individual deliverables included in a multiple arrangement may be treated as separate units of accounting. ASU 2009-13 also modifies the manner in which the transaction consideration is allocated across separately identified deliverables and establishes definitions for determining fair value of elements in an arrangement. This new update is effective for fiscal years beginning on or after June 15, 2010. Early adoption is allowed. The new standard may impact our application service provider arrangements to recognize revenues, such as installation and data conversion, which are generally provided at the beginning of the arrangement as incurred instead of ratably over the life of the initial hosting term. The adoption of this standard is not expected to have a material impact on our financial condition or results of operation.

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. Our investments available-for-sale consist of auction rate municipal securities (ARS) which are collateralized debt obligations supported by municipal and state agencies and do not include mortgage-backed securities.

Non-current investments available-for-sale consist of two ARS with stated maturities ranging from 22 to 33 years, for which the interest rate is designed to be reset through Dutch auctions approximately every 30 days which would have qualified as Level 1 under ASC 820, Fair Value Measurements. However, due to events in the credit markets, auctions for these securities have not occurred since February 2008. Therefore, quoted prices in active markets are no longer available and we determined the estimated fair values of these securities as of December 31, 2009, utilizing a discounted trinomial model.

In association with this estimate of fair value, we have recorded an after-tax temporary unrealized loss on our non-current ARS of \$18,000, net of related tax effects of \$10,000 in 2009, which is included in accumulated other comprehensive loss on our balance sheet. The unrealized loss includes the impact of adjusting previously recorded unrealized losses of approximately \$120,000, net of related tax effects of \$65,000 as of December 31, 2008 for several ARS which were subsequently redeemed for \$2.5 million at par during 2009. We consider the impairment in our ARS as temporary because we do not have the intent to sell, nor is it more-likely-than-not that we will be required to sell these securities before recovery of their cost basis. We believe that this temporary decline in fair value is due entirely to liquidity issues, because the underlying assets of these securities are supported by municipal and state agencies and do not include mortgage-backed securities, have redemption features which call for redemption at 100% of par value and have a current credit rating of A or AAA. The ratings on the ARS take into account credit support through insurance policies guaranteeing each of the bonds' payment of principal and accrued interest, if it becomes necessary. In addition, both ARS have had very small partial redemptions at par in the period July 2009 through February 2010. Based on our cash and cash equivalents balance of \$15.7 million and expected operating cash flows, we do not believe a lack of liquidity associated with our ARS will adversely affect our ability to conduct business, and believe we have the ability to hold the securities throughout the currently estimated recovery period. We will continue to evaluate any changes in the market value of our ARS and in the future, depending upon existing market conditions, we may be required to record an other-than-temporary decline in market value.

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

The reports of our independent registered public accounting firm and our 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.

ITEM 9A. CONTROLS AND PROCEDURES.

Evaluation of Disclosure Controls and Procedures We maintain disclosure controls and procedures (as defined in Rule 13a-15(e) of the Securities Exchange Act) designed to provide reasonable assurance that the information required to be disclosed by us in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. These include controls and procedures designed to ensure that this information is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate to allow timely decisions regarding required disclosures. Management, with the participation of the chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures as of December 31, 2009. Based on this evaluation the chief executive officer and chief financial officer have concluded that our disclosure controls and procedures were effective as of December 31, 2009.

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, 2009. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control - Integrated Framework*. Based on our assessment, we concluded that, as of December 31, 2009, Tyler's internal control over financial reporting was effective based on those criteria. Tyler's internal control over financial reporting as of December 31, 2009 has been audited by Ernst & Young LLP, the independent registered public accounting firm who also audited Tyler's financial statements. Ernst & Young's attestation report on Tyler's internal control over financial reporting appears on page F-2 hereof.

Changes in Internal Control Over Financial Reporting During the quarter ended December 31, 2009, there were no changes in our internal control over financial reporting, as defined in Securities Exchange Act Rule 13a-15(f), that are materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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.	Headings in Proxy Statement Tyler Management and Corporate Governance Principles and Board Matters
ITEM 11.	EXECUTIVE COMPENSATION.	Executive Compensation
ITEM 12.	SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS.	Security Ownership of Certain Beneficial Owners and Management
ITEM 13.	CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE.	Executive Compensation and Certain Relationships and Related Transactions
ITEM 14.	PRINCIPAL ACCOUNTING FEES AND SERVICES.	

The information required under this item may be found under the section captioned "Proposals For Consideration Proposal Three Ratification of Ernst & Young LLP as Our Independent Auditors for Fiscal Year 2010" in our Proxy Statement and is incorporated herein by reference.

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PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES.

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

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

	Page
<u>Reports of Independent Registered Public Accounting Firm</u>	F-1
<u>Statements of Operations for the years ended December 31, 2009, 2008, and 2007</u>	F-3
<u>Balance Sheets as of December 31, 2009 and 2008</u>	F-4
<u>Statements of Shareholders' Equity for the years ended December 31, 2009, 2008 and 2007</u>	F-5
<u>Statements of Cash Flows for the years ended December 31, 2009, 2008 and 2007</u>	F-6
<u>Notes to Financial Statements</u>	F-7

(2) Financial statement schedules:

There are no financial statement schedules filed as part of this Annual Report, since the required information is included in the financial statements, including the notes thereto, or the circumstances requiring inclusion of such schedules are not present.

(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).
4.2	Second Amendment to the Second Amended and Restated Credit Agreement by and between Tyler Technologies, Inc. and Bank of Texas, N.A. dated August 21, 2009 (filed as Exhibit 4.1 to our Form 10-Q for the three months ended September 30, 2009 and incorporated by reference herein).
4.3	First Amendment to the Second Amended and Restated Pledge and Security Agreement by and between Tyler Technologies, Inc. and Bank of Texas, N.A. dated October 19, 2009 (filed as Exhibit 4.3 to our Form 10-Q for the three months ended September 30, 2009 and incorporated by reference herein).
4.4	Third Amended and Restated Credit Agreement by and between Tyler Technologies, Inc. and Bank of Texas, N.A. dated October 19, 2009 (filed as Exhibit 4.2 to our Form 10-Q for the three months ended September 30, 2009 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	Employment and Non-Competition Agreement between Tyler Technologies, Inc. and John S. Marr Jr. dated February 26, 2008 (filed as Exhibit 10.5 to our Form 10-K for the year ended December 31, 2007 and incorporated by reference herein).
10.4	Employment and Non-Competition Agreement between Tyler Technologies, Inc. and Dustin R. Womble dated February 26, 2008 (filed as Exhibit 10.6 to our Form 10-K for the year ended December 31, 2007 and incorporated by reference herein).
10.5	Employment and Non-Competition Agreement between Tyler Technologies, Inc. and Brian K. Miller, dated February 26, 2008 (filed as Exhibit 10.7 to our Form 10-K for the year ended December 31, 2007 and incorporated by reference herein).
10.6	Employment and Non-Competition Agreement between Tyler Technologies, Inc. and H. Lynn Moore dated February 26, 2008 (filed as Exhibit 10.8 to our Form 10-K for the year ended December 31, 2007 and incorporated by reference herein).

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Exhibit Number	Description
10.7	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
*31.1	Rule 13a-14(a) Certification by Principal Executive Officer.
*31.2	Rule 13a-14(a) Certification by Principal Financial Officer.
*32	Section 1350 Certification of Principal Executive Officer and Principal Financial Officer.

* Filed herewith.

A copy of each exhibit may be obtained at a price of 15 cents per page, with a \$10.00 minimum order, by writing Investor Relations, 5949 Sherry Lane, Suite 1400, Dallas, Texas, 75225.

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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 24, 2010

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 24, 2010

By: /s/ John S. Marr
John S. Marr
Chief Executive Officer and President Director
(principal executive officer)

Date: February 24, 2010

By: /s/ John M. Yeaman
John M. Yeaman
Chairman of the Board

Date: February 24, 2010

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

Date: February 24, 2010

By: /s/ W. Michael Smith
W. Michael Smith
Vice President and Chief Accounting Officer
(principal accounting officer)

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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 balance sheets of Tyler Technologies, Inc. as of December 31, 2009 and 2008, and the related statements of operations, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2009. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Tyler Technologies, Inc. at December 31, 2009 and 2008, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2009, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Tyler Technologies, Inc.'s internal control over financial reporting as of December 31, 2009, 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 25, 2010 expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP

Dallas, Texas

February 25, 2010

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders

Tyler Technologies, Inc.

We have audited Tyler Technologies, Inc.'s internal control over financial reporting as of December 31, 2009, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Tyler Technologies, Inc.'s management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

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

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

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

In our opinion, Tyler Technologies, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2009, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the balance sheets of Tyler Technologies, Inc. as of December 31, 2009 and 2008, and the related statements of operations, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2009 and our report dated February 25, 2010 expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP

Dallas, Texas

February 25, 2010

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

	2009	2008	2007
Revenues:			
Software licenses	\$ 42,131	\$ 41,490	\$ 35,063
Subscriptions	17,181	14,374	10,406
Software services	80,405	74,997	60,283
Maintenance	124,512	107,458	85,411
Appraisal services	18,740	19,098	21,318
Hardware and other	7,317	7,684	7,315
Total revenues	290,286	265,101	219,796
Cost of revenues:			
Software licenses	5,440	9,224	7,953
Acquired software	1,411	1,799	2,279
Software services, maintenance and subscriptions	137,199	126,247	104,993
Appraisal services	11,518	12,251	14,467
Hardware and other	5,955	5,793	5,679
Total cost of revenues	161,523	155,314	135,371
Gross profit	128,763	109,787	84,425
Selling, general and administrative expenses	70,115	62,923	51,724
Research and development expense	11,159	7,286	4,443
Amortization of customer and trade name intangibles	2,705	2,438	1,478
Non-cash legal settlement related to warrants		9,045	
Operating income	44,784	28,095	26,780
Other (expense) income, net	(146)	1,181	1,800
Income before income taxes	44,638	29,276	28,580
Income tax provision	17,628	14,414	11,079
Net income	\$ 27,010	\$ 14,862	\$ 17,501
Earnings per common share:			
Basic	\$ 0.77	\$ 0.39	\$ 0.45
Diluted	\$ 0.74	\$ 0.38	\$ 0.42

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Basic weighted average common shares outstanding	35,240	37,714	38,735
Diluted weighted average common shares outstanding	36,624	39,184	41,352
See accompanying notes.			

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Tyler Technologies, Inc.

Balance Sheets

December 31

In thousands, except share and per share amounts

	2009	2008
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 9,696	\$ 1,762
Restricted cash equivalents	6,000	5,082
Short-term investments available-for-sale	50	775
Accounts receivable (less allowance for losses of \$2,389 in 2009 and \$2,115 in 2008)	81,245	76,989
Prepaid expenses	7,921	8,602
Other current assets	1,437	1,444
Deferred income taxes	3,338	2,570
Total current assets	109,687	97,224
Accounts receivable, long-term portion	1,018	197
Property and equipment, net	35,750	26,522
Non-current investments available-for-sale	1,976	3,779
Other assets:		
Goodwill	90,258	88,791
Customer related intangibles, net	25,490	27,438
Software, net	4,218	5,112
Trade name, net	2,063	2,471
Sundry	210	227
	\$ 270,670	\$ 251,761
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	\$ 3,807	\$ 2,617
Accrued liabilities	26,110	22,913
Short-term revolving line of credit		8,000
Deferred revenue	99,116	95,773
Income taxes payable	220	166
Total current liabilities	129,253	129,469
Deferred income taxes	7,059	8,030
Commitments and contingencies		
Shareholders equity:		
Preferred stock, \$10.00 par value; 1,000,000 shares authorized, none issued	481	481

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Common stock, \$0.01 par value; 100,000,000 shares authorized; 48,147,969 shares issued in 2009 and 2008		
Additional paid-in capital	153,734	151,245
Accumulated other comprehensive loss, net of tax	(405)	(387)
Retained earnings	77,504	50,494
Treasury stock, at cost; 13,027,838 and 12,333,549 shares in 2009 and 2008, respectively	(96,956)	(87,571)
Total shareholders' equity	134,358	114,262
	\$ 270,670	\$ 251,761

See accompanying notes.

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Tyler Technologies, Inc.
 Statements of Shareholders' Equity
 For the years ended December 31, 2009, 2008 and 2007
 In thousands

	Common Stock		Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)		Retained Earnings	Treasury Stock		Total Shareholders' Equity
	Shares	Amount		Shares	Amount				
Balance at December 31, 2006	48,148	\$ 481	\$ 151,627	\$ (10)	\$ 18,131	(9,256)	\$ (44,354)	\$ 125,875	
Comprehensive income:									
Net income					17,501			17,501	
Unrealized gain on investment securities, net of tax				10				10	
Total comprehensive income								17,511	
Issuance of shares pursuant to stock compensation plan			(7,339)			878	10,928	3,589	
Stock compensation			2,365					2,365	
Treasury stock purchases						(1,250)	(16,163)	(16,163)	
Issuance of shares pursuant to Employee Stock Purchase Plan			(2)			100	1,119	1,117	
Federal income tax benefit related to exercise of stock options			2,917					2,917	
Balance at December 31, 2007	48,148	481	149,568		35,632	(9,528)	(48,470)	137,211	
Comprehensive income:									
Net income					14,862			14,862	
Unrealized loss on investment				(387)				(387)	

securities, net of tax									
Total comprehensive income									14,475
Issuance of shares pursuant to stock compensation plan			(3,495)			379	5,310		1,815
Stock compensation			3,820						3,820
Treasury stock purchases						(4,283)	(58,984)		(58,984)
Issuance of shares pursuant to Employee Stock Purchase Plan			(186)			101	1,376		1,190
Federal income tax benefit related to exercise of stock options			822						822
Issuance of shares in connection with legal settlement			455			802	10,595		11,050
Issuance of shares for acquisitions			261			196	2,602		2,863
Balance at December 31, 2008	48,148	481	151,245	(387)	50,494	(12,333)	(87,571)		114,262
Comprehensive income:									
Net income					27,010				27,010
Unrealized loss on investment securities, net of tax				(18)					(18)
Total comprehensive income									26,992
Issuance of shares pursuant to stock compensation plan			(3,774)			425	6,069		2,295
Stock compensation			5,045						5,045
Treasury stock purchases						(1,235)	(17,000)		(17,000)
			(118)			115	1,546		1,428

Issuance of shares
pursuant to
Employee Stock
Purchase Plan
Federal income tax
benefit related to
exercise of stock
options

1,336

1,336

Balance at
December 31,
2009

48,148 \$ 481 \$ 153,734 \$ (405) \$ 77,504 (13,028) \$ (96,956) \$ 134,358

See accompanying notes.

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

	2009	2008	2007			
Cash flows from operating activities:						
Net income	\$ 27,010	\$ 14,862	\$ 17,501			
Adjustments to reconcile net income to net cash provided by operating activities:						
Depreciation and amortization	9,497	12,611	11,211			
Non-cash legal settlement related to warrants		9,045				
Share-based compensation expense	5,045	3,820	2,365			
Provision for losses accounts receivable	1,538	1,764	753			
Excess tax benefit from exercises of share-based arrangements	(1,125)	(666)	(1,891)			
Deferred income tax benefit	(1,730)	(2,151)	(1,598)			
Changes in operating assets and liabilities, exclusive of effects of acquired companies:						
Accounts receivable	(6,277)	(11,853)	(1,575)			
Income tax payable	1,391	827	3,919			
Prepaid expenses and other current assets	1,377	(338)	(304)			
Accounts payable	1,190	(870)	(1,955)			
Accrued liabilities						
Equity securities	13,621	(1,223)	46	12,443	(1,462)	57
Total less than 12 months	\$76,701	\$(1,774)	84	\$104,963	\$(3,164)	108
12 months or greater:						
Fixed maturity securities						
States and municipalities	—	—	—	1,049	(1)	1
Corporate securities	1,070	(13)	1	1,024	(65)	1
Residential mortgage-backed securities	2,572	(401)	5	2,692	(584)	5
Total fixed maturity securities	3,642	(414)	6	4,765	(650)	7
Equity securities	444	(43)	7	452	(93)	4
Total 12 months or greater	\$4,086	\$(457)	13	\$5,217	\$(743)	11
Total available-for-sale:						
Fixed maturity securities						
U.S. Treasuries	\$13,893	\$(8)	5	\$5,076	\$(1)	2
U.S. Agencies	—	—	—	11,124	(14)	3
States and municipalities	29,189	(366)	8	6,143	(186)	2
Corporate securities	20,904	(188)	11	65,870	(1,546)	31
Residential mortgage-backed securities	2,736	(403)	20	7,608	(604)	19
Commercial mortgage-backed securities	—	—	—	1,464	(1)	1
Total fixed maturity securities	66,722	(965)	44	97,285	(2,352)	58
Equity securities	14,065	(1,266)	53	12,895	(1,555)	61
Total available-for-sale	\$80,787	\$(2,231)	97	\$110,180	\$(3,907)	119

Based on reviews of the fixed maturity securities, the Company determined that unrealized losses as of June 30, 2012 were primarily the result of changes in prevailing interest rates and not the credit quality of the issuers. The fixed maturity securities whose total fair value was less than amortized cost were not determined to be other-than-temporarily impaired given the severity and duration of the impairment, the credit quality of the issuers, the Company's intent to not sell the securities, and a determination that it is not more likely than not that the Company will be required to sell the securities until fair value recovers to above cost, or to maturity.

Based on reviews of the equity securities as of June 30, 2012, the Company recognized total impairments of \$0.5 million in the fair values of seven equity securities as a result of the severity and duration of the change in fair values of those securities.

Realized gains on investments, net and the change in unrealized gains (losses) on fixed maturity and equity securities are determined on a specific-identification basis and were as follows:

	Three Months Ended June 30, 2012		Six Months Ended June 30, 2012	
	2011	2011	2011	2011
	(in thousands)			
Realized gains on investments, net				
Fixed maturity securities				
Gross gains	\$592	\$866	\$2,295	\$932
Gross losses	—	(55	) (5	) (148
Realized gains on fixed maturity securities, net	\$592	\$811	\$2,290	\$784
Equity securities				
Gross gains	\$613	\$291	\$1,161	\$555
Gross losses	(260	) —	(728	) (3
Realized gains on equity securities, net	\$353	\$291	\$433	\$552
Total	\$945	\$1,102	\$2,723	\$1,336
Change in unrealized gains (losses)				
Fixed maturity securities	\$8,015	\$28,395	\$3,558	\$19,458
Equity securities	(3,047	) 163	8,931	4,492
Total	\$4,968	\$28,558	\$12,489	\$23,950

Net investment income was as follows:

	Three Months Ended June 30, 2012		Six Months Ended June 30, 2012	
	2011	2011	2011	2011
	(in thousands)			
Fixed maturity securities	\$18,019	\$20,349	\$36,237	\$40,893
Equity securities	777	469	1,424	918
Cash equivalents and restricted cash	120	91	275	196
	18,916	20,909	37,936	42,007
Investment expenses	(619	) (603	) (1,254	) (1,208
Net investment income	\$18,297	\$20,306	\$36,682	\$40,799

The Company is required by various state laws and regulations to keep securities or letters of credit in depository accounts with the states in which it does business. As of June 30, 2012 and December 31, 2011, securities having a fair value of \$528.4 million and \$522.6 million, respectively, were on deposit. These laws and regulations govern not only the amount, but also the types of securities that are eligible for deposit. The deposits are limited to fixed maturity securities in all states. Additionally, certain reinsurance contracts require Company funds to be held in trust for the benefit of the ceding reinsurer to secure the outstanding liabilities assumed by the Company. The fair value of securities held in trust for reinsurance at June 30, 2012 and December 31, 2011 was \$34.4 million and \$40.3 million, respectively. A portion of the Company's debt was secured by fixed maturity securities and restricted cash and cash equivalents that had a fair value of \$114.5 million and \$126.7 million at June 30, 2012 and December 31, 2011, respectively.

5. Income Taxes

Income tax expense for interim periods is measured using an estimated effective tax rate for the annual period. The following is a reconciliation of the federal statutory income tax rate to the Company's effective tax rates for the periods presented.

	Six Months Ended			
	June 30,			
	2012	2011		
Expense computed at statutory rate	35.0	35.0	%	%
Dividends received deduction and tax-exempt interest	(110.6)	(46.3)))
LPT Agreement	(73.6)	(25.0)))
Other	(0.4)	0.4))
Effective tax rate	(149.6)	(35.9))%)%

6. Liability for Unpaid Losses and Loss Adjustment Expenses

The following table represents a reconciliation of changes in the liability for unpaid losses and LAE.

	Six Months Ended	
	June 30,	
	2012	2011
	(in thousands)	
Unpaid losses and LAE, gross of reinsurance, at beginning of period	\$2,272,363	\$2,279,729
Less reinsurance recoverables for unpaid losses and LAE	940,840	956,043
Net unpaid losses and LAE at beginning of period	1,331,523	1,323,686
Losses and LAE, net of reinsurance, related to:		
Current period	176,145	131,885
Prior periods	1,054	467
Total net losses and LAE incurred during the period	177,199	132,352
Deduct payments for losses and LAE, net of reinsurance, related to:		
Current period	18,520	15,367
Prior periods	128,460	121,694
Total net payments for losses and LAE during the period	146,980	137,061
Ending unpaid losses and LAE, net of reinsurance	1,361,742	1,318,977
Reinsurance recoverable for unpaid losses and LAE	920,047	936,554
Unpaid losses and LAE, gross of reinsurance, at end of period	\$2,281,789	\$2,255,531

Total net losses and LAE included in the above table excludes the impact of the amortization of the deferred reinsurance gain—LPT Agreement (Deferred Gain) (Note 7).

The increase in the estimates of incurred losses and LAE attributable to insured events for prior periods was entirely related to the Company's assigned risk business.

7. LPT Agreement

The Company is party to a 100% quota share retroactive reinsurance agreement (LPT Agreement) under which \$1.5 billion in liabilities for losses and LAE related to claims incurred by EICN prior to July 1, 1995 were reinsured for consideration of \$775.0 million. The LPT Agreement provides coverage up to \$2.0 billion. The initial Deferred Gain resulting from the LPT Agreement was recorded as a liability in the accompanying consolidated balance sheets and is being amortized using the recovery method, whereby the amortization is determined by the proportion of actual reinsurance recoveries to total estimated recoveries. The Company amortized \$8.0 million and \$8.8 million of the Deferred Gain for the six months ended June 30, 2012 and 2011, respectively. Any adjustments to the Deferred Gain are recorded in losses and LAE incurred in the accompanying consolidated statements of comprehensive income. No adjustments occurred in the current period. The remaining Deferred Gain was \$345.2 million and \$353.2 million as of June 30, 2012 and December 31, 2011, respectively, and is included in the accompanying consolidated balance sheets. The estimated remaining liabilities subject to the LPT Agreement were \$789.3 million and \$807.5 million as of June 30, 2012 and December 31, 2011, respectively. Losses and LAE paid with respect to the LPT Agreement totaled

\$588.2 million and \$569.9 million through June 30, 2012 and December 31, 2011, respectively.

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8. Accumulated Other Comprehensive Income, net

Accumulated other comprehensive income is comprised of unrealized gains on investments classified as available-for-sale, net of deferred tax expense. The following table summarizes the components of accumulated other comprehensive income, net:

	June 30, 2012 (in thousands)	December 31, 2011
Net unrealized gain on investments, before taxes	\$ 192,056	\$ 179,567
Deferred tax expense on net unrealized gains	(67,220	) (62,848
Total accumulated other comprehensive income, net	\$ 124,836	\$ 116,719

9. Stock-Based Compensation

The Company awarded stock options, restricted stock units (RSUs) and performance share awards (PSAs) to certain officers and Directors of the Company as follows:

	Number Awarded	Fair Value on Date of Grant	Exercise Price	Aggregate Fair Value on Date of Grant (in millions)
March 2012				
Stock options ⁽¹⁾	242,300	\$5.64	\$17.02	\$1.4
Restricted stock units ⁽¹⁾	79,450	17.02	—	1.4
Performance share awards ⁽²⁾	158,900	17.02	—	2.7
May 2012				
Restricted stock units ⁽¹⁾	36,355	17.40	—	0.6

The stock options and RSUs were awarded to certain officers of the Company and have a service vesting period of four years after the date awarded and vest 25% on each of the subsequent four anniversaries of the grant date. The stock options and RSUs are subject to accelerated vesting in certain circumstances, such as: death or disability, or in connection with change of control of the Company. The stock options expire seven years from the date of grant. The RSUs awarded in May 2012 include 27,584 RSUs granted to non-employee Directors of the Company that have a service vesting period of one year from the date awarded.

The PSAs have a performance period of three years and are subject to certain performance goals, based on the Company's statutory combined ratio, with payouts that range from 0% to 200% of the target awards.

A total of 25,944 and 92,646 stock options were exercised during the six months ended June 30, 2012 and the year ended December 31, 2011, respectively.

10. Earnings Per Share

Basic earnings per share includes no dilution and is computed by dividing income applicable to stockholders by the weighted average number of shares outstanding for the period. Diluted earnings per share reflects the potential dilutive impact of all convertible securities on earnings per share. Diluted earnings per share includes shares assumed issued under the “treasury stock method,” which reflects the potential dilution that would occur if outstanding options were to be exercised. The following table presents the net income and the weighted average shares outstanding used in the earnings per common share calculations.

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2012	2011	2012	2011
	(in thousands, except share data)			
Net income available to stockholders—basic and diluted	\$5,006	\$8,251	\$11,228	\$16,596
Weighted average number of shares outstanding—basic	31,537,452	38,468,113	32,093,328	38,570,576
Effect of dilutive securities:				
Performance share awards	20,229	—	8,975	—
Stock options	82,385	75,880	87,747	84,941
Restricted stock units	45,570	52,320	52,541	66,507
Dilutive potential shares	148,184	128,200	149,263	151,448
Weighted average number of shares outstanding—diluted	31,685,636	38,596,313	32,242,591	38,722,024

Diluted earnings per share exclude outstanding options and other common stock equivalents in periods where the inclusion of such options and common stock equivalents would be anti-dilutive. The following table presents options and RSUs that were excluded from diluted earnings per share.

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2012	2011	2012	2011
Options excluded as the exercise price was greater than the average market price	934,597	1,041,836	934,597	1,041,836
Options and RSUs excluded under the treasury method, as the potential proceeds on settlement or exercise price was greater than the value of shares acquired	654,123	453,810	555,084	453,810

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

You should read the following discussion and analysis in conjunction with our consolidated financial statements and the related notes thereto included in Item 1 of Part I. Unless otherwise indicated, all references to "we," "us," "our," "the Company" or similar terms refer to Employers Holdings, Inc. (EHI), together with its subsidiaries. The information contained in this quarterly report is not a complete description of our business or the risks associated with an investment in our common stock. We urge you to carefully review and consider the various disclosures made by us in this quarterly report and in our other reports filed with the Securities and Exchange Commission (SEC), including our Annual Report on Form 10-K for the year ended December 31, 2011 (Annual Report).

The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements if accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those discussed. You should not place undue reliance on these statements, which speak only as of the date of this report. Forward-looking statements include those related to our expected financial position, business, financing plans, litigation, future premiums, revenues, earnings, pricing, investments, business relationships, expected losses, loss reserves, acquisitions, competition, rate increases with respect to our business, and the insurance industry in general. Statements including words such as "expect," "intend," "plan," "believe," "estimate," "may," "anticipate," similar statements of a future or forward-looking nature identify forward-looking statements.

We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events, or otherwise, except as required by law. All forward-looking statements address matters that involve risks and uncertainties that could cause actual results to differ materially from historical or anticipated results, depending on a number of factors. These risks and uncertainties include, but are not limited to, those described in our Annual Report and other documents that we have filed with the SEC.

Overview

We are a Nevada holding company. Through our insurance subsidiaries, we provide workers' compensation insurance coverage to select, small businesses in low to medium hazard industries. Workers' compensation insurance is provided under a statutory system wherein most employers are required to provide coverage for their employees' medical, disability, vocational rehabilitation, and/or death benefit costs for work-related injuries or illnesses. We provide workers' compensation insurance in 31 states and the District of Columbia, with a concentration in California, where over one-half of our business is generated. Our revenues are primarily comprised of net premiums earned, net investment income, and net realized gains on investments.

We target small businesses, as we believe that this market is traditionally characterized by fewer competitors, more attractive pricing, and stronger persistency when compared to the U.S. workers' compensation insurance industry in general. We believe we are able to price our policies at levels that are competitive and profitable over the long-term. Our underwriting approach is to consistently underwrite small business accounts at appropriate and competitive prices without sacrificing long-term profitability and stability for short-term top-line revenue growth.

Our goal is to maintain our focus on disciplined underwriting and to continue to pursue profitable growth opportunities across market cycles; however, we continue to be affected by the impacts of the 2008-2009 recession. The pace of recovery remains persistently slow and, although total employment and payroll are increasing, we do not believe overall economic conditions will change significantly in the near-term.

We market and sell our workers' compensation insurance products through independent local, regional, and national agents and brokers; through our strategic partnerships and alliances, including our principal partners ADP, Inc. and Anthem Blue Cross of California; and through relationships with national and regional trade groups and associations, including the National Federation of Independent Business.

Results of Operations

Overall, net income was \$5.0 million and \$11.2 million for the three and six months ended June 30, 2012, respectively, compared to \$8.3 million and \$16.6 million for the corresponding periods of 2011. We recognized underwriting losses of \$15.8 million and \$33.3 million for the three and six months ended June 30, 2012, respectively, compared to underwriting losses of \$14.3 million and \$28.2 million for the same periods of 2011. Underwriting income or loss is determined by deducting losses and LAE, commission expense, policyholder dividends, and underwriting and other operating expenses from net premiums earned. Key factors that affected our financial

performance during the three and six months ended June 30, 2012, compared to the same period of 2011, include:

• Gross premiums written increased 42% and 40%;

• Net premiums earned increased 35% and 34%;

• Losses and LAE increased 38% and 37%;

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Underwriting and other operating expenses increased 13% and 19%; and
 Income tax benefit increased to \$2.3 million and \$6.7 million during the three and six months ended June 30, 2012, respectively, compared to \$2.0 million and \$4.4 million for the corresponding periods of 2011.
 Additionally, the Financial Accounting Standards Board issued guidance that, beginning in 2012, changed the definition of policy acquisition costs which may be capitalized. Our underwriting and other operating expenses increased \$2.2 million and \$5.2 million during the three and six months ended June 30, 2012 as a result of this change (see Note 2 in the Notes to Consolidated Financial Statements for additional information). We expect that the total impact for 2012 will be approximately \$7 million in increased underwriting and other operating expenses.
 We measure our performance by our ability to increase stockholders' equity, including the impact of the deferred reinsurance gain—LPT Agreement (Deferred Gain), over the long-term. The following table shows our stockholders' equity including the Deferred Gain, stockholders' equity on a GAAP basis, and number of common shares outstanding at:

	June 30, 2012	December 31, 2011
	(in thousands, except share data)	
Stockholders' equity including the Deferred Gain ⁽¹⁾	\$799,861	\$827,380
GAAP stockholders' equity	\$454,651	\$474,186
Common shares outstanding	30,947,550	32,996,809

⁽¹⁾ Stockholders' equity, including the Deferred Gain, is a non-GAAP measure that is defined as total stockholders' equity plus the Deferred Gain, which we believe is an important supplemental measure of our capital position. The comparative components of net income are set forth in the following table:

	Three Months Ended		Six Months Ended	
	June 30,	2011	June 30,	2011
	(in thousands)			
Gross premiums written	\$153,094	\$107,830	\$295,888	\$211,057
Net premiums written	\$150,364	\$105,566	290,728	206,692
Net premiums earned	\$118,955	\$88,128	\$228,855	\$170,555
Net investment income	18,297	20,306	36,682	40,799
Realized gains on investments	945	1,102	2,723	1,336
Other income	114	3	195	123
Total revenues	138,311	109,539	268,455	212,813
Losses and LAE	88,293	64,150	169,216	123,571
Commission expense	16,147	11,119	29,676	21,400
Policyholder dividends	803	914	1,650	1,926
Underwriting and other operating expenses	29,513	26,200	61,655	51,878
Interest expense	858	908	1,760	1,825
Income tax benefit	(2,309)	(2,003)	(6,730)	(4,383)
Total expenses	133,305	101,288	257,227	196,217
Net income	\$5,006	\$8,251	\$11,228	\$16,596
Less impact of the Deferred Gain	\$3,828	\$4,262	\$7,984	\$8,782
Net income before impact of the Deferred Gain ⁽¹⁾	\$1,178	\$3,989	\$3,244	\$7,814

⁽¹⁾ We define net income before impact of the Deferred Gain as net income less: (a) amortization of Deferred Gain and (b) adjustments to LPT Agreement ceded reserves. Deferred Gain reflects the unamortized gain from our LPT Agreement. Under GAAP, this gain is deferred and is being amortized using the recovery method, whereby the amortization is determined by the proportion of actual reinsurance recoveries to total estimated recoveries, and the amortization is reflected in losses and LAE. We periodically reevaluate the remaining direct reserves subject to the

LPT Agreement. Our reevaluation results in corresponding adjustments, if needed, to reserves, ceded reserves, reinsurance recoverables, and the Deferred Gain, with the net effect being an increase or decrease, as the case may be, to net income. Net income before impact of the Deferred Gain is not a measurement of financial performance under GAAP, but rather reflects the difference in accounting treatment between statutory and GAAP, and should not be considered in isolation or as an alternative to net income before income taxes, net income, or any other measure of performance derived in accordance with GAAP.

We present net income before impact of the Deferred Gain because we believe that it is an important supplemental measure of operating performance to be used by analysts, investors and other interested parties in evaluating us. The LPT Agreement was a non-recurring transaction and the Deferred Gain does not result in ongoing cash benefits. Consequently, we believe this presentation is useful in providing a meaningful understanding of our operating performance. In addition, we believe this non-GAAP measure, as we have defined it, is helpful to our management in identifying trends in our performance because the excluded item has limited significance on our current and ongoing operations.

Net Premiums Earned

Net premiums earned increased 35.0% and 34.2% for the three and six months ended June 30, 2012, compared to the corresponding periods in 2011. These increases are primarily due to increasing policy count as we continue to execute our strategy.

The following table shows the percentage change in our in-force premium, policy count, average policy size, payroll exposure upon which our premiums are based, and net rate.

	As of June 30, 2012	
	Year-to-Date Increase	Year-Over-Year Increase (Decrease)
In-force premiums	20.9	% 37.2
In-force policy count	18.6	38.3
Average in-force policy size	1.9	(0.8)
In-force payroll exposure	16.1	32.2
Net rate ⁽¹⁾	4.1	3.8

Net rate, defined as total premium in-force divided by total insured payroll exposure, is a function of a variety of (1) factors, including rate changes, underwriting risk profiles and pricing, and changes in business mix related to economic and competitive pressures.

Our in-force premiums and number of policies in-force by select states were as follows:

State	June 30, 2012		December 31, 2011		June 30, 2011		December 31, 2010	
	Premiums In-force	Policies In-force	Premiums In-force	Policies In-force	Premiums In-force	Policies In-force	Premiums In-force	Policies In-force
	(dollars in thousands)							
California	\$274,379	42,577	\$221,910	36,867	\$191,684	32,987	\$172,621	29,244
Illinois	28,816	3,125	24,744	2,433	22,690	1,574	18,617	932
Georgia	19,882	2,628	16,393	2,050	12,915	1,387	10,772	757
Florida	16,909	2,723	15,226	2,399	14,885	2,212	15,071	1,963
Nevada	15,748	3,845	14,639	3,718	15,932	3,622	16,940	3,596
Other	120,473	17,073	101,009	13,226	89,067	10,256	87,116	8,069
Total	\$476,207	71,971	\$393,921	60,693	\$347,173	52,038	\$321,137	44,561

Our strategic partnerships and alliances generated \$109.5 million and \$80.5 million, or 23.0% and 23.2%, of our in-force premiums as of June 30, 2012 and 2011, respectively. We believe that the bundling of products and services through these relationships contributes to higher retention rates than business generated by our independent agents. These relationships also allow us to access new customers that we may not have access to through our independent agent distribution channel. We continue to expand our existing relationships and actively seek new partnerships and alliances.

In April 2011, the Workers' Compensation Insurance Rating Bureau (WCIRB) of California provided an informational filing highlighting the cost drivers that indicated a cumulative 39.8% increase in the claims cost benchmark since January 1, 2009 based on an analysis of December 31, 2010 loss experience. This included deterioration of more than 12 percentage points in the claims cost benchmark since the WCIRB's previous recommendation for a 27.7% increase based on an analysis of June 30, 2010 loss experience. The WCIRB indicated that this further deterioration was due to: (a) continued adverse loss development on the 2009 accident year; (b) high emerging costs on the 2010 accident year, primarily due to increased claims frequency; (c) less optimistic forecasts for statewide wage growth in

California; and (d) increased LAE that is likely as a result of certain Workers' Compensation Appeals Board decisions.

In August 2011, the WCIRB modified its benchmark for pure premium rates. The WCIRB's pure premium rate filings are now based on the industry average filed pure premium rate, rather than the pure premium rate approved by the California Commissioner of Insurance. The WCIRB submitted its benchmark for the proposed advisory pure premium rate to be effective January 1, 2012. The WCIRB noted that while 2012 projected claims costs continue to be below pre-reform highs and the proposed pure premium rate was slightly less than the industry average filed rate, these rates reflected significant deterioration in projected losses and LAE and less optimistic economic forecasts, compared to the prior year.

In April 2012, the WCIRB submitted its pure premium rate filing recommending an increase in advisory pure premium rates to be effective July 1, 2012. That filing proposed a 4.1% increase over the industry average filed pure premium rate as of January 1, 2012. The filing was based on an analysis of December 31, 2011 experience and reflects increased loss development on the 2010 and 2011 accident years, increased LAE, and lower forecasts of wage growth in California for 2012 and 2013.

We set our own premium rates in California based upon actuarial analyses of current and anticipated loss trends with a goal of maintaining underwriting profitability. Due to increasing loss costs, primarily medical cost inflation, we have increased our filed premium rates in California by a cumulative 41.3% since February 1, 2009.

The following table sets forth the percentage increases to our filed California rates effective for new and renewal policies incepting on or after the dates shown.

Effective Date	Premium Rate Change Filed in California	%
February 1, 2009	10.0	
August 15, 2009	10.5	
March 15, 2010	3.0	
March 15, 2011	2.5	
September 15, 2011	3.9	
June 15, 2012	6.0	

We expect that total premiums in 2012 across our markets will continue to reflect:

- overall rate increases;
- increasing policy count as we continue to execute our strategy;
- increasing average policy size; and
- lessened competitive pressures.

Net Investment Income and Realized Gains on Investments

We invest our holding company assets, statutory surplus, and the funds supporting our insurance liabilities, including unearned premiums and unpaid losses and LAE. We invest in fixed maturity securities, equity securities, and cash equivalents. Net investment income includes interest and dividends earned on our invested assets and amortization of premiums and discounts on our fixed maturity securities, less bank service charges and custodial and portfolio management fees. We have established a high quality/short duration bias in our investment portfolio.

Net investment income decreased 9.9% and 10.1% for the three and six months ended June 30, 2012, respectively, compared to the corresponding periods of 2011. The decrease was primarily related to decreases in the average pre-tax book yield on invested assets to 3.7% for the three and six months ended June 30, 2012, compared to 4.2% for the same periods of 2011. The tax-equivalent yield on invested assets decreased to 4.8% at June 30, 2012, compared to 5.2% at June 30, 2011.

Realized gains and losses on our investments are reported separately from our net investment income. Realized gains and losses on investments include the gain or loss on a security at the time of sale compared to its original or adjusted cost (equity securities) or amortized cost (fixed maturity securities). Realized losses are also recognized when securities are written down as a result of an other-than-temporary impairment.

Net realized gains on investments were \$0.9 million and \$2.7 million for the three and six months ended June 30, 2012, respectively, compared to \$1.1 million and \$1.3 million for the corresponding periods of 2011.

Additional information regarding our Investments is set forth under “—Liquidity and Capital Resources—Investments.”

Combined Ratio

The combined ratio, expressed as a percentage, is a key measurement of underwriting profitability. The combined ratio is the sum of the loss and LAE ratio, the commission expense ratio, policyholder dividends ratio, and underwriting and other operating expenses ratio. When the combined ratio is below 100%, we have recorded underwriting income, and conversely, when the combined ratio is greater than 100%, we cannot be profitable without investment income. Because we only have one operating segment, holding company expenses are included in our calculation of the combined ratio.

The following table provides the calculation of our calendar year combined ratios.

	Three Months Ended		Six Months Ended		
	June 30,		June 30,		
	2012	2011	2012	2011	
Loss and LAE ratio	74.2	% 72.8	% 73.9	% 72.5	%
Underwriting and other operating expenses ratio	24.8	29.8	27.0	30.4	
Commission expense ratio	13.6	12.6	13.0	12.5	
Policyholder dividends ratio	0.7	1.0	0.7	1.1	
Combined ratio	113.3	% 116.2	% 114.6	% 116.5	%

Loss and LAE Ratio. Expressed as a percentage, this is the ratio of losses and LAE to net premiums earned.

Losses and LAE represents our largest expense item and includes claim payments made, amortization of the Deferred Gain, estimates for future claim payments and changes in those estimates for current and prior periods, and costs associated with investigating, defending, and adjusting claims. The quality of our financial reporting depends in large part on accurately predicting our losses and LAE, which are inherently uncertain as they are estimates of the ultimate cost of individual claims based on actuarial estimation techniques.

In California, we are experiencing an increase in indemnity claims frequency (the number of claims expressed as a percentage of payroll). Our loss experience also indicates an upward trend in medical and indemnity costs that are reflected in our current accident year loss estimate. We are also seeing increased medical and indemnity costs in many of our other states, partially offset by continuing favorable loss cost trends in Nevada. We believe our current accident year loss estimate is adequate; however, ultimate losses will not be known with any certainty for many years. We assume that increasing medical and indemnity cost trends will continue to impact our long-term claims costs and current accident year loss estimate.

Overall, losses and LAE increased 37.6% and 36.9% for the three and six months ended June 30, 2012, respectively, compared to the corresponding periods of 2011. These increases were primarily due to increases in net earned premiums. Prior accident year loss development in both periods was entirely related to our assigned risk business. Our current accident year loss estimate was 77.0% for the three and six months ended June 30, 2012, compared to 78.0% and 77.3% for the same periods of 2011.

Excluding the impact from the LPT Agreement, losses and LAE would have been \$92.1 million and \$68.4 million, or 77.4% and 77.6% of net premiums earned, for the three months ended June 30, 2012 and 2011, respectively. For the six months ended June 30, 2012 and 2011, losses and LAE would have been \$177.2 million and \$132.4 million, or 77.4% and 77.6% of net premiums earned, respectively.

The table below reflects the losses and LAE reserve adjustments.

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2012	2011	2012	2011
	(in millions)		(in millions)	
Prior accident year loss development, net	\$(0.5	) \$0.4	\$(1.1	) \$(0.5
LPT amortization of the deferred reinsurance gain	\$3.8	\$4.3	\$8.0	\$8.8

Underwriting and Other Operating Expenses Ratio. The underwriting and other operating expenses ratio is the ratio (expressed as a percentage) of underwriting and other operating expenses to net premiums earned and measures an insurance company's operational efficiency in producing, underwriting, and administering its insurance business.

Underwriting and other operating expenses are those costs that we incur to underwrite and maintain the insurance policies we issue, excluding commission. These expenses include premium taxes and certain other general expenses that vary with, and are primarily related to, producing new or renewal business. Other underwriting expenses include changes in estimates of future write-offs of premiums receivable, general administrative expenses such as salaries and benefits, rent, office supplies, depreciation, and all other operating expenses not otherwise classified separately. Policy acquisition costs are variable based on premiums earned; however, other operating costs are more fixed in nature and become a smaller percentage of net premiums earned as premiums increase.

Our underwriting and other operating expenses ratio decreased 5.0 percentage points and 3.4 percentage points for the three and six months ended June 30, 2012, compared to the same periods of 2011, primarily due to net premiums earned increasing at a faster rate than our expenses during these periods.

Underwriting and other operating expenses increased 12.6% for the three months ended June 30, 2012, compared to the same period of 2011. During the three months ended June 30, 2012, compensation related expenses increased \$0.9 million, bad debt expense increased \$0.6 million, and our premium taxes and assessments increased \$0.4 million, partially offset by a \$0.6 million decrease in professional services fees, compared to the same period of 2011.

Our underwriting and other operating expenses increased 18.8% for the six months ended June 30, 2012, compared to the same period of 2011. During the six months ended June 30, 2012, compensation related expenses increased \$2.0 million, bad debt expense increased \$1.3 million, and our premium taxes and assessments increased \$1.2 million, compared to the same period of 2011.

Additionally, implementation of the new accounting guidance for deferred policy acquisition costs resulted in a \$2.2 million and \$5.2 million increase in our underwriting and other operating expenses for the three and six months ended June 30, 2012, respectively. Excluding the impact of this new guidance, underwriting and other operating expenses would have increased 4.4% and 8.9% for the three and six months ended June 30, 2012, respectively, compared to the same periods of 2011.

Commission Expense Ratio. The commission expense ratio is the ratio (expressed as a percentage) of commission expense to net premiums earned and measures the cost of compensating agents and brokers for the business we have underwritten.

Commission expense includes direct commissions to our agents and brokers for the premiums that they produce for us, as well as incentive payments, other marketing costs, and fees. Commission expense is net of contingent profit commission income related to the LPT Agreement.

Commission expense increased 45.2% and 38.7% for the three and six months ended June 30, 2012, respectively, compared to the corresponding periods of 2011, primarily due to higher net premiums earned in 2012 and higher agency incentive commissions due to increased agent production through the second quarter of 2012 compared to the same period of 2011.

Policyholder Dividends Ratio. The policyholder dividends ratio is the ratio (expressed as a percentage) of the policyholder dividends to net premiums earned and measures the cost of returning premium to policyholders in the form of dividends.

In administered pricing states such as Florida and Wisconsin, insurance rates are set by state insurance regulators. Rate competition generally is not permitted and policyholder dividend programs are an important competitive factor in these states. We offer dividend programs to eligible policyholders, under which a portion of the policyholders' premium may be returned in the form of dividends.

Policyholder dividends were \$0.8 million and \$1.7 million for the three and six months ended June 30, 2012, respectively, compared to \$0.9 million and \$1.9 million for the corresponding periods of 2011. Policyholder dividends may fluctuate from time to time due to changes in premium levels on dividend policies and the eligibility of policyholders to receive dividend payments.

Income Tax Benefit

Income tax benefit was \$2.3 million and \$6.7 million for the three and six months ended June 30, 2012, respectively, compared to \$2.0 million and \$4.4 million for the corresponding periods of 2011. The effective tax rates were (85.6)% and (149.6)% for the three and six months ended June 30, 2012, respectively, compared to (32.1)% and (35.9)% for the same periods of 2011. The increased tax benefits were primarily due to increases in tax exempt interest income as

a percentage of pretax net income to approximately 228% and 278% for the three and six months ended June 30, 2012, compared to 128% and 133% for the corresponding periods of 2011.

Liquidity and Capital Resources

Parent Company

Operating Cash and Cash Equivalents. We are a holding company and our ability to fund our operations is contingent upon existing capital and our insurance subsidiaries and their ability to pay dividends up to the holding company.

Payment of dividends by our insurance subsidiaries is restricted by state insurance laws, including laws establishing minimum solvency and liquidity thresholds. We require cash to pay stockholder dividends, repurchase common stock, make interest and principal payments on our

outstanding debt obligations, provide additional surplus to our insurance subsidiaries, and fund our operating expenses.

Based on our current growth projections, we expect to make a capital contribution to our operating subsidiaries of up to \$70 million in the third quarter of 2012 to maintain the financial strength ratings of our operating subsidiaries. The holding company had \$134.9 million of cash and cash equivalents and fixed maturity securities maturing within the next 24 months at June 30, 2012. Ten million dollars of our line of credit is payable on each of December 31, 2012 and 2013. We believe that the liquidity needs of the holding company over the next 24 months will be met with cash, maturing investments, and dividends from our insurance subsidiaries.

Share Repurchases. In November 2010, the EHI Board of Directors (Board of Directors) authorized a share repurchase program for repurchases of up to \$100 million of the Company's common stock from November 8, 2010 through June 30, 2012 (the 2011 Program). In November 2011, the Board of Directors authorized a \$100 million expansion of the 2011 Program, to \$200 million, and extended the repurchase authority pursuant to the 2011 Program through June 30, 2013. Repurchases under the 2011 Program may be commenced or suspended from time-to-time without prior notice, and the 2011 Program may be suspended or discontinued at any time. From inception of the 2011 Program through June 30, 2012, we repurchased a total of 9,174,743 shares of common stock at an average price of \$15.73 per share, including commissions, for a total of \$144.4 million.

Outstanding Debt. In December 2010, we entered into the Third Amended and Restated Credit Agreement with Wells Fargo (Amended Credit Facility) under which we were provided with: (a) \$100.0 million line of credit through December 31, 2011; (b) \$90.0 million line of credit from January 1, 2012 through December 31, 2012; (c) \$80.0 million line of credit from January 1, 2013 through December 31, 2013; (d) \$70.0 million line of credit from January 1, 2014 through December 31, 2014; and (e) \$60.0 million line of credit from January 1, 2015 through December 31, 2015. Amounts outstanding bear interest at a rate equal to, at our option: (a) a fluctuating rate of 1.75% above prime rate or (b) a fixed rate that is 1.75% above the LIBOR rate then in effect. The Amended Credit Facility is secured by fixed maturity securities and restricted cash and cash equivalents that had a fair value of \$114.5 million and \$126.7 million at June 30, 2012 and December 31, 2011, respectively. The Amended Credit Facility contains customary non-financial covenants and requires us to maintain \$5.0 million of cash and cash equivalents at all times at the holding company. We are currently in compliance with all applicable covenants.

Our capital structure is comprised of outstanding debt and stockholders' equity. As of June 30, 2012, our capital structure consisted of \$90.0 million principal balance on our Amended Credit Facility, \$32.0 million in surplus notes maturing in 2034, and \$799.9 million of stockholders' equity, including the Deferred Gain. Outstanding debt was 13.2% of total capitalization, including the Deferred Gain, as of June 30, 2012.

Operating Subsidiaries

Operating Cash and Cash Equivalents. The primary sources of cash for our insurance operating subsidiaries are funds generated from underwriting operations, investment income, maturities and sales of investments, and capital contribution from the parent holding company. The primary uses of cash are payments of claims and operating expenses, purchases of investments, and payments of dividends to the parent holding company, which are subject to state insurance laws and regulations.

Our insurance subsidiaries had \$319.2 million of cash and cash equivalents and fixed maturity securities maturing within the next 24 months at June 30, 2012. We believe that our subsidiaries' liquidity needs over the next 24 months will be met with cash from operations, investment income, and maturing investments.

We purchase reinsurance to protect us against the costs of severe claims and catastrophic events. On July 1, 2012, we entered into a new reinsurance program that is effective through June 30, 2013. The reinsurance program consists of one treaty covering excess of loss and catastrophic loss events in five layers of coverage. Our reinsurance coverage is \$195 million in excess of our \$5.0 million retention on a per occurrence basis, subject to a \$2.0 million annual aggregate deductible and certain exclusions. We believe that our reinsurance program meets our needs and that we are sufficiently capitalized.

Various state regulations require us to keep securities or letters of credit on deposit with the states in which we do business. Securities having a fair value of \$528.4 million and \$522.6 million were on deposit at June 30, 2012 and December 31, 2011, respectively. These laws and regulations govern both the amount and types of fixed maturity

securities that are eligible for deposit. Additionally, certain reinsurance contracts require Company funds to be held in trust for the benefit of the ceding reinsurer to secure the outstanding liabilities we assumed. The fair value of securities held in trust for reinsurance was \$34.4 million and \$40.3 million at June 30, 2012 and December 31, 2011, respectively.

Cash Flows

We monitor cash flows at both the consolidated and subsidiary levels. We use trend and variance analyses to project future cash needs, making adjustments to our forecasts as appropriate.

The table below shows our net cash flows for the six months ended:

	June 30, 2012	2011
	(in thousands)	
Cash and cash equivalents provided by (used in):		
Operating activities	\$54,361	\$12,712
Investing activities	(56,447	) 94,254
Financing activities	(41,423	) (24,909
(Decrease) increase in cash and cash equivalents	\$(43,509	) \$82,057

Operating Activities. Major components of net cash provided by operating activities for the six months ended June 30, 2012 included net premiums received of \$234.9 million, investment income received of \$40.3 million, and amounts recovered from reinsurers of \$20.7 million. These were partially offset by claims payments of \$166.6 million, underwriting and other operating expenses paid of \$48.2 million (including premium taxes paid of \$10.3 million), and commissions paid of \$22.6 million.

Major components of net cash provided by operating activities for the six months ended June 30, 2011 included net premiums received of \$166.3 million and investment income received of \$45.8 million. These were partially offset by claims payments of \$133.5 million and underwriting and other operating expenses paid of \$65.9 million.

Investing Activities. The major source of net cash used in investing activities for the six months ended June 30, 2012 was the purchase of fixed maturity and equity securities.

The major sources of net cash provided by investing activities for the six months ended June 30, 2011 included the sales, maturities, and redemptions of certain fixed maturity securities.

Financing Activities. The majority of cash used in financing activities for the six months ended June 30, 2012 and 2011 was to repurchase \$37.3 million and \$21.1 million, respectively, of our common stock, and to pay dividends to stockholders.

Investments

The cost or amortized cost of our investment portfolio was \$1.8 billion and the fair value was \$2.0 billion as of June 30, 2012.

We employ an investment strategy that emphasizes asset quality and considers the durations of fixed maturity securities against anticipated claim payments and expenditures, other liabilities, and capital needs. Our investment portfolio is structured so that investments mature periodically in reasonable relation to current expectations of future claim payments. Currently, we make claim payments from positive cash flow from operations and use excess cash to invest in operations, invest in marketable securities, return capital to our stockholders (through dividends and share repurchases), and fund growth.

As of June 30, 2012, our investment portfolio, which is classified as available-for-sale, consisted of 93.9% fixed maturity securities whose fair values may fluctuate due to interest rate changes. We strive to limit interest rate risk by managing the duration of our fixed maturity securities. Our fixed maturity securities (excluding cash and cash equivalents) had a duration of 4.1 at June 30, 2012. To minimize interest rate risk, our portfolio is weighted toward short-term and intermediate-term bonds; however, our investment strategy balances consideration of duration, yield, and credit risk. Our investment guidelines require that the minimum weighted average quality of our fixed maturity securities portfolio be "AA-." Our fixed maturity securities portfolio had a weighted average quality of "AA" as of June 30, 2012, with 68.0% of the portfolio rated "AA" or better, based on market value.

We carry our portfolio of equity securities on our balance sheet at fair value. We minimize our exposure to equity price risk by investing primarily in the equity securities of mid-to-large capitalization issuers and by diversifying our equity holdings across several industry sectors. Equity securities represented 6.1% of our investment portfolio at June 30, 2012.

Given current economic uncertainty and continuing market volatility, we believe that our asset allocation best meets our strategy to preserve capital for policyholders, to provide sufficient income to support insurance operations, and to effectively grow book value over a long-term investment horizon.

The following table shows the estimated fair value, the percentage of the fair value to total invested assets, and the average tax equivalent yield based on the fair value of each category of invested assets as of June 30, 2012.

Category	Estimated Fair Value	Percentage of Total	Yield	
	(in thousands, except percentages)			
U.S. Treasuries	\$150,778	7.5	% 2.6	%
U.S. Agencies	101,880	5.1	3.2	
States and municipalities	784,617	38.9	5.8	
Corporate securities	551,651	27.3	4.3	
Residential mortgage-backed securities	257,462	12.8	4.6	
Commercial mortgage-backed securities	30,574	1.5	3.9	
Asset-backed securities	15,686	0.8	3.2	
Equity securities	122,262	6.1	4.8	
Total	\$2,014,910	100.0	%	
Weighted average yield			4.8	%

The following table shows the percentage of total estimated fair value of our fixed maturity securities as of June 30, 2012 by credit rating category, using the lower of ratings assigned by Moody's Investor Services and/or Standard & Poor's.

Rating	Percentage of Total Estimated Fair Value	
"AAA"	10.4	%
"AA"	57.6	
"A"	20.8	
"BBB"	11.1	
Below investment grade	0.1	
Total	100.0	%

Investments that we currently own could be subject to default by the issuer or could suffer declines in fair value that become other-than-temporary. We regularly assess individual securities as part of our ongoing portfolio management, including the identification of other-than-temporary declines in fair value. Our other-than-temporary assessment includes reviewing the extent and duration of declines in fair value of investments below amortized cost, historical and projected financial performance and near-term prospects of the issuer, the outlook for industry sectors, credit rating, and macro-economic changes. We also make a determination as to whether it is not more likely than not that we will be required to sell the security before its fair value recovers above cost, or to maturity.

Based on our review of fixed maturity and equity securities, we believe that we appropriately identified the declines in the fair values of our unrealized losses at June 30, 2012. We determined that the unrealized losses on fixed maturity securities were primarily the result of prevailing interest rates and not the credit quality of the issuers. The fixed maturity securities whose fair value was less than amortized cost were not determined to be other-than-temporarily impaired given the severity and duration of the impairment, the credit quality of the issuers, the Company's intent to not sell the securities, and a determination that it is not more likely than not that the Company will be required to sell the securities until fair value recovers to above cost, or to maturity.

Based on reviews of the equity securities as of June 30, 2012, the Company recognized total impairments of \$0.5 million in the fair values of seven equity securities as a result of the severity and duration of the change in fair values of those securities.

The cost or amortized cost, gross unrealized gains, gross unrealized losses, and estimated fair value of our investments were as follows:

	Cost or Amortized Cost (in thousands)	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
June 30, 2012				
Fixed maturity securities				
U.S. Treasuries	\$ 136,989	\$ 13,797	\$(8)	\$ 150,778
U.S. Agencies	95,411	6,469	—	101,880
States and municipalities	716,929	68,054	(366)	784,617
Corporate securities	509,341	42,498	(188)	551,651
Residential mortgaged-backed securities	238,950	18,915	(403)	257,462
Commercial mortgaged-backed securities	29,615	959	—	30,574
Asset-backed securities	15,372	314	—	15,686
Total fixed maturity securities	1,742,607	151,006	(965)	1,892,648
Equity securities	80,247	43,281	(1,266)	122,262
Total investments	\$ 1,822,854	\$		