TYLER TECHNOLOGIES INC
Form 10-Q
July 28, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.
For the quarterly period ended 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 incorporation or organization)	(I.R.S. employer 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 x 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 x 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	x	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 x

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

See accompanying notes.

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TYLER TECHNOLOGIES, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except par value and share amounts)

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

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.

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TYLER TECHNOLOGIES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

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

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

See accompanying notes.

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Tyler Technologies, Inc.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

(Tables in thousands, except per share data)

(1) Basis of Presentation

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

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

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

(2) Acquisitions

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

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

(3) Other Assets

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

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

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

(4) Shareholders' Equity

The following table details activity in our common stock:

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

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

(5) Revolving Line of Credit

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

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

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

(6) Income Tax Provision

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

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

(7) Earnings Per Share

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

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

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

(8) Share-Based Compensation

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

	Three months ended June 30,		Six months 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.

For the three months ended June 30, 2016

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

For the six months ended June 30, 2016

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

For the three months ended June 30, 2015

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

For the six months ended June 30, 2015

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

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

(10) Commitments and Contingencies

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

(11) New Accounting Pronouncements

Revenue from Contracts with Customers. On May 28, 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, "Revenue from Contracts with Customers." This ASU is the result of a convergence project between the FASB and the International Accounting Standards Board. The core principle behind ASU 2014-09 is that an entity should recognize revenue to depict the transfer of promised goods and services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for delivering those goods and services. This model involves a five-step process that includes identifying the contract with the customer, identifying the performance obligations in the contract, determining the transaction price, allocating the transaction prices to the performance obligations in the contract and recognizing revenue when (or as) the entity satisfies the performance obligations. The guidance in the ASU supersedes existing revenue recognition guidance and is effective for annual reporting periods beginning after December 15, 2016 with early application not permitted. The ASU allows two methods of adoption; a full retrospective approach where three years of financial information are presented in accordance with the new standard, and a modified retrospective approach where the ASU is applied to the most current period presented in the financial statements.

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

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

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

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

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

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

ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations
CAUTIONARY NOTE CONCERNING FORWARD-LOOKING STATEMENTS

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

GENERAL

We provide integrated information management solutions and services for the public sector, with a focus on local governments. We develop and market a broad line of software products and services to address the IT needs of cities, counties, schools and other local government entities. In addition, we provide professional IT services to our clients, including software and hardware installation, data conversion, training and for certain clients, product modifications, along with continuing maintenance and support for clients using our systems. We also provide subscription-based services such as software as a service ("SaaS"), which utilizes the Tyler private cloud, and electronic document filing solutions ("e-filing"), which simplify the filing and management of court related documents. We also provide property appraisal outsourcing services for taxing jurisdictions.

Our products generally automate six major functional areas: (1) financial management and education, (2) courts and justice, (3) public safety, (4) property appraisal and tax, (5) planning, regulatory and maintenance, and (6) land and vital records management. We report our results in two segments. The Enterprise Software Solutions ("ESS") segment provides municipal and county governments and schools with software systems and services to meet their information technology and automation needs for mission-critical "back-office" functions such as financial management; courts and justice processes; public safety; planning, regulatory and maintenance; and land and vital records management. The Appraisal and Tax Software Solutions and Services ("ATSS") segment provides systems and software that automate the appraisal and assessment of real and personal property as well as property appraisal outsourcing services for local governments and taxing authorities. Property appraisal outsourcing services include: the physical inspection of commercial and residential properties; data collection and processing; computer analysis for property valuation; preparation of tax rolls; community education; and arbitration between taxpayers and the assessing jurisdiction.

Our total employee count increased to 3,723 at June 30, 2016 from 3,068 at June 30, 2015. This increase includes 515 employees added as the result of two acquisitions.

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

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

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The discussion and analysis of our financial condition and results of operations are based upon our condensed consolidated financial statements. These condensed consolidated financial statements have been prepared following the requirements of accounting principles generally accepted in the United States ("GAAP") for the interim period and require us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates, including those related to revenue recognition and amortization and potential impairment of intangible assets and goodwill and share-based compensation expense. As these are condensed financial statements, one should also read expanded information about our critical accounting policies and estimates provided in Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations," included in our Form 10-K for the year ended December 31, 2015. There have been no material changes to our critical accounting policies and estimates from the information provided in our Form 10-K for the year ended December 31, 2015.

ANALYSIS OF RESULTS OF OPERATIONS

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

Net income	10.0 %	12.8 %	9.8 %	12.8 %

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Revenues

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

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

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

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

Software licenses and royalties

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

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

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

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

Subscriptions

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

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

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

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

Software services

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

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

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

Maintenance

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

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