

TYLER TECHNOLOGIES INC  
Form 10-Q  
July 28, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

OR

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

Commission File Number 1-10485

TYLER TECHNOLOGIES, INC.

(Exact name of registrant as specified in its charter)

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

incorporation or organization) identification no.)

5101 TENNYSON PARKWAY

PLANO, TEXAS

75024

(Address of principal executive offices)

(Zip code)

(972) 713-3700

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer  Accelerated filer

Non-accelerated filer  Smaller Reporting Company

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

The number of shares of common stock of registrant outstanding on July 22, 2016 was 36,340,400.

## PART I. FINANCIAL INFORMATION

## ITEM 1. Financial Statements

## TYLER TECHNOLOGIES, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per share amounts)

(Unaudited)

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

See accompanying notes.

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## TYLER TECHNOLOGIES, INC.

## CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except par value and share amounts)

	June 30, 2016 (unaudited)	December 31, 2015
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$41,327	\$33,087
Accounts receivable (less allowance for losses of \$1,560 in 2016 and \$1,640 in 2015)	209,483	176,360
Short-term investments	22,642	13,423
Prepaid expenses	22,976	22,334
Income tax receivable	23,994	21,080
Other current assets	3,529	1,931
Total current assets	323,951	268,215
Accounts receivable, long-term	2,579	2,777
Property and equipment, net	115,886	101,112
Other assets:		
Goodwill	655,393	653,666
Other intangibles, net	285,491	295,378
Non-current investments and other assets	29,752	35,422
	\$1,413,052	\$1,356,570
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$6,574	\$6,789
Accrued liabilities	49,875	49,156
Deferred revenue	296,481	281,627
Total current liabilities	352,930	337,572
Revolving line of credit	135,000	66,000
Deferred revenue, long-term	3,704	3,115
Deferred income taxes	92,110	91,026
Commitments and contingencies		
Shareholders' equity:		
Preferred stock, \$10.00 par value; 1,000,000 shares authorized; none issued	—	—
Common stock, \$0.01 par value; 100,000,000 shares authorized; 48,147,969 shares issued and outstanding as of June 30, 2016 and December 31, 2015	481	481
Additional paid-in capital	605,179	607,755

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

See accompanying notes.

## TYLER TECHNOLOGIES, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

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

Cash and cash equivalents at end of period	\$41,327	\$204,103
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See accompanying notes.

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Tyler Technologies, Inc.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

(Tables in thousands, except per share data)

### (1) Basis of Presentation

We prepared the accompanying condensed consolidated financial statements following the requirements of the Securities and Exchange Commission (“SEC”) and accounting principles generally accepted in the United States, or GAAP, for interim reporting. As permitted under those rules, certain footnotes or other financial information that are normally required by GAAP can be condensed or omitted for interim periods. Balance sheet amounts are as of June 30, 2016 and December 31, 2015 and operating result amounts are for the three and six months ended June 30, 2016 and 2015, respectively, and include all normal and recurring adjustments that we considered necessary for the fair summarized presentation of our financial position and operating results. As these are condensed financial statements, one should also read the financial statements and notes included in our latest Form 10-K for the year ended December 31, 2015. Revenues, expenses, assets and liabilities can vary during each quarter of the year. Therefore, the results and trends in these interim financial statements may not be the same as those for the full year.

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

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

### (2) Acquisitions

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

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

### (3) Other Assets

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

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

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

#### (4) Shareholders' Equity

The following table details activity in our common stock:

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

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

#### (5) Revolving Line of Credit

On November 16, 2015, we entered into a \$300.0 million Credit Agreement (the “Credit Facility”) with the various lenders party thereto and Wells Fargo Bank, National Association, as Administrative Agent. The Credit Facility provides for a revolving credit line up to \$300.0 million, including a \$10.0 million sublimit for letters of credit. The Credit Facility matures on November 16, 2020. Borrowings under the Credit Facility may be used for general corporate purposes, including working capital requirements, acquisitions and share repurchases.

Borrowings under the Credit Facility bear interest at a rate of either (1) Wells Fargo Bank’s prime rate (subject to certain higher rate determinations) plus a margin of 0.25% to 1.00% or (2) the 30, 60, 90 or 180 day LIBOR rate plus a margin of 1.25% to 2.00%. As of June 30, 2016, our interest rate was 1.7%. The Credit Facility is secured by substantially all of our assets. The Credit Facility requires us to maintain certain financial ratios and other financial conditions and prohibits us from making certain investments, advances, cash dividends or loans, and limits incurrence of additional indebtedness and liens. As of June 30, 2016, we were in compliance with those covenants.

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

#### (6) Income Tax Provision

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

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

#### (7) Earnings Per Share

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

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

For the three and six months ended June 30, 2016, stock options representing the right to purchase common stock of approximately 708,000 shares and 735,000 shares, respectively, were not included in the computation of diluted earnings per share because their inclusion would have had an anti-dilutive effect. For the three and six months ended June 30, 2015, stock options representing the right to purchase common stock of approximately 492,000 shares and 570,000 shares, respectively, were not included in the computation of diluted earnings per share because their inclusion would have had an anti-dilutive effect.

## (8) Share-Based Compensation

The following table summarizes share-based compensation expense related to share-based awards recorded in the statements of income, pursuant to Accounting Standards Codification (“ASC”) 718, Stock Compensation:

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

## (9) Segment and Related Information

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

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

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

In accordance with ASC 280-10, Segment Reporting, the financial management, education and planning, regulatory and maintenance software solutions unit; financial management, municipal courts, planning, regulatory and maintenance, and land and vital records management software solutions unit; and the courts and justice and public safety software solutions unit meet the criteria for aggregation and are presented in one reportable segment, Enterprise Software Solutions (“ESS”). The ESS segment provides municipal and county governments and schools with software systems and services to meet their information technology and automation needs for mission-critical “back-office” functions such as financial management and courts and justice processes. The Appraisal and Tax Software Solutions and Services (“ATSS”) segment provides systems and software that automate the appraisal and assessment of real and personal property as well as property appraisal outsourcing services for local governments and taxing authorities. Property appraisal outsourcing services include: the physical inspection of commercial and residential properties; data collection and processing; computer analysis for property valuation; preparation of tax rolls; community education; and arbitration between taxpayers and the assessing jurisdiction.

We evaluate performance based on several factors, of which the primary financial measure is business segment operating income. We define segment operating income for our business units as income before non-cash amortization of intangible assets associated with their acquisition, interest expense and income taxes. Segment operating income includes intercompany transactions. The majority of intercompany transactions relate to contracts involving more than one unit and are valued based on the contractual arrangement. Segment operating income for corporate primarily consists of compensation costs for the executive management team and certain accounting and administrative staff and share-based compensation expense for the entire company. Corporate segment operating income also includes revenues and expenses related to a company-wide user conference.



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For the three months ended June 30, 2016

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