SKYE INTERNATIONAL, INC
Form 10-K
March 26, 2009

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

Form 10-K

(Mark One)

þ	ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 For the fiscal year ended December 31, 2008
	or
o	TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 For the transition period from to _________

Commission file number: 000-27549

SKYE INTERNATIONAL, INC.

(Exact name of registrant as specified in its charter)

Nevada (State or other jurisdiction of incorporation or organization)	88-0362112 (I.R.S. Employer Identification No.)
7701 E. Gray Rd., Suite 104 Scottsdale, Arizona (Address of principal executive offices)	85260 (Zip Code)

Registrant's telephone number, including area code:
(480) 993-2300

Securities registered pursuant to Section 12(b) of the Act:
None

Securities registered pursuant to Section 12(g) of the Act:
Common Stock, $0.001 par value

(Title of class)

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

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

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

Large accelerated filer	o	Accelerated filer	o
Non-accelerated filer	o	Smaller reporting company	þ

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was sold, or the average bid and asked price of such common equity, as of the last business day of the registrant's most recently completed second fiscal quarter: $2,040,884 as of June 30, 2008.

As of December 31, 2008 and March 10, 2009, the registrant had 13,927,915 shares of common stock outstanding.

FORWARD-LOOKING STATEMENTS

This report contains "forward-looking statements". All statements, other than statements of historical fact, are "forward-looking statements" for purposes of federal and state securities laws, including statements regarding, among other items, the Company's business strategies, continued growth in the Company's markets, projections, and anticipated trends in the Company's business and the industry in which it operates. Forward-looking statements generally can be identified by phrases such as the Company or its management "believes," "expects," "anticipates," "foresees," "forecasts," "estimates" or other words or phrases of similar import. Similarly, statements in this report describe the Company's business strategy, outlook, objectives, plans, intentions or goals also are forward-looking statements. Although we believe that the expectations reflected in any of our forward-looking statements are reasonable, actual results could differ materially from those projected or assumed in any of our forward-looking statements. Our future financial condition and results of operations, as well as any forward-looking statements, are subject to change and subject to inherent risks and uncertainties. The factors impacting these risks and uncertainties include, but are not limited to: the substantial losses the Company has incurred to date; demand for and market acceptance of new products; successful development of new products; the timing of new product introductions and product quality; the Company's ability to anticipate trends and develop products for which there will be market demand; the availability of manufacturing capacity; pricing pressures and other competitive factors; changes in product mix; product obsolescence; the ability of our customers to manage inventory; the ability to develop and implement new technologies and to obtain protection for the related intellectual property; the uncertainties of litigation and the demands it may place on the time and attention of company management, general economic conditions and conditions in the markets addressed by the Company; as well as other risks and uncertainties, including those detailed from time to time in our other Securities and Exchange Commission filings. The forward-looking statements are made only as of the date hereof. The Company does not undertake any obligation to update or revise the forward-looking statements, whether as a result of new information, future events or otherwise.

For a detailed description of these and other factors that could cause actual results to differ materially from those expressed in any forward-looking statement, please see Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations" in this document.

Throughout this Form 10-K, references to "we", "our", "us", "the Company", and similar terms refer to SKYE International Inc. and its former 100% owned subsidiaries, Envirotech Systems Worldwide Inc., Valeo Industries Inc. and ION Tankless Inc.

SKYE INTERNATIONAL, INC.

FORM 10-K

FOR THE FISCAL YEAR ENDED
DECEMBER 31, 2008
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PART I

ITEM 1. BUSINESS

Corporate Overview

SKYE International, Inc., a Nevada corporation ("SKYE"), was originally organized on November 23, 1993, as Amexan, Inc. The name was changed on June 1, 1998, to Nostalgia Motorcars, Inc. Prior to the name change, Amexan was an inactive company from the date of incorporation. On June 11, 2002, the name was changed to Elution Technologies, Inc. On June 4, 2003, in connection with the pending acquisition of Envirotech Systems Worldwide, Inc., and the commencement of the Company's current line of business, it changed its name to Tankless Systems Worldwide, Inc. The Company's acquisition of Envirotech Systems Worldwide, Inc. was completed on November 7, 2003, in a share exchange that resulted in the Company acquiring 100% of the issued and outstanding common shares of Envirotech Systems Worldwide, Inc. On October 21, 2005, as part of its overall plan to create a brand name for its revised business plan and expanded product lines, the Company changed its name to SKYE International, Inc.

SKYE had three subsidiary corporations, all of which were wholly-owned and all of which were wound-up or administratively dissolved during the fiscal year ended December 31, 2008:

- Envirotech Systems Worldwide, Inc., an Arizona corporation ("Envirotech");
- ION Tankless, Inc., an Arizona corporation ("ION"); and
- Valeo Industries, Inc., a Nevada corporation ("Valeo").

As of the date of this Report, the Company has no subsidiaries or affiliates.

Except as otherwise specified, all references herein to the "Company", "we" our", "us" refer to SKYE and its wholly-owned subsidiaries, Envirotech, ION and Valeo. The business office of the Company is located at 7701 E. Gray Rd., Suite104, Scottsdale, Arizona 85260. The Company's fiscal year ends on December 31.

Envirotech

Envirotech was formed December 9, 1998, in Arizona and had a limited history of operations. The initial period of its existence involved research and development of a line of electric tankless water heaters. The first sales of its products occurred in 2000. Envirotech filed for relief under Chapter 11 of the United States Bankruptcy Code in the United States Bankruptcy Court for the District of Arizona, on August 6, 2004 (the "Chapter 11 Proceedings"). Envirotech subsequently withdrew from voluntary bankruptcy protection pursuant to an order of the Bankruptcy court on February 24, 2006, that granted Envirotech's motion to dismiss its voluntary petition in bankruptcy with prejudice. Envirotech later filed for bankruptcy under Chapter 7 of the United States Bankruptcy Code in the United States Bankruptcy Court for the District of Arizona, on June 24, 2008 (the "Chapter 7 Proceedings"). The filing of the Chapter 7 proceedings stayed all then-existing litigation, judgments and efforts to collect on judgments entered against Envirotech. As of the date of the filing of the Chapter 7 Bankruptcy Petition, Envirotech had liabilities in excess of approximately $1.6 million, and non-liquidated contingent liabilities in connection with the Seitz Suit (as defined and explained under "Legal Proceedings" below). On January 7, 2009, the Bankruptcy Court partially lifted the stay of proceedings to permit the Seitz Suit to proceed. On January 20, 2009, S. William Manera, the Chapter 7 Trustee appointed by the Bankruptcy Court to administer the bankrupt estate of Envirotech, filed a Notice of Intention to Abandon the remaining assets of Envirotech comprising US Patent No. 6,389,226 and miscellaneous inventory to the Company on the grounds that the remaining assets in the estate were of negligible value to the estate. Envirotech's assets were subsequently abandoned to the Company. Envirotech was administratively dissolved by the State of Arizona in 2008. As of the date of this Report the Chapter 7 proceedings continue and the Company expects the matter will be concluded in 2009. All accounting entries to reflect the dissolution of Envirotech are contained in the Company’s consolidated financial statements.

ITEM 1. BUSINESS - continued

ION

SKYE made a decision in early 2004 to pursue its own research and development for new water heating technologies, out of which it could develop a completely new line of products. In January 2004, SKYE formed a wholly-owned, non-operating subsidiary, ION Tankless, Inc., through which it had conducted research and development of alternative heating technologies and products. SKYE invested heavily through ION in a research and development program to develop new and innovative methods of heating fluids and such efforts have resulted in the issuance of several US patents and several more that remain pending as of the date of this Report. All of the assets of ION were transferred to the Company during the 2008 fiscal year and ION was dissolved. All accounting entries to reflect the dissolution of ION are contained in the Company's consolidated financial statements.

Valeo

Valeo was formed by SKYE in January 2005 as a wholly-owned operating subsidiary. It was intended that Valeo would become the manufacturing entity for the Company. Consistent with a Board of Directors decision in 2007, the Company has elected to pursue a "Fabrication Free" business plan and outsource all production to qualified contract manufacturers. As a result Valeo was wound up and dissolved in the 2008 fiscal period, and all accounting entries to reflect the dissolution are contained in the Company's consolidated financial statements.

Business of the Company

The Company is in the business of designing, developing, and marketing consumer heating appliance products. All of the Company's products are produced for the Company by third party contract manufacturers. The Company entered its current line of business through the acquisition of Envirotech and its product line - the ESI-2000 electric tankless water heater. Though viewed by many to be a significant advancement in whole house electric tankless, the ESI-2000 product line never achieved critical sales levels, and thus production of the ESI-2000 product line concluded in late 2005. In response to lackluster ESI-2000 product sales, the Company engaged in a substantial research and development program to design a line of replacement heating appliances. The first product that the Company released to the market in October 2008 was the FORTIS™ electric tankless whole house water heater. The FORTIS™ tankless water heater is small, easy to install and supplies virtually endless amounts of hot water with energy savings. The FORTIS™ uses advanced technology and high quality stainless steel components that are expected to provide increased reliability and longevity. The FORTIS™ series heats water only as long as you require hot water, and only at the temperature you desire. Electricity is only used when heated water is required, therefore the cost of heating water can be reduced by as much as 30%. Because the FORTIS™ series is compact, durable, self-contained and safe, it can be easily installed close to where hot water is being used, and it is ideal for condos, apartments, multifamily residences and homes where space is at a premium.

Additionally, the Company has continued to focus development efforts on the commercialization of its new Paradigm™ technology. The Company has worked hard to introduce its Paradigm™ line of point-of-use water heaters. As of the date of this Report the Company has completed the engineering phase of the project and has begun preliminary steps to obtain product certification to the requisite UL 499 standard. The Company expects that a series of Paradigm™ product will be certified and commercially available for sale during fiscal 2009.

In late 2008 the Company entered into an Agreement with a supplier to produce the Company's Heatwave™ line of point-of-use water heating products. Utilizing revolutionary thin-film on quartz technology the Heatwave™ line is an inexpensive commercial point-of-use heating solution. Ideally suited for small lavatory and bathroom applications, the Heatwave™ provides a commercial building project with an inexpensive solution to the code requirement for heated water. The Company received UL 499 and CSA 22.2 No. 64 certification in January 2009 and expects to commence commercial sale and distribution of the Heatwave in the second quarter of fiscal 2009.

We have expended considerable efforts to develop a sales and distribution network in North America. We have chosen to sell our products through wholesale distribution utilizing manufacturer representatives. As of December 31, 2008, we have appointed a number of manufacturer representatives covering a number of states, primarily in the southwest and southeast portions of the United States. We continue to review opportunities for the appointment of additional manufacturer representatives in territories across the United States, and we anticipate hiring a VP Sales and Marketing to coordinate all of the Company’s sales and marketing programs.

ITEM 1. BUSINESS - continued

The Marketplace for Tankless Water Heaters.

Historically, in the U.S., electric tankless water heaters have suffered from poor design and had problems such as water flow limits, overheating at low flow, shut downs, and burnout of elements at low flow rates. As a result, some plumbing contractors and specifying engineers believe tankless heaters do not perform well and they discourage consumers from buying tankless systems. There is a common perception that tankless heaters are expensive, more complicated and more time consuming to install. In the past, tankless water heaters have not provided a viable option for heating water for a whole house. In addition, conventional tank water heaters today are more efficient and reliable than in the past. As tankless heaters continue to gain market acceptance in the U.S., management expects that consumer sentiment will change and become more favorable to tankless as the "green" cost-saving benefits of the technology become more widely known to the public.

The conventional water heater market is highly competitive, highly concentrated, and mature, and dominated by a small number of manufacturers. Conventional tank water heaters maintain approximately 92% market share of residential water heater sales (Frost & Sullivan, 2004). Management believes that tankless products comprise nearly 8% of the U.S. marketplace as of the end of 2008. Some contractors are loyal to their favorite brands and are comfortable installing what they know. The five dominant U.S. manufacturers have substantial resources, well known brand names, established distribution networks, worldwide manufacturing capabilities, and sizeable engineering, research and development resources to protect and increase their market share and profitability. Studies report that sales growth in tankless water heaters will require better tankless products than in the past and educating both representatives and installers in the plumbing industry as well as consumers and builders in the advancements in products.

Until just a few years ago, there were only a few tankless water heater manufacturers with a presence in the United States. Today, there are no electric water heaters manufactured in Japan. The Japanese have a 40-year history of using gas-based instant water heaters, and leverage that experience in the U.S. marketplace. These Japanese manufacturers include Takagi, Noritz, and Rinnai. The European competitors in the U.S. marketplace in gas, and to a lesser extent electric-based heaters include Bosch and Steibel Eltron, both of which gained their market experience in Europe where point-of-use instant use water heaters are commonplace.

One of the significant barriers to the entry of an electric tankless unit has been the inability of an electrically powered unit to generate enough heated water flow for the average U.S. household. The Company's FORTIS™ product addresses this problem by incorporating a "multi-pass" serpentine heating technology that keeps incoming water in contact with a large heating surface for a longer time period of time when compared to many other electric models. The greater contact with a larger heating surface results in the ability to produce greater volumes of heated water because of the added operating efficiency of the product. Additionally, SKYE's control algorithms are capable of very precise temperature control even under fluctuating flow conditions. This new level of functionality afforded by the Company's patented technology we believe will give SKYE a competitive advantage over many other electrically powered tankless water heaters, and for the first time provide what SKYE believes to be a truly viable alternative for the consumer that demands higher flows of heated water.

Product Overview

The FORTIS™ series.

The Company has developed what it believes will be the world's most advanced, efficient, reliable, safe and durable electric tankless whole house water heater. The FORTIS™ series has substantially all stainless steel metal construction and features a backlit LCD display for ease of use. The units offer remote controls for home automation, programmable processor to allow easy installation of the latest software, a modular design for ease of expansion of heating capacity, easy replacement of immersion elements, and industry-standard non-proprietary components for cost-effective replacement parts.

Safety features include mechanical power breakers (included within the heater eliminating the need for an external sub-panel), wet sensor-leak detection, a valve to flush any sediment that may have accumulated in the system, an optional self-cleaning mode, and mechanical over temp switch that will shut off the unit in the event other safety devices fail. The units also feature a built-in USB port to ease troubleshooting and allow the user to download performance logs or updated firmware. The sophisticated FORTIS™ controller provides functionality not included in many other electric tankless products including remote bath fill, remote temperature set point, auto shut-off leak detection, remote wireless communication, real-time voltage and current detection, usage data logging, as well as communication with other ZigBee™ enabled devices operating on the IEEE 802.15.4 standard so as to allow whole house electric load controlling and other energy-saving functions. The FORTIS™ has been designed with both energy efficiency and ease of use in mind. The controller allows the user to program “time of day” or demand-based savings programs so as to reduce day to day operating costs.

ITEM 1. BUSINESS - continued

Product Overview - continued

The FORTIS™ is a durable tank-replacement product that is capable of meeting the needs of most whole house applications. The Company believes that endless hot water, energy savings, compact design and redundant safety systems make this tankless water heater one of the “best in class”.

The Paradigm™ Series.

The Paradigm™ series point-of-use water heaters heat water using new innovative thick-film on steel technology. Essentially, instead of putting the heater in the water, the Paradigm™ series water heaters pass the water through the heater. As a result, the Paradigm™ technology provides virtually instantaneous hot water and is nearly 100% efficient in operation. The Paradigm™ series can heat water to over 100°F in only seconds and, like the FORTIS™, does not require a tank. With a standard point-of-use heating element weighing less than 10 ounces, there is little thermal mass to heat or cool, so that a 30-amp version of this heater can provide up to 3.0 gallons per minute of heated flow under the average sink. The Paradigm™ series is a complement to the FORTIS™ in that it provides the “instant” hot water, and the FORTIS™ provides the “endless” hot water.

Included in the Paradigm™ series of heaters are planned whole house boost and under-the-sink versions of tankless water heaters. Moreover, the Company believes that this Paradigm™ technology will likely find a significant market owing to its small size, low cost and efficient operation. Management believes that the Paradigm™ will do particularly well in the multi-family and condo market where space is a premium. Additionally, given its overall efficiency, management believes that homes and building products that seek LEEDS or other “green” certifications will likely be consumers of this new product line.

The Heatwave™ Series.

The Company’s Heatwave™ line of commercial point-of-use water heaters incorporates revolutionary thin-film on quartz technology to provide compact, inexpensive and practical heating solutions for commercial installations. Wherever local codes require heated water, the Heatwave™ is capable of providing heated water to meet code. Additionally, given its compact size, commercial builders are expected to benefit from space savings, low install costs and industry leading product longevity. The Heatwave™ product line is currently in 5.5Kw and 8.7Kw versions suitable for most small sized commercial applications. The Company expects to expand this product line by fiscal 2010 to include smaller 120V versions, as well as larger 11.0Kw – 14.4Kw version for larger commercial installations.

On-Going Product Research.

The Company intends to continue to research and develop new products that either incorporate existing SKYE technologies, or that complement existing product lines. Current development efforts include, to name a few, a fully-integrated load controller to work in tandem with the FORTIS™ series, a new small space hydronic heating mechanism, and a whole house electric monitoring system capable of detecting household appliance failures or service needs.

Warranty and Right of Return

In connection with the sale of each product, we provide a limited 30-day money back guarantee less a 6% restocking charge. After the 30 days, we provide a five-year warranty on replacement of parts. The tank chamber is warranted not to leak for 10 years.

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ITEM 1. BUSINESS - continued

Governmental Approvals, Effect of Regulations

SKYE's products are tested to ensure compliance with applicable code requirements. Additionally, SKYE submits many of its products to other agencies for certifications, including:

- NSF (National Sanitation Foundation – for compliance with NSF standard 61
- IAPMO (International Association of Plumbing and Mechanical Officers – for UPC certification)
- Intertek Testing – for CE (European Standards Certification Mark)
- Intertek Testing for UL499 and CSA 22.2 No. 64

On September 4, 2007, the Company opened an investigation of its proposed FORTIS™ line of water heating product with Intertek Testing Services NA, Inc. ("Intertek") in order to determine its compliance with ANSI/UL standard 499 for Electric Heating Devices. On October 12, 2007, the Company was advised that Intertek had issued its Listing Report in connection with the investigation and approval for listing of the FORTIS™ product series. The testing confirmed compliance with UL standard 499 and received "Approval to Mark" the trademarked "ETL" certification mark on the FORTIS™ product series.

On January 13, 2009, the Company was advised that Intertek had completed testing of its Heatwave™ product series and found that it complied with the requirements of UL standard 499 for electric heating appliances, and CSA standard 22.2 No. 64 for instantaneous water heaters. The Listing Report in connection with such investigation was issued on March 6, 2009, and the Heatwave™ product line is currently in production for expected delivery in the early second quarter of 2009.

Consumer safety, building, electric and plumbing codes are in a constant state of change and thus SKYE is always subject to the potentially negative impacts of any adverse legislation, including legislation that could require changes, including significant changes, to existing product specifications and components. SKYE is not currently aware of any pending legislation that will adversely affect the ability of SKYE to conduct its business.

Cost of Environmental Compliance.

Because SKYE does not manufacture any of its products, it does not anticipate incurring material costs related to environmental compliance, which is the responsibility of the manufacturer.

Sales and Distribution

Because tankless water heaters are still relatively new in the U.S., SKYE will use wholesale distribution through appointed manufacturer representatives to enter the market place. As consumer knowledge of tankless is still quite low, SKYE believes that a "push" style distribution through wholesale distribution is needed. Utilizing the resources of wholesalers to make sales calls and stock inventory locally will help to reduce initial capital needs and expedite a broader distribution network. SKYE has appointed manufacturer representatives in many states and expects that it will continue to appoint more representatives over the balance of 2009 and 2010, including manufacturer representatives in Canada, Mexico and Europe.

Although existing agreements are currently under review by management, the current major terms of the contracts are: (a) distributors receive a graduated discount based on volume with the greatest discount being 37%, and 7% commissions to manufacturer representatives; (b) exclusive territories; (c) termination upon 30 days' notice and; (d) no maximum purchase requirements and sales goals to be mutually agreed, or in default, $1,000,000 per territory.

In addition, the Company is also hiring and appointing “factory sales managers” to deal with sales territories across the U.S. As of the date of this Report the Company has hired three factory sales managers covering the following states: CA, OR, WA, ID, AK. HI, AZ, NV, NM, CO, MT, WY, UT, TX, OK, AR, LA, TN, KY, NC, SC, MS, AL, GA, FL. The Company expects to hire additional managers as sales and revenues warrant. Factory sales managers are responsible for supporting the wholesale channel, as well as installer and service technician training for all wholesalers and retailers of the Company’s products. In order to accelerate training of installers in the U.S. the Company has created “SKYE University” that conducts both in-house training at its facilities in AZ, as well as remote field training across the U.S. The Company plans to hire a Vice President of Sales and Marketing with overall responsibility to oversee the sales, service and training functions of the Company.

ITEM 1.	Denominator:							
Weighted-average basic common shares outstanding		35,118		38,474		35,226		38,093
Assumed conversion of dilutive securities: Stock options		1,369		1,545		1,333		1,533
Denominator for diluted earnings per share Adjusted weighted-average shares		36,487		40,019		36,559		39,626
Earnings per common share: Basic	$	0.21	$	0.17	$	0.58	$	0.26
Diluted	$	0.20	$	0.16	$	0.56	$	0.25

For both the three and nine months ended September 30, 2009 stock options representing the right to purchase common stock of 2.7 million shares 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, 2008, stock options representing the right to purchase common stock of 2.1 million shares and 1.3 million shares, respectively, were not included in the computation of diluted earnings per share because their inclusion would have had an anti-dilutive effect.

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(9) Share-Based Compensation

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

	Three months ended September 30,		Nine months ended September 30,	
	2009	2008	2009	2008
Cost of software services, maintenance and subscriptions	$ 139	$ 100	$ 393	$ 250
Selling, general and administrative expense	1,149	998	3,260	2,469
Total share-based compensation expense	$ 1,288	$ 1,098	$ 3,653	$ 2,719

(10) Commitments and Contingencies

On November 3, 2008, a putative collective action complaint was filed against us in the United States District Court for the Eastern District of Texas (the Court) on behalf of current and former customer support analysts, client liaisons, engineers, trainers, and education services specialists. The petition alleges that we misclassified these groups of employees as exempt rather than non-exempt under the Fair Labor Standards Act and that we therefore failed to properly pay overtime wages. The suit was initiated by six former employees working out of our Longview, Texas, office and seeks to recover damages in the form of lost overtime pay since October 31, 2005, liquidated damages equal to the amount of lost overtime pay, interest, costs, and attorneys fees. On June 23, 2009, the Court issued an Order granting Plaintiffs motion for conditional certification for the purpose of providing notice to potential plaintiffs about the litigation. On September 22, 2009, the Court granted Plaintiffs motion to provide for additional email notice to potential plaintiffs and to extend the opt in period for an additional thirty days. We intend to vigorously defend the action. Given the preliminary nature of the alleged claims and the inherent unpredictability of litigation, we cannot at this time estimate the possible outcome of any such action.

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

(11) Recent Accounting Pronouncements

Effective July 1, 2009, we adopted the Financial Accounting Standards Board (FASB) Accounting Standards Codification (FASB ASC) 105-10, Generally Accepted Accounting Principles (FASB ASC 105-10). FASB ASC 105-10 establishes the FASB Accounting Standards Codification (the Codification) as the source of authoritative accounting principles recognized by the FASB to be applied by nongovernmental entities in the preparation of financial statements in conformity with GAAP. Rules and interpretive releases of the SEC under authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. All guidance contained in the Codification carries an equal level of authority. The Codification superseded all existing non-SEC accounting and reporting standards. All other non-grandfathered, non-SEC accounting literature not included in the Codification is non-authoritative. The FASB will not issue new standards in the form of Statements, FASB Staff Positions or Emerging Issues Task Force Abstracts. Instead, it will issue Accounting Standards Updates (ASUs). The FASB will not consider ASUs as authoritative in their own right. ASUs will serve only to update the Codification, provide background information about the guidance and provide the bases for conclusions on the change(s) in the Codification. References made to FASB guidance throughout this document have been updated for the Codification.

On September 23, 2009, the FASB ratified Emerging Issues Task Force Issue No. 08-1, Revenue Arrangements with Multiple Deliverables (EITF). EITF 08-1 updates the current guidance pertaining to multiple-element revenue arrangements included in FASB ASC 605-25, which originated primarily from EITF 00-21, also titled Revenue Arrangements with Multiple Deliverables. EITF 08-1 will be effective for annual reporting periods beginning January 1, 2011 for calendar-year entities. We are currently evaluating the impact of EITF 08-1 on our financial position, results of operations, cash flows, and disclosures.

(12) Subsequent Events

We evaluate events and transactions that occur after the balance sheet date as potential subsequent events. We performed this evaluation through October 29, 2009, the date on which we issued our financial statements.

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, forecas estimates, plans, intends, continues, may, will, should, projects, might, could or other similar wo Similarly, statements that describe our business strategy, outlook, objectives, plans, intentions or goals also are forward-looking statements. We believe there is a reasonable basis for our forward-looking statements, but they are inherently subject to risks and uncertainties and actual results could differ materially from the expectations and beliefs reflected in the forward-looking statements. We presently consider the following to be among the important factors that could cause actual results to differ materially from our expectations and beliefs: (1) economic, political and market conditions, including the recent global economic and financial crisis, and the general tightening of access to debt or equity capital; (2) our ability to achieve our financial forecasts due to various factors, including project delays by our customers, reductions in transaction size, fewer transactions, delays in delivery of new products or releases or a decline in our renewal rates for service agreements; (3) changes in the budgets or regulatory environments of our customers, primarily local and state governments, that could negatively impact information technology spending; (4) technological and market risks associated with the development of new products or services or of new versions of existing or acquired products or services; (5) our ability to successfully complete acquisitions and achieve growth or operational synergies through the integration of acquired businesses, while avoiding unanticipated costs and disruptions to existing operations; (6) competition in the industry in which we conduct business and the impact of competition on pricing, customer retention and pressure for new products or services; (7) the ability to attract and retain qualified personnel and dealing with the loss or retirement of key members of management or other key personnel; and (8) costs of compliance and any failure to comply with government and stock exchange regulations. A detailed discussion of these factors and other risks that affect our business are described in 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 local governments. We develop and market a broad line of software products and services to address the information technology (IT) needs of cities, counties, schools and other local government entities. In addition, we provide professional IT services to our customers, including software and hardware installation, data conversion, and training and for certain customers, product modifications, along with continuing maintenance and support for customers using our systems. We also provide subscription-based services such as application service provider arrangements and other hosting services as well as property appraisal outsourcing services for taxing jurisdictions.

On April 3, 2009, we completed the acquisition of all of the capital stock of Assessment Evaluation Services, Inc. (AES). AES develops integrated property appraisal solutions and specializes in applications that deal with the unique provisions of the California Revenue and Taxation Code. The purchase price was approximately $1.1 million in cash.

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

In the nine months ended September 30, 2009, we have also paid approximately $1.1 million for various software assets to compliment our tax and appraisal solutions and our student information management solutions. See Note 3 in the Notes to the Unaudited Condensed Financial Statements.

As of September 30, 2009, our total employee count increased to 1,979 from 1,938 at September 30, 2008.

Outlook

The financial market crisis has continued to disrupt credit and equity markets worldwide in 2009. Local and state governments may face financial pressures that could in turn affect our growth rate and operating results in 2009. We are closely monitoring market conditions and the potential impact on our business.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The discussion and analysis of our financial condition and results of operations are based upon our condensed financial statements. These condensed financial statements have been prepared following the requirements of accounting principles generally accepted in the United States (GAAP) for interim periods 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, 2008. There have been no material changes to our critical accounting policies and estimates from the information provided in our 10-K for the year ended December 31, 2008.

ANALYSIS OF RESULTS OF OPERATIONS

Revenues

The following table sets forth the key components of our revenues for the periods presented as of September 30:

($ in thousands)	Third Quarter 2009	% of Total	2008	% of Total	% Increase/ (Decrease)	Nine Months 2009	% of Total	2008	% of Total	% Increase/ (Decrease)
Software licenses	$ 10,167	14%	$ 11,372	17%	(11)%	$ 30,835	14%	$ 31,646	16%	(3)%
Subscription	4,558	6	3,526	5	29	12,694	6	10,503	5	21
Software services	20,383	28	18,600	27	10	60,945	28	54,973	28	11
Maintenance	32,744	44	28,353	41	15	92,106	43	79,102	41	16
Appraisal services	4,692	6	5,289	8	(11)	14,638	7	14,249	7	3
Hardware and other	1,788	2	1,497	2	19	4,851	2	5,084	3	(5)
Total revenues	$ 74,332	100%	$ 68,637	100%	8%	$ 216,069	100%	$ 195,557	100%	10%

Software licenses. Software license revenues consist of the following components for the periods presented as of September 30:

($ in thousands)	Third Quarter 2009	% of Total	2008	% of Total	% Increase/ (Decrease)	Nine Months 2009	% of Total	2008	% of Total	% Increase/ (Decrease)
Financial management and education	$ 5,346	53%	$ 6,452	57%	(17)%	$ 17,579	57%	$ 21,023	66%	(16)%
Courts and justice	3,607	35	3,914	34	(8)	9,999	32	7,754	25	29
Appraisal and tax and other	1,214	12	1,006	9	21	3,257	11	2,869	9	14

Total software license revenues	$ 10,167	100%	$ 11,372	100%	(11)%	$ 30,835	100%	$ 31,646	100%	(3)%

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In the three months ended September 30, 2009, we signed 17 new large contracts with average software license fees of approximately $411,000 compared to 16 new large contracts signed in the three months ended September 30, 2008 with average software license fees of approximately $215,000. In the nine months ended September 30, 2009, we signed 47 new large contracts with average software license fees of approximately $339,000 compared to 50 new large contracts signed in the nine months ended September 30, 2008 with average software license fees of approximately $310,000. We consider contracts with a license fee component of $100,000 or more to be large. Although a contract is signed in a particular quarter, the period in which the revenue is recognized may be different because we recognize revenue according to our revenue recognition policy as described in Note 2 in the Notes to the Unaudited Condensed Financial Statements.

Changes in software license revenues consist of the following components:

Software license revenue related to our financial management and education solutions for three and nine months ended September 30, 2009 declined $1.1 million and $3.4 million, respectively, compared to the prior year periods due to several factors. In the past few months our sales cycle to negotiate and close contracts which have reached the request for proposal phase has lengthened slightly. The software installation period for most of our financial management and education solutions is relatively short and delays in the timing of signing new contracts will impact our results in the short term. In addition, a few contracts have included requirements to construct interfaces to existing systems or other essential functionality which results in recognizing revenue over a longer period of time. We have also entered into a few contract arrangements with extended payment terms which negatively impacted the amount of software license revenue we could recognize in the three months ended September 30, 2009. We currently expect software license revenues for the three months ended December 31, 2009 to be comparable to the prior year period.

In addition, we acquired a student information and financial management solution for K-12 schools in August 2008, which contributed approximately $189,000 and $940,000 to software license revenues for the three and nine months ended September 30, 2009, respectively.

Software license revenue related to our courts and justice software solutions for three months ended September 30, 2009 declined $307,000 compared to the three months ended September 30, 2008 mainly because the prior year period included $1.7 million from one contract which had been deferred in accordance with the terms of the contract. Courts and justice software license revenue increased $2.2 million for the nine months ended September 30, 2009 compared to the prior year period. Both year-to-date periods included approximately $1.7 million from contracts which had been deferred in accordance with the terms of these contracts. Courts and justice software license revenues increased due to contract arrangements that included more software license revenue than in the comparable prior year periods and from improved installation processes as our primary courts and justice solution matures.

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

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

Software services revenue related to financial management and education solutions, which comprise approximately 50% of our software services revenue in the periods presented, increased 9% and 12% compared to the three and nine months ended September 30, 2008, respectively. This increase was driven in part by additions to our implementation and support staff as well as leverage in the utilization of our implementation and support staff. In addition, our revenue mix included more contracts with larger customers than the prior year period. Contracts with large customers generally require more project management and consulting services.

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In addition, we acquired a student information and financial management solution for K-12 schools in August 2008, which contributed approximately $265,000 and $831,000 to software service revenues for the three and nine months ended September 30, 2009, respectively.

Software services revenue related to courts and justice solutions comprise approximately 30% of our software services revenues in the periods presented and increased 4% and 17% compared to the three and nine months ended September 30, 2008, respectively. These increases reflect our increased capacity to deliver backlog following additions to our implementation and support staff beginning mid-2008 and slightly higher rates on some arrangements.

Maintenance. We provide maintenance and support services for our software products and third party software. Maintenance revenues increased 15% and 16% for the three and nine months ended September 30, 2009, respectively compared to the prior year periods. Maintenance and support services grew 13% and 14% for the three and nine months ended September 30, 2009, respectively, excluding the impact of acquisitions completed in the prior twelve months. This increase was due to growth in our installed customer base and slightly higher maintenance rates on most of our product lines.

Appraisal services. Appraisal services revenue declined 11% for the three months ended September 30, 2009 compared to the prior year period and rose 3% for the nine months ended September 30, 2009 compared to the prior year period. The appraisal services business is somewhat cyclical and driven in part by scheduled revaluation cycles in various states. We substantially completed several large appraisal projects mid-2009. We began implementing several new revaluation contracts in the three months ended September 30, 2009.

Cost of Revenues and Gross Margins

The following table sets forth a comparison of the key components of our cost of revenues, and those components stated as a percentage of related revenues for the periods presented as of September 30:

	Third Quarter				Nine Months			
($ in thousands)	2009	% of Related Revenues	2008	% of Related Revenues	2009	% of Related Revenues	2008	% of Related Revenues
Software licenses	$ 1,366	13%	$ 2,071	18%	$ 4,075	13%	$ 6,838	22%
Acquired software	369	4	472	4	1,042	3	1,369	4
Software services, maintenance and subscriptions	35,259	61	31,988	63	102,520	62	93,555	65
Appraisal services	2,851	61	3,098	59	9,211	63	9,269	65
Hardware and other	1,252	70	1,058	71	3,697	76	3,684	72
Total cost of revenue	$ 41,097	55%	$ 38,687	56%	$ 120,545	56%	$ 114,715	59%

The following table sets forth a comparison of gross margin percentage by revenue type for the periods presented as of September 30:

	Third Quarter			Nine Months		
Gross Margin percentages	2009	2008	Change	2009	2008	Change
Software licenses and acquired software	82.9%	77.6%	5.3%	83.4%	74.1%	9.3%
Software services, maintenance and subscriptions	38.9	36.6	2.3	38.1	35.3	2.8

Appraisal services	39.2	41.4	(2.2)	37.1	34.9	2.2
Hardware and other	30.0	29.3	0.7	23.8	27.5	(3.7)
Overall gross margin	44.7%	43.6%	1.1%	44.2%	41.3%	2.9%

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Software licenses. Amortization expense for capitalized development costs on certain software products comprises approximately 15% of our cost of software license revenues in the three and nine months ended September 30, 2009, compared to approximately 47% of our cost of software license in the three and nine months ended September 30, 2008. The remaining balance is made up of third party software costs. Once a product is released, we begin to amortize the costs associated with its development over the estimated useful life of the product. Amortization expense is determined on a product-by-product basis at an annual rate not less than straight-line basis over the product s estimated life, which is generally five years. Development costs consist mainly of personnel costs, such as salary and benefits paid to our developers, and rent for related office space.

For the three and nine months ended September 30, 2009, our software license gross margin percentage rose significantly compared to the prior year periods because several products became fully amortized in late 2008, as did software acquired related to a significant acquisition in December 2003.

Software services, maintenance and subscription-based services. Cost of software services, maintenance and subscriptions primarily consists of personnel costs related to installation of our software, conversion of customer data, training customer personnel and support activities and various other services such as ASP and disaster recovery. For the three and nine months ended September 30, 2009, the software services, maintenance and subscriptions gross margin increased 2.3% and 2.8%, respectively from the prior year periods partly because maintenance and various other services such as ASP and disaster recovery costs typically grow at a slower rate than related revenues due to leverage in the utilization of our support and maintenance staff and economies of scale. We have increased our implementation and support staff by 20 employees since September 30, 2008 in order to expand our capacity to implement our contract backlog. The software services, maintenance and subscription-based services gross margin also benefited from slightly higher rates for certain services.

In addition, for the nine months ended September 30, 2008, the gross margin included a benefit of approximately .6% which reflected the impact of revenue which had been deferred pending final acceptance on a certain contract. There were no related costs associated with this revenue in 2008.

Appraisal services. Our appraisal gross margin for the three months ended September 30, 2009 declined compared to the prior year period. We substantially completed several large appraisal contracts mid-year 2009 but did not reduce our workforce because we expect to ramp up efforts on several new revaluations which began mid-year. Our appraisal gross margin for the nine months ended September 30, 2009 increased compared to the prior year period as the result of cost savings and operational efficiencies experienced on an unusually complex project.

Our blended gross margins for the three and nine months ended September 30, 2009 were higher than the prior year due to lower amortization expense of software development costs described above. The gross margin for both periods also benefited from leverage in the utilization of our support and maintenance staff and economies of scale and slightly higher rates on certain services.

Selling, General and Administrative Expenses

The following table sets forth a comparison of our selling, general and administrative (SG&A) expenses for the periods presented as of September 30:

	Third Quarter		Change		Nine Months		Change	
($ in thousands)	2009	2008	$	%	2009	2008	$	%
Selling, general and administrative expenses	$17,114	$15,985	$1,129	7%	$51,608	$46,155	$5,453	12%
Percent of revenues	23.0%	23.3%			23.9%	23.6%		

SG&A as a percentage of revenues for the nine months ended September 30, 2009 grew slightly from the prior year period. For the nine months ended September 30, 2009, the increase in SG&A expenses was comprised of higher stock compensation expense, commission costs as well as marketing expenses. Marketing expenses in the three months ended September 30, 2009 include costs associated with the launch of a new corporate branding initiative.

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Research and Development Expense

The following table sets forth a comparison of our research and development expense for the periods presented as of September 30:

	Third Quarter		Change		Nine Months		Change	
($ in thousands)	2009	2008	$	%	2009	2008	$	%
Research and development expense	$2,973	$1,416	$1,557	110%	$8,047	$5,485	$2,562	47%
Percent of revenues	4.0%	2.1%			3.7%	2.8%		

Research and development expense consist mainly of costs associated with the Microsoft Dynamics AX project, in addition to costs associated with other new product development efforts. In January 2007, we entered into a strategic alliance with Microsoft Corporation to jointly develop core public sector functionality for Microsoft Dynamics AX to address the accounting needs of public sector organizations worldwide. In the nine months ended September 30, 2009 and 2008, we offset our research and development expense by $2.6 million and $987,000, respectively, which were the amounts earned under the terms of our agreement with Microsoft. We amended this agreement in September 2008 to define the scope of reimbursable development through the balance of the project and now expect to offset research and development expense by approximately $850,000 each quarter through the end of 2010. The actual amount and timing of future research and development costs and related reimbursements and whether they are capitalized or expensed may vary.

Non-Cash Legal Settlement Related to Warrants

On June 27, 2008, we settled outstanding litigation related to two Stock Purchase Warrants (the Warrants) owned by Bank of America, N. A. (BANA). As disclosed in prior SEC filings, the Warrants entitled BANA to acquire 1.6 million shares of Tyler common stock at an exercise price of $2.50 per share. Following court-ordered mediation, in July 2008, BANA paid us $2.0 million and we issued to BANA 801,883 restricted shares of Tyler common stock. Accordingly, we recorded a non-cash legal settlement related to warrants charge of $9.0 million, which is not tax deductible, during the three months ended June 30, 2008.

Amortization of Customer and Trade Name Intangibles

Acquisition intangibles are composed of the excess of the purchase price over the fair value of net tangible assets acquired that is allocated to acquired software and customer and trade name intangibles. The remaining excess purchase price is allocated to goodwill that is not subject to amortization. Amortization expense related to acquired software is included with cost of revenues while amortization expense of customer and trade name intangibles is recorded as a non-operating expense. The following table sets forth a comparison of amortization of customer and trade name intangibles for the periods presented as of September 30:

	Third Quarter		Change		Nine Months		Change	
($ in thousands)	2009	2008	$	%	2009	2008	$	%
Amortization of customer and trade name intangibles	$685	$612	$73	12%	$2,034	$1,770	$264	15%

In the nine months ended September 30, 2009, we completed several acquisitions and purchased certain software assets to compliment our tax and appraisal solutions and our student information management solutions. These transactions increased amortizable customer and trade name intangibles by approximately $625,000. This amount will be amortized over approximately 10 years.

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Income Tax Provision

The following table sets forth comparison of our income tax provision for the periods presented as of September 30:

	Third Quarter		Change		Nine Months		Change	
($ in thousands)	2009	2008	$	%	2009	2008	$	%
Income tax provision	$4,946	$5,976	$(1,030)	(17)%	$13,362	$9,700	$3,662	38%
Effective income tax rate	39.8%	48.4%			39.6%	49.9%		

Our effective income tax rate decreased compared to the prior year periods due to a non-cash legal settlement in June 2008 related to warrants charge of $9.0 million, which was not deductible. The effective income tax rates for the three and nine months ended September 30, 2009 and 2008 were different from the statutory United States federal income tax rate of 35% primarily due to a non-cash legal settlement related to warrants charge which was not deductible, as well as state income taxes, non-deductible share-based compensation expense, the qualified manufacturing activities deduction, and non-deductible meals and entertainment costs.

FINANCIAL CONDITION AND LIQUIDITY

As of September 30, 2009, we had cash and cash equivalents (including restricted cash equivalents) of $7.9 million and investments of $2.1 million, compared to cash and cash equivalents (including restricted cash equivalents) of $6.8 million and investments of $4.6 million at December 31, 2008. As of September 30, 2009, we had outstanding borrowings of $2.1 million and unused borrowing capacity of $21.6 million under our revolving line of credit. In addition, as of September 30, 2009, we had issued outstanding letters of credit totaling $7.3 million to secure surety bonds required by some of our customer contracts. These letters of credit have been collateralized by restricted cash balances of $6.0 million and $1.3 million of our available borrowing capacity and expire through mid-2010.

The following table sets forth a summary of cash flows for the nine months ended September 30:

($ in thousands)	2009	2008
Cash flows provided by (used by):		
Operating activities	$ 31,249	$ 45,399
Investing activities	(9,973)	(7,348)
Financing activities	(21,143)	(23,914)
Net increase in cash and cash equivalents	$ 133	$ 14,137

Net cash provided by operating activities continues to be our primary source of funds to finance operating needs and capital expenditures. Other capital resources include cash on hand, public and private issuances of debt and equity securities, and bank borrowings. The capital and credit markets have become more volatile and tight as a result of adverse conditions that have caused the failure and near failure of a number of large financial services companies. It is possible that our ability to access the capital and credit markets may be limited by these or other factors. Notwithstanding the foregoing, at this time we believe that cash provided by operating activities, cash on hand and our revolving line of credit are sufficient to fund our working capital requirements, capital expenditures, income tax obligations, and share repurchases for the foreseeable future.

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Operating Activities

For the nine months ended September 30, 2009, operating activities provided net cash of $31.2 million, primarily generated from net income of $20.4 million, non-cash depreciation and amortization charges of $7.1 million, non-cash share-based compensation expense of $3.7 million, offset by a small increase in net operating assets of $700,000. Net cash provided by operating activities declined approximately $14.1 million due to several factors. Accounts receivable as of September 30, 2009 included several large milestone and retainer billings. In addition maintenance billing activity in the three months ended September 30, 2009 was higher than the comparable prior year period due to an increased number of customers and a slight change in our maintenance billing cycle which shifted some maintenance billing from the second quarter to the third quarter. Cash from operations in the prior year period included several unusually large advance payments from customers. We did not have any similar-sized advance payments from customers in 2009.

Our days sales outstanding (DSO) was 104 days at September 30, 2009, 99 days at December 31, 2008 and 87 days at September 30, 2008. Our maintenance billing cycles typically peak at their highest level in December and June of each year and are followed by collections in the subsequent quarter. As a result our DSO usually declines in the third quarter compared to the fourth quarter. However, our DSO remained higher than December due to several large milestone billings in the third quarter for which the revenue will be recognized in future periods as well as a slight change in our maintenance billing cycle which shifted some maintenance billing from the second quarter to the third quarter. DSO is calculated based on quarter-end accounts receivable divided by the quotient of annualized quarterly revenues divided by 360 days.

Our investments available-for-sale consist of auction rate municipal securities (ARS) which are collateralized debt obligations supported by municipal agencies and do not include mortgage-backed securities. All of our ARS are reflected at estimated fair value in the balance sheet at September 30, 2009. In prior periods, due to the auction process which took place every 28 to 35 days for most ARS, quoted market prices were readily available, which would have qualified as Level 1 as discussed in FASB ASC 820, Fair Value Measurements and Disclosures. However, due to the financial market crisis, the auction events for these securities have failed. Therefore, quoted prices in active markets are no longer available and we determined the estimated fair values of these securities as of September 30, 2009, utilizing a discounted trinomial model. The model considers the probability of three potential occurrences for each auction event through the maturity date of each ARS. The three potential outcomes for each auction are (i) successful auction/early redemption, (ii) failed auction and (iii) issuer default. Inputs in determining the probabilities of the potential outcomes include but are not limited to, the securities collateral, credit rating, insurance, issuer s financial standing, contractual restrictions on disposition and the liquidity in the market. The fair value of each ARS is determined by summing the present value of the probability-weighted future principal and interest payments determined by the model.

In association with this estimate of fair value, we have recorded an after tax temporary unrealized gain on our ARS of $28,000, net of related tax effects of $15,000 in the nine months ended September 30, 2009, which is included in accumulated other comprehensive loss on our balance sheet. As of September 30, 2009, we have continued to earn and collect interest on all of our ARS. We believe that this temporary decline in fair value is due entirely to liquidity issues, because the underlying assets of these securities are supported by municipal agencies and do not include mortgage-backed securities, have redemption features which call for redemption at 100% of par value and have a current credit rating between A and AAA. The ratings on the ARS take into account credit support through insurance policies guaranteeing each of the bonds payment of principal and accrued interest, if it becomes necessary. In addition, we do not plan to sell any of the ARS prior to maturity at an amount below the original purchase value and, at this time, do not deem it probable that we will receive less than 100% of the principal and accrued interest. We liquidated $2.5 million ARS for cash at par during the nine months ended September 30, 2009. Based on our cash and cash equivalents balance of $7.9 million, expected operating cash flows, availability under our revolving credit agreement, and liquidation of $2.5 million of ARS during the nine months ended September 30, 2009, we do not believe a lack of liquidity associated with our ARS will adversely affect our ability to conduct business, and believe we have the ability to hold the securities throughout the currently estimated recovery period. We have classified these securities as non-current because we believe the market for these securities may take in excess of twelve months to fully recover.

We will continue to evaluate any changes in the market value of our ARS and in the future, depending upon existing market conditions, we may be required to record an other-than-temporary decline in market value.

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Investing activities used cash of $10.0 million in the nine months ending September 30, 2009 compared to $7.3 million for the same period in 2008. In connection with plans to consolidate workforces and support planned long-term growth, we paid $6.8 million for construction of an office building in Lubbock, Texas and expect to pay an additional $5.0 million in the next three months to complete this construction. In the nine months ended September 30, 2009, we also liquidated $2.5 million of investments in ARS for cash at par. We also completed the acquisition of all of the capital stock of Assessment Evaluation Services, Inc. for $1.1 million in cash, paid $700,000 in cash for certain assets of KPL, Inc. d/b/a Parker-Lowe & Associates and acquired various software assets for $1.1 million in cash. In the comparable prior year period, we liquidated $35.9 million of short-term investments in ARS for cash at par, and we completed the acquisitions of School Information Systems, Inc., VersaTrans Solutions Inc., and certain assets of Olympia Computing Company, Inc. d/b/a Schoolmaster. The combined purchase price, excluding cash acquired and including transaction costs, was approximately $23.9 million in cash and approximately 196,000 shares of Tyler common stock valued at $2.9 million. We also paid $2.5 million primarily for land in Lubbock, Texas in connection with a planned office development and paid $12.7 million for an office building, land, and a related tenant lease in Yarmouth, Maine. Capital expenditures and acquisitions were funded from cash generated from operations.

Financing activities used cash of $21.1 million in the nine months ending September 30, 2009 compared to $23.9 million in the same period for 2008. Cash used in financing activities was primarily comprised of purchases of treasury shares, net of proceeds from stock option exercises and employee stock purchase plan activity. These purchases were funded by short-term borrowings as well as cash from operations.

During the nine months ended September 30, 2009, we purchased 1.2 million shares of our common stock for an aggregate purchase price of $17.0 million. At September 30, 2009, we had authorization to repurchase up to 2.3 million additional shares of Tyler common stock. A summary of the repurchase activity during the nine months ended September 30, 2009 is as follows:

(Shares in thousands)	Total number of shares repurchased	Additional number of shares authorized that may be repurchased	Average price paid per share	Maximum number of shares that may be repurchased under current authorization
January 1 through January 31	266		$ 11.93	1,232
February 1 through February 28	233		12.87	999
March 1 through March 31	208		12.79	791
April 1 through April 30				791
Additional authorization by the board of directors		2,000		2,791
May 1 through May 31				2,791
June 1 through June 30	8		15.28	2,783
July 1 through July 31	35		15.28	2,748
August 1 through August 31	485		15.50	2,263
September 1 through September 30				2,263
Total nine months ended September 30, 2009	1,235	2,000	$ 13.77	

The repurchase program, which was approved by our board of directors, was announced in October 2002, and was amended in April and July 2003, October 2004, October 2005, May 2007, May 2008 and May 2009. There is no expiration date specified for the authorization and we intend to repurchase stock under the plan from time to time in the future.

We made federal and state income tax payments, net of refunds of $13.2 million in the nine months ended September 30, 2009 compared to $10.1 million in the comparable prior year.

Excluding acquisitions, we anticipate that 2009 capital spending will be between $14.0 million and $15.0 million. Approximately $12.0 million of these expenditures will be incurred to complete the construction of an office building in Lubbock, Texas. The remainder of our 2009 expenditures is primarily related to computer equipment and software for infrastructure expansions. We currently do not expect to capitalize significant amounts related to software development in 2009, but the actual amount and timing of those costs, and whether they are capitalized or expensed may result in additional capitalized software development. Capital spending in 2009 is expected to be funded from existing cash balances, cash flows from operations and our revolving line of credit.

From time to time we engage in discussions with potential acquisition candidates. In order to consummate any such opportunities, which could require significant commitments of capital; we may be required to incur debt or to issue additional potentially dilutive securities in the future. No assurance can be given as to our future acquisitions and how such acquisitions may be financed.

ITEM 3. Quantitative and Qualitative Disclosures About Market Risk

Market risk represents the risk of loss that may affect us due to adverse changes in financial market prices and interest rates. Our investments available-for-sale consist of auction rate municipal securities (ARS) which are collateralized debt obligations supported by municipal agencies and do not include mortgage-backed securities.

All of our ARS are reflected at estimated fair value in the balance sheet at September 30, 2009. In prior periods, due to the auction process which took place every 28 to 35 days for most ARS, quoted market prices were readily available, which would have qualified as Level 1 as discussed in FASB ASC 820 Fair Value Measurements and Disclosures. However, due to the financial market crisis, the auction events for most of these securities have failed. Therefore, quoted prices in active markets are no longer available and we determined the estimated fair values of these securities as of September 30, 2009, utilizing a discounted trinomial model.

In association with this estimate of fair value, we have recorded an after tax temporary unrealized gain on our ARS of $28,000, net of related tax effects of $15,000 in the nine months ended September 30, 2009, which is included in accumulated other comprehensive loss on our balance sheet. As of September 30, 2009, we have continued to earn and collect interest on all of our ARS. We believe that this temporary decline in fair value is due entirely to liquidity issues, because the underlying assets of these securities are supported by municipal agencies and do not include mortgage-backed securities, have redemption features which call for redemption at 100% of par value and have a current credit rating between A and AAA. The ratings on the ARS take into account credit support through insurance policies guaranteeing each of the bonds payment of principal and accrued interest, if it becomes necessary. In addition, we do not plan to sell any of the ARS prior to maturity at an amount below the original purchase value and, at this time, do not deem it probable that we will receive less than 100% of the principal and accrued interest. We liquidated $2.5 million ARS for cash at par during the nine months ended September 30, 2009. Based on our cash and cash equivalents balance of $7.9 million, expected operating cash flows, availability under our revolving credit agreement, and liquidation of $2.5 million of ARS during the nine months ended September 30, 2009, we do not believe a lack of liquidity associated with our ARS will adversely affect our ability to conduct business, and believe we have the ability to hold the securities throughout the currently estimated recovery period. We have classified these securities as non-current because we believe the market for these securities may take in excess of twelve months to fully recover. We will continue to evaluate any changes in the market value of our ARS and in the future, depending upon existing market conditions, we may be required to record an other-than-temporary decline in market value.

ITEM 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures. We maintain disclosure controls and procedures (as defined in Rule 13a-15(e) of the Securities Exchange Act) designed to provide reasonable assurance that the information required to be disclosed by us in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms. These include controls and procedures designed to ensure that this information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosures. Management, with the participation of the Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Based on this evaluation the Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were effective as of September 30, 2009.

Changes in Internal Control over Financial Reporting. There were no changes in our internal control over financial reporting (as defined in Rule 13a-15(f) of the Exchange Act) during the three months ended September 30, 2009, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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Part II. OTHER INFORMATION

ITEM 1. Legal Proceedings

On November 3, 2008, a putative collective action complaint was filed against us in the United States District Court for the Eastern District of Texas (the Court) on behalf of current and former customer support analysts, client liaisons, engineers, trainers, and education services specialists. The petition alleges that we misclassified these groups of employees as exempt rather than non-exempt under the Fair Labor Standards Act and that we therefore failed to properly pay overtime wages. The suit was initiated by six former employees working out of our Longview, Texas, office and seeks to recover damages in the form of lost overtime pay since October 31, 2005, liquidated damages equal to the amount of lost overtime pay, interest, costs, and attorneys fees. On June 23, 2009, the Court issued an Order granting Plaintiffs motion for conditional certification for the purpose of providing notice to potential plaintiffs about the litigation. On September 22, 2009, the Court granted Plaintiffs motion to provide for additional email notice to potential plaintiffs and to extend the opt in period for an additional thirty days. We intend to vigorously defend the action. Given the preliminary nature of the alleged claims and the inherent unpredictability of litigation, we cannot at this time estimate the possible outcome of any such action.

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

ITEM 1A. Risk Factors

In addition to the other information set forth in this report, one should carefully consider the discussion of various risks and uncertainties contained in Part I, Item 1A. Risk Factors in our 2008 Annual Report on Form 10-K. We believe those risk factors are the most relevant to our business and could cause our results to differ materially from the forward-looking statements made by us. Please note, however, that those are not the only risk factors facing us. Additional risks that we do not consider material, or of which we are not currently aware, may also have an adverse impact on us. Our business, financial condition and results of operations could be seriously harmed if any of these risks or uncertainties actually occurs or materializes. In that event, the market price for our common stock could decline, and our shareholders may lose all or part of their investment. During the first nine months of 2009, there were no material changes in the information regarding risk factors contained in our Annual Report on Form 10-K for the year ended December 31, 2008.

ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds

None

ITEM 3. Defaults Upon Senior Securities

None

ITEM 4. Submission of Matters to a Vote of Security Holders

None

ITEM 5. Other Information

None

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ITEM 6. Exhibits

Exhibit 4.1	Second Amendment to the Second Amended and Restated Credit Agreement by and between Tyler Technologies, Inc. and Bank of Texas, N. A. dated August 21, 2009.
Exhibit 4.2	Third Amended and Restated Credit Agreement by and between Tyler Technologies, Inc. and Bank of Texas, N. A. dated October 19, 2009.
Exhibit 4.3	First Amendment to the Second Amended and Restated Pledge and Security Agreement by and between Tyler Technologies, Inc. and Bank of Texas, N. A. dated October 19, 2009.
Exhibit 31.1	Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
Exhibit 31.2	Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
Exhibit 32.1	Certifications Pursuant to 18 U.S.C. Section 1350, as adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

TYLER TECHNOLOGIES, INC.

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

Date: October 27, 2009