TYLER TECHNOLOGIES INC
Form 10-Q
October 21, 2015

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 September 30, 2015

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 October 16, 2015 was 33,939,000.

PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements
TYLER TECHNOLOGIES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands, except per share amounts)

(Unaudited)

	Three months ended September 30, 2015	Three months ended September 30, 2014	Nine months ended September 30, 2015	Nine months ended September 30, 2014
Revenues:				
Software licenses and royalties	$15,690	$13,226	$44,576	$36,541
Subscriptions	29,036	22,694	81,273	64,135
Software services	36,398	31,159	101,765	85,594
Maintenance	61,018	54,713	177,829	156,904
Appraisal services	6,557	5,802	19,337	16,097
Hardware and other	2,146	1,070	7,326	6,390
Total revenues	150,845	128,664	432,106	365,661
Cost of revenues:				
Software licenses and royalties	147	565	1,183	1,439
Acquired software	552	448	1,464	1,373
Software services, maintenance and subscriptions	72,764	61,428	207,819	174,701
Appraisal services	3,984	3,764	12,397	10,740
Hardware and other	1,565	667	5,278	4,528
Total cost of revenues	79,012	66,872	228,141	192,781
Gross profit	71,833	61,792	203,965	172,880
Selling, general and administrative expenses	31,869	27,344	90,810	80,130
Research and development expense	7,193	6,567	21,307	19,128
Amortization of customer and trade name intangibles	1,282	1,136	3,585	3,393
Operating income	31,489	26,745	88,263	70,229
Other income (expense), net	255	(47)	621	(522)
Income before income taxes	31,744	26,698	88,884	69,707
Income tax provision	11,602	9,698	32,633	26,084
Net income	$20,142	$17,000	$56,251	$43,623
Earnings per common share:				
Basic	$0.59	$0.52	$1.66	$1.32
Diluted	$0.55	$0.48	$1.56	$1.23

Comprehensive income	$20,142	$17,000	$56,251	$43,623

See accompanying notes.

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TYLER TECHNOLOGIES, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except par value and share amounts)

	September 30, 2015 (unaudited)	December 31, 2014
ASSETS		
Current assets:		
Cash and cash equivalents	$ 238,614	$ 206,167
Accounts receivable (less allowance for losses of $1,499 in 2015 and $1,725 in 2014)	129,228	112,660
Short-term investments	9,124	—
Prepaid expenses	18,044	17,851
Other current assets	6,821	358
Deferred income taxes	9,674	9,674
Total current assets	411,505	346,710
Accounts receivable, long-term portion	1,072	1,761
Property and equipment, net	68,092	65,910
Other assets:		
Goodwill	125,932	124,142
Other intangibles, net	35,701	34,722
Cost method investment	15,000	—
Non-current investments and other assets	21,080	737
	$ 678,382	$ 573,982
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 4,385	$ 4,119
Accrued liabilities	37,199	39,508
Deferred revenue	200,890	189,212
Total current liabilities	242,474	232,839
Deferred income taxes	4,813	4,170
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 in 2015 and 2014	481	481
Additional paid-in capital	230,840	201,389

Accumulated other comprehensive loss, net of tax	(46)	(46)
Retained earnings	317,401	261,150
Treasury stock, at cost; 14,218,757 and 14,678,782 shares in 2015 and 2014, respectively	(117,581)	(126,001)
Total shareholders' equity	431,095	336,973
	$ 678,382	$ 573,982

See accompanying notes.

TYLER TECHNOLOGIES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Nine months ended September 30,	
	2015	2014
Cash flows from operating activities:		
Net income	$56,251	$43,623
Adjustments to reconcile net income to cash provided by operations:		
Depreciation and amortization	11,586	10,936
Share-based compensation expense	14,459	10,887
Excess tax benefit from exercises of share-based arrangements	(10,801)	(6,717)
Changes in operating assets and liabilities, exclusive of effects of acquired companies:		
Accounts receivable	(14,356)	(5,851)
Prepaid expenses and other current assets	717	(1,570)
Income taxes	4,754	16,182
Accounts payable	(369)	864
Accrued liabilities	(3,349)	(1,815)
Deferred revenue	11,021	28,592
Net cash provided by operating activities	69,913	95,131
Cash flows from investing activities:		
Purchase of cost method investment	(15,000)	—
Purchase of held-to-maturity securities	(29,391)	—
Proceeds from sale of investments	—	808
Cost of acquisitions, net of cash acquired	(6,447)	(3,242)
Additions to property and equipment	(8,525)	(8,037)
Decrease in other	5	219
Net cash used by investing activities	(59,358)	(10,252)
Cash flows from financing activities:		
Purchase of treasury shares	(645)	(22,817)
Proceeds from exercise of stock options	8,369	6,739
Contributions from employee stock purchase plan	3,367	3,037
Excess tax benefit from exercises of share-based arrangements	10,801	6,717
Net cash provided (used) by financing activities	21,892	(6,324)
Net increase in cash and cash equivalents	32,447	78,555
Cash and cash equivalents at beginning of period	206,167	78,876
Cash and cash equivalents at end of period	$238,614	$157,431

See accompanying notes.

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 September 30, 2015 and December 31, 2014 and operating result amounts are for the three and nine months ended September 30, 2015 and 2014, 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, 2014. 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.

(2) Acquisitions

On May 29, 2015, we acquired all of the capital stock of Brazos Technology Corporation ("Brazos"), which provides mobile hand-held solutions primarily to law enforcement agencies for field accident reporting and electronically issuing citations. The purchase price, net of cash acquired of $312,000 and including debt assumed of $733,000, was $6.1 million in cash and 12,500 shares of Tyler common stock valued at $1.5 million. As of September 30, 2015, the purchase price allocation of Brazos is in process mainly due to completing the valuation of the acquired intangible assets. We currently expect to finalize the allocation of the purchase price in the fourth quarter. The impact of this acquisition on our operating results is not material.

(3) Other Assets

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

As of September 2015, we have $29.4 million in investment grade corporate and municipal bonds with maturity dates ranging from 2015 through mid-2017. 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.

On January 30, 2015, we made a $15.0 million investment in convertible preferred stock representing a 20% interest in Record Holdings Pty Limited ("Record Holdings"), a privately held Australian company specializing in digitizing the spoken word in court and legal settings. We do not believe we have the ability to significantly influence the day-to-day activities of Record Holdings and are accounting for this investment under the cost method.

(4) Shareholders' Equity

The following table details activity in our common stock:

	Nine months ended September 30,			
	2015		2014	
	Shares	Amount	Shares	Amount
Stock option exercises	420	$ 8,369	419	$ 6,739
Employee stock plan purchases	33	3,367	39	3,037
Shares issued for acquisitions	13	1,519	17	1,473
Purchase of common stock	(5)	(645)	(294)	(22,817)

As of September 30, 2015, we had authorization from our board of directors to repurchase up to 1.4 million additional shares of Tyler common stock.

(5) Income Tax Provision

For the three and nine months ended September 30, 2015, we had an effective income tax rate of 36.5% and 36.7%, respectively, compared to an effective income tax rate of 36.3% and 37.4% for the three and nine months ended months September 30, 2014, respectively. The effective income tax rates for the periods presented were different from the statutory United States federal income tax rate of 35% primarily due to state income taxes, non-deductible share-based compensation expense, the qualified manufacturing activities deduction, and non-deductible meals and entertainment costs.

We made federal and state tax payments of $27.2 million during the nine months ended September 30, 2015 compared to $9.9 million for the same period in the prior year.

(6) Earnings Per Share

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

	Three months ended September 30,		Nine months ended September 30,	
	2015	2014	2015	2014
Numerator for basic and diluted earnings per share:				
Net income	$20,142	$17,000	$56,251	$43,623
Denominator:				
Weighted-average basic common shares outstanding	33,900	32,935	33,787	32,947
Assumed conversion of dilutive securities:				
Stock options	2,449	2,349	2,376	2,392
Denominator for diluted earnings per share - Adjusted weighted-average shares	36,349	35,284	36,163	35,339
Earnings per common share:				
Basic	$0.59	$0.52	$1.66	$1.32
Diluted	$0.55	$0.48	$1.56	$1.23

For the three and nine months ended September 30, 2015, stock options representing the right to purchase common stock of approximately 416,000 shares and 519,000 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 nine months ended September 30, 2014, stock options representing the right to purchase common stock of approximately 651,000 shares and 540,000 shares, respectively, were not included in the computation of diluted earnings per share because their inclusion would have had an anti-dilutive effect.

(7) Share-Based Compensation

The following table summarizes share-based compensation expense related to share-based awards recorded in the statements of comprehensive income, pursuant to ASC 718, Stock Compensation:

	Three months ended September 30,		Nine months ended September 30,	
	2015	2014	2015	2014
Cost of software services, maintenance and subscriptions	$902	$569	$2,349	$1,595
Selling, general and administrative expenses	4,696	3,316	12,110	9,292
Total share-based compensation expenses	$5,598	$3,885	$14,459	$10,887

(8) 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, and land and vital records management software solutions;
- courts and justice 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 and land and vital records management software solutions unit; and the courts and justice 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 noncash 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 September 30, 2015

	Enterprise Software Solutions	Appraisal and Tax Software Solutions and Services	Corporate	Totals
Revenues				
Software licenses and royalties	$ 14,680	$ 1,010	$ —	$ 15,690
Subscriptions	27,772	1,264	—	29,036
Software services	33,210	3,188	—	36,398
Maintenance	56,451	4,567	—	61,018
Appraisal services	—	6,557	—	6,557
Hardware and other	2,162	—	(16)	2,146
Intercompany	1,014	—	(1,014)	—
Total revenues	$ 135,289	$ 16,586	$ (1,030)	$ 150,845
Segment operating income	$ 37,853	$ 4,420	$ (8,950)	$ 33,323

For the nine months ended September 30, 2015

	Enterprise Software Solutions	Appraisal and Tax Software Solutions and Services	Corporate	Totals
Revenues				
Software licenses and royalties	$ 40,563	$ 4,013	$ —	$ 44,576

Subscriptions	77,814	3,459	—	81,273
Software services	94,203	7,562	—	101,765
Maintenance	164,457	13,372	—	177,829
Appraisal services	—	19,337	—	19,337
Hardware and other	4,632	11	2,683	7,326
Intercompany	2,919	—	(2,919)	—
Total revenues	$ 384,588	$ 47,754	$ (236)	$ 432,106
Segment operating income	$ 104,513	$ 11,391	$ (22,592)	$ 93,312

For the three months ended September 30, 2014

	Enterprise Software Solutions	Appraisal and Tax Software Solutions and Services	Corporate	Totals
Revenues				
Software licenses and royalties	$ 12,192	$ 1,034	$ —	$ 13,226
Subscriptions	21,725	969	—	22,694
Software services	28,398	2,761	—	31,159
Maintenance	50,486	4,227	—	54,713
Appraisal services	—	5,802	—	5,802
Hardware and other	1,079	—	(9)	1,070
Intercompany	629	—	(629)	—
Total revenues	$ 114,509	$ 14,793	$ (638)	$ 128,664
Segment operating income	$ 31,797	$ 3,230	$ (6,698)	$ 28,329

For the nine months ended September 30, 2014

	Enterprise Software Solutions	Appraisal and Tax Software Solutions and Services	Corporate	Totals
Revenues				
Software licenses and royalties	$ 34,336	$ 2,205	$ —	$ 36,541
Subscriptions	61,571	2,564	—	64,135
Software services	78,006	7,588	—	85,594
Maintenance	144,344	12,560	—	156,904
Appraisal services	—	16,097	—	16,097
Hardware and other	3,929	—	2,461	6,390
Intercompany	1,634	—	(1,634)	—
Total revenues	$ 323,820	$ 41,014	$ 827	$ 365,661
Segment operating income	$ 84,972	$ 7,996	$ (17,973)	$ 74,995

	Three months ended September 30,		Nine months ended September 30,	
Reconciliation of reportable segment operating income to the Company's consolidated totals:	2015	2014	2015	2014
Total segment operating income	$ 33,323	$ 28,329	$ 93,312	$ 74,995
Amortization of acquired software	(552)	(448)	(1,464)	(1,373)

Amortization of customer and trade name intangibles	(1,282)	(1,136)	(3,585)	(3,393)
Other income (expense), net	255	(47)	621	(522)
Income before income taxes	$31,744	$26,698	$88,884	$69,707

(9) 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.

(10) New Accounting Pronouncements

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 April 1, 2015, the FASB voted for a one-year deferral of the effective date of the new standard and will issue an exposure draft proposing the deferral, with a 30-day comment period. The proposal would now require 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 currently expect to adopt the new standard in fiscal year 2018 in accordance with the revised effective date.

We are currently assessing the financial impact of adopting the new standard and the methods of adoption; however, given the scope of the new standard, 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.

(11) Subsequent event

On September 30, 2015, we signed a definitive agreement (the “Merger Agreement”) to acquire privately held New World Systems Corporation (“NWS”) for $670.0 million in cash and stock. NWS is a leading provider of public safety and financial solutions for local governments.

Under the terms of the agreement, we will acquire all of the equity in NWS for $360.0 million in cash and approximately 2.1 million shares of Tyler's common stock, representing approximately 5.9% of Tyler's outstanding common shares post transaction, subject to customary post-closing adjustments. The transaction is expected to close in the fourth quarter of 2015 and is subject to regulatory approval and customary closing conditions. The cash portion of the purchase price will be funded from cash on hand and proceeds from a new revolving credit facility. We expect to enter into a credit arrangement that will provide for a revolving credit line of $300.0 million and mature in five years.

The Merger Agreement may be terminated by each of Tyler and NWS under certain circumstances, including if the merger is not consummated by December 31, 2015. The Merger Agreement also provides for certain termination rights for both Tyler and NWS. Tyler may also terminate the Merger Agreement if it determines that it is unable to obtain sufficient debt financing, which when coupled with Tyler’s available cash would be sufficient to fund the cash portion of the merger consideration. If Tyler terminates the Merger Agreement in this limited circumstance, Tyler will be required to pay NWS a termination fee of $45.0 million.

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) material portions of our business require the Internet infrastructure to be adequately maintained; (4) 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; (5) general economic, political and market conditions; (6) technological and market risks associated with the development of new products or services or of new versions of existing or acquired products or services; (7) our ability to successfully achieve growth or operational synergies through the integration of acquired businesses, while avoiding unanticipated costs and disruptions to existing operations; (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 our filings with the Securities and Exchange Commission, including the detailed "Risk Factors" contained in our most recent annual report on Form 10-K. 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 information technology ("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 five major functional areas: (1) financial management and education, (2) courts and justice, (3) property appraisal and tax, (4) planning, regulatory and maintenance, and (5) 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; planning, regulatory and maintenance processes; 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.

On January 30, 2015, we made a $15.0 million investment in convertible preferred stock representing a 20% interest in Record Holdings Pty Limited, a privately held Australian company specializing in digitizing the spoken word in court and legal settings.

On May 29, 2015, we acquired all of the capital stock of Brazos Technology Corporation (“Brazos”), which provides mobile hand-held solutions primarily to law enforcement agencies for field accident reporting and electronically issuing citations. The purchase price was $6.1 million in cash, net of cash acquired of $312,000 and including $733,000 assumed debt, and 12,500 shares of Tyler common stock valued at $1.5 million, based on the stock price on the acquisition date.

On September 30, 2015, we signed a definitive agreement to acquire privately held New World Systems Corporation (“NWS”) for $670.0 million in cash and stock. This transaction is expected to close in the fourth quarter of 2015 and is subject to regulatory approval and customary closing conditions. Under the terms of the agreement, we will acquire all of the equity in NWS for $360.0 million in cash and approximately 2.1 million shares of Tyler's common stock, representing approximately 5.9% of Tyler's outstanding common shares post transaction, subject to customary post-closing adjustments. The cash portion of the purchase price will be funded from cash on hand and proceeds from a new revolving credit facility. In the fourth quarter of 2015, we expect to enter into a credit arrangement that will provide for a revolving credit line of $300.0 million and mature in five years.

Our total employee count increased to 3,075 at September 30, 2015 from 2,796 at September 30, 2014. This increase includes 39 employees added as the result of acquisitions.

Outlook

We believe activity in the local government market has returned to normal, pre-recession levels. Although we are seeing some pressure on margin expansion in 2015 as we absorb onboarding costs associated with staffing additions in recent quarters, make some strategic incremental product investments, and continue to grow our SaaS and e-filing client bases, our expectation is that 2015 will be another year of very solid revenue and earnings growth.

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, 2014. 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, 2014.

ANALYSIS OF RESULTS OF OPERATIONS

	Percent of Total Revenues			
	Third Quarter		Nine Months	
	2015	2014	2015	2014
Revenues:				
Software licenses and royalties	10.4 %	10.3 %	10.3 %	10.0 %
Subscriptions	19.2	17.6	18.8	17.5
Software services	24.2	24.2	23.6	23.4
Maintenance	40.5	42.5	41.2	42.9
Appraisal services	4.3	4.5	4.5	4.4
Hardware and other	1.4	0.9	1.6	1.8
Total revenues	100.0	100.0	100.0	100.0
Operating Expenses:				
Cost of software licenses, royalties and acquired software	0.6	0.8	0.6	0.8
Cost of software services, maintenance and subscriptions	48.2	47.7	48.1	47.8
Cost of appraisal services	2.6	2.9	2.9	2.9
Cost of hardware and other	1.0	0.5	1.2	1.2
Selling, general and administrative expenses	21.1	21.3	21.0	21.9
Research and development expense	4.8	5.1	4.9	5.2
Amortization of customer and trade name intangibles	0.8	0.9	0.8	1.0
Operating income	20.9	20.8	20.5	19.2

Other income (expense), net	—	—	—	(0.1)
Income before income taxes	20.9	20.8	20.5	19.1
Income tax provision	7.6	7.6	7.5	7.2
Net income	13.3 %	13.2 %	13.0 %	11.9 %

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Software licenses and royalties

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

	Third Quarter		Change		Nine Months		Change	
($ in thousands)	2015	2014	$	%	2015	2014	$	%
ESS	$14,680	$12,192	$2,488	20 %	$40,563	$34,336	$6,227	18 %
ATSS	1,010	1,034	(24)	(2)	4,013	2,205	1,808	82
Total software licenses and royalties revenue	$15,690	$13,226	$2,464	19 %	$44,576	$36,541	$8,035	22 %

In August 2014, we acquired a company which provides civil process management, typically to county sheriff departments. In May 2015, we acquired a company which provides mobile hand-held solutions primarily to law enforcement agencies for field accident reporting and electronically issuing citations. The results of these two companies are included in our ESS segment from their respective dates of acquisition. Excluding the results of acquisitions, software license revenue increased 17% and 20% for the three and nine months ended September 30, 2015, respectively. The majority of this growth was due to a more active marketplace as the result of improvement in local government economic conditions, as well as our increasingly strong competitive position, which we attribute in part to our investment in product development in recent years. In addition, for the three and nine months ended September 30, 2015, add-on sales from our existing customer base increased approximately $800,000 and $1.4 million, respectively, for courts and justice related solutions that assist and support the transition to a paperless environment. Royalties on sales of Microsoft Dynamics AX by other Microsoft partners increased approximately $110,000 and $937,000 for the three and nine months ended September 30, 2015, respectively.

Although the mix of new contracts between subscription-based and perpetual license arrangement may vary from quarter to quarter and year-to-year, we expect our longer-term software license growth rate 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. For the nine months ended September 30, 2015, approximately 76% of our new clients selected perpetual software license arrangements and approximately 24% selected subscription-based arrangements compared to approximately 71% perpetual software license arrangements and approximately 29% subscription-based arrangements for the same period in 2014. 35 and 101 new clients entered into subscription-based agreements in the three and nine months ended September 30, 2015, respectively, compared to 38 and 114 new clients in the three and nine months ended September 30, 2014, respectively.

Subscriptions

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

	Third Quarter		Change		Nine Months		Change	
($ in thousands)	2015	2014	$	%	2015	2014	$	%

ESS	$27,772	$21,725	$6,047	28 %	$77,814	$61,571	$16,243	26 %
ATSS	1,264	969	295	30	3,459	2,564	895	35
Total subscriptions revenue	$29,036	$22,694	$6,342	28 %	$81,273	$64,135	$17,138	27 %

Subscriptions revenue primarily consists of revenue derived from 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. Revenue from e-filings are derived from transaction fees and fixed fee arrangements. The initial contract terms for SaaS arrangements are typically for periods of three to seven years.

Subscriptions revenue grew 28% and 27% for the three and nine months ending September 30, 2015, respectively, compared to the prior year periods. E-filing services contributed approximately $2.3 million and $5.9 million of the subscriptions revenue increase for the three and nine months ended September 30, 2015, respectively. Most of the e-filing revenue increase related to several statewide contracts, three of which implemented mandatory electronic filing near the end of 2014. New SaaS clients as well as existing clients who converted to our SaaS model provided the remainder of the subscriptions revenue increase. In the three and nine months ending September 30, 2015, we added 35 and 101 new SaaS clients, respectively, and 18 and 57 existing on-premises clients converted to our

SaaS model, respectively. Since September 30, 2014, we have added 125 new SaaS clients and 69 existing on-premises clients have converted to our SaaS model.

Software services

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

	Third Quarter		Change		Nine Months		Change	
($ in thousands)	2015	2014	$	%	2015	2014	$	%
ESS	$33,210	$28,398	$4,812	17 %	$94,203	$78,006	$16,197	21 %
ATSS	3,188	2,761	427	15	7,562	7,588	(26)	—
Total software services revenue	$36,398	$31,159	$5,239	17 %	$101,765	$85,594	$16,171	19 %

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, software services revenue grew 16% and 18% for the three and nine months ended September 30, 2015, respectively, compared to the prior year periods. This growth is mainly due to much higher revenue from proprietary software arrangements, as well as additions to our implementation and support staff, which increased our capacity to deliver backlog.

Maintenance

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

	Third Quarter		Change		Nine Months		Change	
($ in thousands)	2015	2014	$	%	2015	2014	$	%
ESS	$56,451	$50,486	$5,965	12 %	$164,457	$144,344	$20,113	14 %
ATSS	4,567	4,227	340	8	13,372	12,560	812	6
Total maintenance revenue	$61,018	$54,713	$6,305	12 %	$177,829	$156,904	$20,925	13 %

We provide maintenance and support services for our software products and third party software. Most of our clients who purchase our software license also contract with us for maintenance and support. Excluding the results of acquisitions, maintenance revenue increased 10% and 12%, respectively, for the three and nine months ended September 30, 2015, compared to the prior year periods, mainly due to growth in our installed customer base from new software license sales as well as maintenance rate increases.

Appraisal services

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

($ in thousands)	Third Quarter 2015	2014	Change $	%	Nine Months 2015	2014	Change $	%
ESS	$ —							