TYLER TECHNOLOGIES INC
Form 10-Q
May 10, 2018

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 March 31, 2018
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, a non-accelerated filer, smaller reporting company, or an emerging growth company. See definition of “large accelerated filer," "accelerated filer,” "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

| | |
|---|---|
| Large accelerated filer x | Accelerated filer |
| Non-accelerated filer | Smaller reporting company |
| | Emerging growth company |

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any

new or revised financial accounting standards
provided pursuant to Section 13(a) of the Exchange
Act.

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 May 8, 2018 was 38,287,263.

PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements
TYLER TECHNOLOGIES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(In thousands, except per share amounts)
(Unaudited)

| | Three Months Ended March 31, | |
|---|---|---|
| | 2018 | 2017 As Adjusted |
| Revenues: | | |
| Software licenses and royalties | $22,776 | $21,758 |
| Subscriptions | 49,028 | 39,862 |
| Software services | 45,939 | 42,496 |
| Maintenance | 93,897 | 86,307 |
| Appraisal services | 5,394 | 6,612 |
| Hardware and other | 4,140 | 2,694 |
| Total revenues | 221,174 | 199,729 |
| | | |
| Cost of revenues: | | |
| Software licenses and royalties | 778 | 731 |
| Acquired software | 5,382 | 5,410 |
| Software services, maintenance and subscriptions | 106,085 | 93,540 |
| Appraisal services | 3,781 | 4,197 |
| Hardware and other | 2,343 | 1,316 |
| Total cost of revenues | 118,369 | 105,194 |
| | | |
| Gross profit | 102,805 | 94,535 |
| | | |
| Selling, general and administrative expenses | 47,604 | 42,780 |
| Research and development expense | 13,048 | 11,599 |
| Amortization of customer and trade name intangibles | 3,315 | 3,325 |
| | | |
| Operating income | 38,838 | 36,831 |
| | | |
| Other income (expense), net | 599 | (190) |
| Income before income taxes | 39,437 | 36,641 |
| Income tax provision | 1,612 | 3,872 |
| Net income | $37,825 | $32,769 |
| | | |
| Earnings per common share: | | |
| Basic | $1.00 | $0.89 |
| Diluted | $0.95 | $0.84 |

See accompanying notes.

TYLER TECHNOLOGIES, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except par value and share amounts)

| | March 31, 2018 (unaudited) | December 31, 2017 As Adjusted |
|---|---|---|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | $210,616 | $185,926 |
| Accounts receivable (less allowance for losses of $4,780 in 2018 and $5,427 in 2017) | 216,516 | 246,188 |
| Short-term investments | 65,858 | 43,159 |
| Prepaid expenses | 30,262 | 32,206 |
| Income tax receivable | 7,286 | 11,339 |
| Other current assets | 2,098 | 1,997 |
| Total current assets | 532,636 | 520,815 |
| | | |
| Accounts receivable, long-term | 11,550 | 12,107 |
| Property and equipment, net | 154,254 | 152,315 |
| Other assets: | | |
| Goodwill | 657,727 | 657,987 |
| Other intangibles, net | 221,069 | 229,617 |
| Non-current investments and other assets | 48,388 | 38,510 |
| Total assets | $1,625,624 | $1,611,351 |
| | | |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable | $6,421 | $8,174 |
| Accrued liabilities | 44,996 | 64,675 |
| Deferred revenue | 268,132 | 298,613 |
| Total current liabilities | 319,549 | 371,462 |
| | | |
| Deferred revenue, long-term | 641 | 1,274 |
| Deferred income taxes | 44,220 | 46,879 |
| | | |
| Commitments and contingencies | | |
| | | |
| Shareholders' equity: | | |
| Preferred stock, $10.00 par value; 1,000,000 shares authorized; none issued | — | — |
| Common stock, $0.01 par value; 100,000,000 shares authorized; 48,147,969 shares issued and outstanding as of March 31, 2018 and December 31, 2017 | 481 | 481 |
| Additional paid-in capital | 652,909 | 626,867 |
| Accumulated other comprehensive loss, net of tax | (46) | (46) |
| Retained earnings | 662,288 | 624,463 |
| Treasury stock, at cost; 9,900,041 and 10,262,182 shares in 2018 and 2017, respectively | (54,418) | (60,029) |
| Total shareholders' equity | 1,261,214 | 1,191,736 |
| Total liabilities and shareholders' equity | $1,625,624 | $1,611,351 |

See accompanying notes.

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TYLER TECHNOLOGIES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

| | Three Months Ended March 31, 2018 | 2017 As Adjusted |
|---|---|---|
| Cash flows from operating activities: | | |
| Net income | $ 37,825 | $ 32,769 |
| Adjustments to reconcile net income to cash provided by operating activities: | | |
| Depreciation and amortization | 14,112 | 12,967 |
| Share-based compensation expense | 10,557 | 8,676 |
| Deferred income tax (benefit) | (2,658) | (3,870) |
| Changes in operating assets and liabilities, exclusive of effects of acquired companies: | | |
| Accounts receivable | 30,227 | 37,542 |
| Income taxes | 4,053 | 7,576 |
| Prepaid expenses and other current assets | 1,333 | (919) |
| Accounts payable | (1,752) | (1,166) |
| Accrued liabilities | (17,952) | (15,939) |
| Deferred revenue | (31,114) | (29,457) |
| Net cash provided by operating activities | 44,631 | 48,179 |
| Cash flows from investing activities: | | |
| Additions to property and equipment | (8,895) | (19,820) |
| Purchase of marketable security investments | (43,962) | (7,128) |
| Proceeds from marketable security investments | 11,077 | 6,896 |
| Decrease (increase) in other | 743 | (16) |

| | | |
|---|---|---|
| Net cash used by investing activities | (41,037) | (20,068) |
| Cash flows from financing activities: | | |
| Decrease in net borrowings on revolving line of credit | — | (10,000) |
| Purchase of treasury shares | — | (7,032) |
| Proceeds from exercise of stock options | 19,298 | 14,851 |
| Contributions from employee stock purchase plan | 1,798 | 1,650 |
| Net cash provided (used) by financing activities | 21,096 | (531) |
| Net increase in cash and cash equivalents | 24,690 | 27,580 |
| Cash and cash equivalents at beginning of period | 185,926 | 36,151 |
| Cash and cash equivalents at end of period | $ 210,616 | $ 63,731 |

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 March 31, 2018, and December 31, 2017, and operating result amounts are for the three months ended March 31, 2018, and 2017, respectively, and include all normal and recurring adjustments that we considered necessary for the fair summarized presentation of our financial position and operating results. As these are condensed financial statements, one should also read the financial statements and notes included in our latest Form 10-K for the year ended December 31, 2017. Revenues, expenses, assets and liabilities can vary during each quarter of the year. Therefore, the results and trends in these interim financial statements may not be the same as those for the full year.

Comprehensive income (loss) is defined as the change in equity of a business enterprise during a period from transactions, and other events and circumstances from non-owner sources and includes all components of net income (loss) and other comprehensive income (loss). We had no items of other comprehensive income (loss) for the three months ended March 31, 2018 and 2017.

Effective January 1, 2018, we adopted the requirements of Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers, utilizing the full retrospective approach as discussed in Note 2 - Accounting Standards and Significant Accounting Policies. All amounts and disclosures set forth in this Form 10-Q have been updated to comply with the new standard, as indicated by the "as adjusted" footnote.

(2) Accounting Standards and Significant Accounting Policies

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Except for the accounting policies for revenue recognition and deferred commissions that were adjusted as a result of adopting ASU No. 2014-09, there have been no changes to our significant accounting policies described in the Annual Report on Form 10-K for the year ended December 31, 2017, filed with the SEC on February 22, 2018, that have had a material impact on our condensed consolidated financial statements and related notes.

USE OF ESTIMATES

The preparation of our financial statements in conformity with accounting principles generally accepted in the United States ("GAAP") requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant items subject to such estimates and assumptions include revenue recognition, determining the nature and timing of satisfaction of performance obligations, and determining the standalone selling price ("SSP") of performance obligations, variable consideration, and other obligations such as returns and refunds; loss contingencies; the estimated useful life of deferred commissions; the carrying amount and estimated useful lives of intangible assets; determining share-based compensation expense; the valuation allowance for receivables; and determining the potential outcome of future tax consequences of events that have been recognized on our consolidated financial statements or tax returns. Actual results could differ from estimates.

REVENUE RECOGNITION

Nature of Products and Services

We provide integrated software systems and related services for the public sector, with a focus on local governments. We develop and market a broad line of software solutions 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, including software and hardware installation, data conversion, training, and for certain customers, product modifications, along with continuing maintenance and support for customers using our systems. We also provide subscription-based services such as software as a service (“SaaS”) arrangements, which utilize the Tyler private cloud, and electronic document filing solutions (“e-filing”). In addition, we provide property appraisal outsourcing services for taxing jurisdictions.

We earn revenue from software licenses, royalties, subscription-based services, software services, post-contract customer support (“PCS” or “maintenance”), hardware, and appraisal services. Revenue is recognized upon transfer of control of promised products or services to customers in an amount that reflects the consideration we expect to receive in exchange for those products or services. We determine revenue recognition through the following steps:

- Identification of the contract, or contracts, with a customer
- Identification of the performance obligations in the contract
- Determination of the transaction price
- Allocation of the transaction price to the performance obligations in the contract
- Recognition of revenue when, or as, we satisfy a performance obligation

Most of our software arrangements with customers contain multiple performance obligations that range from software licenses, installation, training, and consulting to software modification and customization to meet specific customer needs (services) and post-contract support (PCS). For these contracts, we account for individual performance obligations separately when they are distinct. We evaluate whether separate performance obligations can be distinct or should be accounted for as one performance obligation. Arrangements that include software services, such as training or installation, are evaluated to determine whether those services are essential to the product’s functionality. The transaction price is allocated to the distinct performance obligations on a relative standalone selling price ("SSP") basis. We determine the SSP based on our overall pricing objectives, taking into consideration market conditions and other factors, including the value of our contracts, the applications sold, customer demographics, and the number and types of users within our contracts. Revenue is recognized net of allowances for sales adjustments and any taxes collected from customers, which are subsequently remitted to governmental authorities.

Software Arrangements:

Software Licenses and Royalties

Many of our software arrangements involve “off-the-shelf” software. We recognize the revenue allocable to "off the shelf" software licenses and specified upgrades at a point in time when control of the software license transfers to the customer, unless the software is not considered distinct. We consider off-the-shelf software to be distinct when it can be added to an arrangement with minor changes in the underlying code, it can be used by the customer for the customer’s purpose upon installation and remaining services such as training are not considered essential to the product's functionality.

For arrangements that involve significant production, modification or customization of the software, or where software services are otherwise not considered distinct, we recognize revenue over time by measuring progress-to-completion. We measure progress-to-completion primarily using labor hours incurred as it best depicts the transfer of control to the customer which occurs as we incur costs on our contracts. These arrangements are often implemented over an extended period and occasionally require us to revise total cost estimates. Amounts recognized in revenue are calculated using the progress-to-completion measurement after giving effect to any changes in our cost estimates. Changes to total estimated contract costs, if any, are recorded in the period they are determined. Estimated losses on uncompleted contracts are recorded in the period in which we first determine that a loss is apparent.

Software license fees are billed in accordance with the contract terms. Typically a majority of the fee is due when access to the software license is made available to the customer and the remainder of the fee due over a passage of time stipulated by the contract. We record amounts that have been invoiced in accounts receivable and in deferred revenue or revenues, depending on whether the revenue recognition criteria have been met.

We recognize royalty revenue when earned under the terms of our third-party royalty arrangements. Currently, our third-party royalties are recognized at a point in time based on an estimated basis and trued up when we receive notice of amounts earned. Typically, we receive notice of royalty revenues earned and billed on a quarterly basis in the quarter immediately following the royalty reporting period.

Software Services

As noted above, some of our software arrangements include services considered essential or require significant customization to meet the customer's desired functionality. For these software arrangements, both the software licenses and related software services revenue are not distinct and are recognized over time using the progress-to-completion method. We measure progress-to-completion primarily using labor hours incurred as it best depicts the transfer of control to the customer which occurs as we incur costs on our contracts. Contract fees are typically billed on a milestone basis as defined within contract terms. We record amounts that have been invoiced in accounts receivable and in deferred revenue or revenues, depending on whether the revenue recognition criteria have been met. When software services are distinct, the fee allocable to the service element is recognized over the time we perform the services and is billed on a time and material basis.

Post-Contract Customer Support

Our customers generally enter into PCS agreements when they purchase our software licenses. PCS includes telephone support, bug fixes, and rights to upgrades on a when-and-if available basis. PCS is considered distinct when purchased with our software licenses. Our PCS agreements are typically renewable annually. PCS is recognized over time on a straight-line basis over the period the PCS is provided. All significant costs and expenses associated with PCS are expensed as incurred.

Computer Hardware Equipment

Revenue allocable to computer hardware equipment is recognized at a point in time when control of the equipment is transferred to the customer.

Subscription-Based Services:

Subscription-based services consist of revenues derived from SaaS arrangements, which utilize the Tyler private cloud, and electronic filing transactions. Revenue from subscription-based services is generally recognized over time on a ratable basis over the contract term, beginning on the date that our service is made available to the customer. Our subscription contracts are generally three to five years or longer in length, billed annually in advance, and non-cancelable.

For SaaS arrangements, we evaluate whether the customer has the contractual right to take possession of our software at any time during the hosting period without significant penalty and whether the customer can feasibly maintain the software on the customer’s hardware or enter into another arrangement with a third-party to host the software. We allocate contract value to each performance obligation of the arrangement that qualifies for treatment as a distinct element based on estimated SSP. When it is determined that software is distinct and the customer has the ability to take control of the software, we recognize revenue allocable to the software license fee when access to the software license is made available to the customer. We recognize hosting services ratably over the term of the arrangement, which range from one to ten years but are typically for a period of three to five years. For software and software services associated with SaaS arrangements that are not distinct or are contingent on the transfer of other performance obligations, we recognize the revenue ratably over the remaining contractual period once we have provided the customer access to the software. We record amounts that have been invoiced in accounts receivable and in deferred revenue or revenues, depending on whether the revenue recognition criteria have been met.

Electronic filing transaction fees primarily pertain to documents filed with the courts by attorneys and other third-parties via our e-filing services and retrieval of filed documents via our access services. For each document filed with a court, the filer generally pays a transaction fee and a court filing fee to us and we remit a portion of the transaction fee and the filing fee to the court. We record as revenue the transaction fee, while the portion of the transaction fee remitted to the courts is recorded as cost of sales as we are acting as a principal in the arrangement. Court filing fees collected on behalf of the courts and remitted to the courts are recorded on a net basis and thus do not affect the statement of comprehensive income. For e-filing transaction fees, we have the right to charge the customer in an amount that directly corresponds with the value to the customer of our performance to date. Therefore, we recognize revenue for these services over time based on the amount billable to the customer in accordance with the 'as invoiced' practical expedient in ASC 606-10-55-18. In some cases, we are paid on a fixed fee basis and recognize the revenue ratably over the contractual period.

Costs of performing services under subscription-based arrangements are expensed as incurred, except for certain direct and incremental contract origination and set-up costs associated with SaaS arrangements. Such direct and incremental costs are capitalized and amortized ratably over the useful life.

Appraisal Services:

For our property appraisal projects, we recognize revenue using the progress-to-completion method of revenue recognition since many of these projects are implemented over one to three-year periods and consist of various unique activities. Appraisal services require a significant level of integration and interdependency with various individual service components; therefore the service components are not considered distinct. Appraisal services are recognized over time by measuring progress-to-completion primarily using labor hours incurred as it best depicts the transfer of control to the customer which occurs as we incur costs on our contracts. These arrangements are often implemented over an extended period and occasionally require us to revise total cost estimates. Amounts recognized in revenue are calculated using the progress-to-completion measurement after giving effect to any changes in our cost estimates. Changes to total estimated contract costs, if any, are recorded in the period they are determined. Estimated losses on uncompleted contracts are recorded in the period in which we first determine that a loss is apparent. Contract fees are typically billed on a milestone basis as defined within contract terms. We record amounts that have been invoiced in accounts receivable and in deferred revenue or revenues, depending on whether the revenue recognition criteria have been met.

Significant Judgments:

Our contracts with customers often include multiple performance obligations to a customer. When a software arrangement (traditional or subscription) includes both software licenses and software services, judgment is required to determine whether the software license is considered distinct and accounted for separately, or not distinct and accounted for together with the software service and recognized over time.

The transaction price is allocated to the separate performance obligations on a relative SSP basis. We determine the SSP based on our overall pricing objectives, taking into consideration market conditions and other factors, including the value of our contracts, the applications sold, customer demographics, and the number and types of users within our contracts. We use a range of amounts to estimate SSP when we sell each of the products and services separately and need to determine whether there is a discount to be allocated based on the relative SSP of the various products and services. In instances where SSP is not directly observable, such as when we do not sell the product or service separately, we determine SSP using the expected cost-plus margin approach.

For arrangements that involve significant production, modification or customization of the software, or where software services otherwise cannot be considered distinct, we recognize revenue as control is transferred to the customer over time using progress-to-completion methods to recognize revenue from these arrangements. Depending on the contract, we measure progress-to-completion primarily using labor hours incurred, or value added. The progress-to-completion method generally results in the recognition of reasonably consistent profit margins over the life of a contract because we can provide reasonably dependable estimates of contract billings and contract costs. We use the level of profit margin that is most likely to occur on a contract. If the most likely profit margin cannot be precisely determined, the lowest probable level of profit margin in the range of estimates is used until the results can be estimated more precisely. These arrangements are often implemented over an extended time period and occasionally require us to revise total cost estimates. Amounts recognized in revenue are calculated using the progress-to-completion measurement after giving effect to any changes in our cost estimates. Changes to total estimated contract costs, if any, are recorded in the period they are determined. Estimated losses on uncompleted contracts are recorded in the period in which we first determine that a loss is apparent.

Typically, the structure of our arrangements does not give rise to variable consideration. However, in those instances whereby variable consideration exists, we include in our estimates additional revenue for variable consideration when we believe we have an enforceable right, the amount can be estimated reliably and its realization is probable.

Refer to Note 11 - Disaggregation of Revenue for further information, including the economic factors that affect the nature, amount, timing, and uncertainty of revenue and cash flows of our various revenue categories.

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Contract Balances:

Accounts receivable and allowance for doubtful accounts

Timing of revenue recognition may differ from the timing of invoicing to customers. We record an unbilled receivable when revenue is recognized prior to invoicing, or deferred revenue when revenue is recognized subsequent to invoicing. For multi-year agreements, we generally invoice customers annually at the beginning of each annual coverage period. We record a receivable related to revenue recognized for on-premises licenses as we have an unconditional right to invoice and receive payment in the future related to those licenses.

We maintain allowances for doubtful accounts, which are provided at the time the revenue is recognized. Since most of our customers are domestic governmental entities, we rarely incur a loss resulting from the inability of a customer to make required payments. Events or changes in circumstances that indicate that the carrying amount for the allowances for doubtful accounts may require revision, include, but are not limited to, deterioration of a customer's financial condition, failure to manage our customer's expectations regarding the scope of the services to be delivered, and defects or errors in new versions or enhancements of our software products.

The following table summarizes the changes in the allowances for doubtful accounts:

| | March 31, 2018 |
|---|---|
| Balance, beginning of period December 31, 2017 | $ 5,427 |
| Provisions for losses - accounts receivable | 320 |
| Deductions for accounts charged off or credits issued | (967 ) |
| Balance, end of period | $ 4,780 |

The allowance for doubtful accounts reflects our best estimate of probable losses inherent in the accounts receivable balance. We determine the allowance based on known troubled accounts, historical experience, and other currently available evidence.

In connection with our appraisal service contracts and certain software service contracts, we may perform work prior to when the software and services are billable and/or payable pursuant to the contract. Unbilled revenue is not billable at the balance sheet date but is recoverable over the remaining life of the contract through billings made in accordance with contractual agreements. The termination clauses in most of our contracts provide for the payment for the value of products delivered or services performed in the event of early termination. We have historically recorded such unbilled receivables (costs and estimated profit in excess of billings) in connection with (1) property appraisal services contracts accounted for using progress-to-completion method of revenue recognition using labor hours as a measure of progress towards completion in which the services are performed in one accounting period but the billing normally occurs subsequently and may span another accounting period; (2) software services contracts accounted for using progress-to-completion method of revenue recognition using labor hours as a measure of progress towards completion in which the services are performed in one accounting period but the billing for the software element of the arrangement may be based upon the specific phase of the implementation; (3) software revenue for which we have recognized revenue at the point in time when the software is made available to the customer but the billing has not yet been submitted to the customer; (4) some of our contracts which provide for an amount to be withheld from a progress billing (generally between 5% and 20% retention) until final and satisfactory project completion is achieved; and (5) in a limited number of cases, extended payment terms, which may be granted to customers with whom we generally have a long-term relationship and favorable collection history.

The opening balance of current and long-term accounts receivable, net of allowance for doubtful accounts, was $226.8 million (as adjusted) as of January 1, 2017.

As of March 31, 2018, and December 31, 2017, total current and long-term accounts receivable, net of allowance for doubtful accounts, was $228.1 million and $258.3 million (as adjusted), respectively. We have recorded unbilled receivables of $77.1 million and $64.6 million (as adjusted) at March 31, 2018, and December 31, 2017, respectively. Included in unbilled receivables are retention receivables of $7.9 million and $7.2 million at March 31, 2018, and December 31, 2017, respectively, which become payable upon the completion of the contract or completion of our fieldwork and formal hearings. Unbilled receivables expected to be collected within one year have been included with accounts receivable, current portion in the accompanying condensed consolidated balance sheets. Unbilled receivables and retention receivables expected to be collected past one year have been included with accounts receivable, long-term portion in the accompanying condensed consolidated balance sheets.

Payment terms and conditions vary by contract type, although terms generally include a requirement of payment within 30 to 60 days. In instances where the timing of revenue recognition differs from the timing of invoicing, we have determined our contracts generally do not include a significant financing component. The primary purpose of our invoicing terms is to provide customers with simplified and predictable ways of purchasing our products and services, not to receive financing from our customers or to provide customers with financing. Examples include invoicing at the beginning of a subscription term with revenue recognized ratably over the contract period, and multi-year on-premises term licenses that are invoiced annually with revenue recognized upfront.

Deferred Revenue

The majority of deferred revenue consists of deferred maintenance revenue that has been billed based on contractual terms in the underlying arrangement, with the remaining balance consisting of payments received in advance of revenue being earned under software licensing, subscription-based services, software and appraisal services and hardware installation. Refer to Note 12 - Deferred Revenue and Performance Obligations for further information, including deferred revenue by segment and changes in deferred revenue during the period.

Deferred Commissions

Sales commissions earned by our sales force are considered incremental and recoverable costs of obtaining a contract with a customer. Sales commissions for initial contracts are deferred and then amortized on a straight-line basis over a period of benefit that we have determined to be three to seven years. We utilized the 'portfolio approach' practical expedient in ASC 606-10-10-4, which allows entities to apply the guidance to a portfolio of contracts with similar characteristics because the effects on the financial statements of this approach would not differ materially from applying the guidance to individual contracts. Using the 'portfolio approach', we determined the period of benefit by taking into consideration our customer contracts, our technology life-cycle and other factors. Sales commissions for renewal contracts are deferred and then amortized on a straight-line basis over the remaining period of benefit. Deferred commissions have been included with prepaid expenses in the accompanying condensed consolidated balance sheets. Amortization expense related to deferred commissions is included in selling, general and administrative expenses in the accompanying condensed consolidated statements of income. Refer to Note 4 - Deferred Commissions for further information.

RECENTLY ADOPTED ACCOUNTING PRONOUNCEMENTS

Revenue from Contracts with Customers. In May 2014, the Financial Accounting Standards Board ("FASB") issued ASU No. 2014-09, Revenue from Contracts with Customers. ASU No. 2014-09 supersedes the revenue recognition requirements in Accounting Standards Codification ("ASC") Topic 605, Revenue Recognition ("Topic 605"), and requires the recognition of revenue when promised goods or services are transferred to customers in an amount that reflects the considerations to which the entity expects to be entitled to in exchange for those goods or 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 price to the performance obligations in the contract and recognizing revenue when (or as) the entity satisfies the performance obligations. Topic 606 also includes Subtopic 340-40 Other Assets and Deferred Costs - Contracts with Customers, which requires the deferral of incremental costs of obtaining a contract with a customer. Collectively, we refer to ASU No. 2014-09 and Subtopic 340-40 as the "new standard."

We adopted the requirements of the new standard as of January 1, 2018, utilizing the full retrospective method of transition. Adoption of the new standard resulted in changes to our accounting policies for revenue recognition, trade and other receivables, and deferred commissions as detailed below. We applied the new standard using a practical expedient where the consideration allocated to the remaining performance obligations or an explanation of when we expect to recognize that amount as revenue for all reporting periods presented before the date of the initial application is not disclosed.

The impact of adopting ASU 2014-09 on our total revenues for 2017 and 2016 was not material. The impact of adopting the new standard on our retained earnings and deferred commissions is material. The most significant impact of the standard relates to our accounting for software license revenue. Specifically, under the new standard, software license fees under perpetual agreements are no longer subject to 100% discount allocations from other performance obligations in the contract. Discounts in arrangements are allocated across all performance obligations increasing license revenues and decreasing revenues allocated to other performance obligations. In addition, in most cases, net license fees (total license fees less any allocated discounts) are recognized at the point in time when control of the software license transfers to the customer versus our legacy policy of recognizing revenue upon delivery and only to the extent billable per the contractual terms. Under the new standard, time-based license fees are no longer recognized over the contractual period of the license and are instead recognized at the point in time when the control of the software license transfers to the customer. Revenues related to our PCS renewals, SaaS offerings and appraisal services remain substantially unchanged. Due to the complexity of certain contracts, the actual revenue recognition treatment required under the new standard is dependent on contract-specific terms and may vary in some instances from recognition at the time of billing.

Adoption of the new standard requires that incremental costs directly related to obtaining a contract (typically sales commissions plus any associated fringe benefits) must be recognized as an asset and expensed on a systematic basis that is consistent with the transfer to the customer of the goods and services to which the asset relates, unless that life is less than one year. Prior to adoption of the new standard, we deferred sales commissions and recognized expense over the relevant initial contractual term, which was generally one to two years. Under the new standard, we amortize these costs over a period of benefit that we have determined to be three to seven years.

We adjusted our condensed consolidated financial statements from amounts previously reported due to the adoption of the new standard. Select unaudited condensed consolidated statement of income line items, which reflect the adoption of the new standard, are as follows (in thousands, except per share data):

| | Three Months Ended March 31, 2017 | | |
|---|---|---|---|
| | As Reported | Adjustments | As Adjusted |
| Statement of Income: | | | |
| Revenues: | | | |
| Software licenses and royalties | $18,223 | $ 3,535 | $21,758 |
| Subscriptions | 40,102 | (240) | 39,862 |
| Software services | 45,018 | (2,522) | 42,496 |
| Maintenance | 86,859 | (552) | 86,307 |
| Appraisal services | 6,612 | — | 6,612 |
| Hardware and other | 2,728 | (34) | 2,694 |
| Total revenues | $199,542 | $ 187 | $199,729 |
| | | | |
| Costs and expenses: | | | |
| Selling, general and administrative expenses | $43,142 | $ (362) | $42,780 |
| Amortization of customer and trade name intangibles | 3,458 | (133) | 3,325 |
| Operating income | 36,149 | 682 | 36,831 |
| Income tax provision | 3,653 | 219 | 3,872 |
| Net income | $32,306 | $ 463 | $32,769 |
| | | | |
| Earnings per common share: | | | |
| Basic | $0.88 | | $0.89 |
| Diluted | $0.83 | | $0.84 |

Select condensed consolidated balance sheet line items, which reflect the adoption of the new standard, are as follows (in thousands):

| | December 31, 2017 | | |
|---|---|---|---|
| | As Reported | Adjustments | As Adjusted |
| Balance Sheet: | | | |
| Assets | | | |
| Accounts receivable | $227,127 | $ 19,061 | $246,188 |
| Prepaid expenses | 27,252 | 4,954 | 32,206 |
| Accounts receivable, long-term | 7,536 | 4,571 | 12,107 |
| Other intangibles, net | 236,444 | (6,827) | 229,617 |
| Total assets | $1,589,592 | $ 21,759 | $1,611,351 |
| | | | |
| Liabilities | | | |
| Deferred revenue | 309,461 | (10,848) | 298,613 |
| Deferred income taxes | 38,914 | 7,965 | 46,879 |
| | | | |
| Retained earnings | $599,821 | $ 24,642 | $624,463 |
| | | | |
| Total liabilities and shareholders' equity | $1,589,592 | $ 21,759 | $1,611,351 |

Our adoption of ASU 2014-09 had no impact on our net cash provided by or used in operating, investing or financing activities for any of the periods reported.

Recent tax legislation. On December 22, 2017, the Tax Cuts and Jobs Act ("Tax Act") was enacted into law. The Tax Act amends the Internal Revenue Code to reduce tax rates and modify policies, credits and deductions for businesses and individuals. For businesses, the Tax Act reduces the U.S. corporate federal tax rate from a maximum of 35% to a flat 21% rate and transitions from a worldwide tax system to a territorial tax system. The Tax Act also adds many new provisions including changes to bonus depreciation, the deduction for executive compensation and a tax on global intangible low-taxed income (GILTI). The most significant impact of the Tax Act to us is the reduction in the U.S. federal corporate income tax rate from 35% to 21% in 2017. Refer to Note 7 - Income Tax Provision for further information.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

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

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

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

Topic 842 is effective for fiscal years beginning after December 15, 2018, including interim periods therein. Early application is permitted for all business entities upon issuance. We are assessing the financial impact of adopting the new standard, however; we are currently unable to provide a reasonable estimate regarding the financial impact. We expect to adopt the new standard in fiscal year 2019.

(3) Shareholders' Equity

The following table details activity in our common stock:

| | Three Months Ended March 31, | | | |
|---|---|---|---|---|
| | 2018 | | 2017 | |
| | Shares | Amount | Shares | Amount |
| Purchases of treasury shares | — | $ — | (42 ) | $ (6,171 ) |
| Stock option exercises | 350 | 19,298 | 324 | 14,851 |
| Employee stock plan purchases | 12 | 1,798 | 14 | 1,650 |

As of March 31, 2018, we had authorization from our board of directors to repurchase up to 2.0 million additional shares of Tyler common stock.

(4) Deferred Commissions

Sales commissions earned by our sales force are considered incremental and recoverable costs of obtaining a contract with a customer. Sales commissions for initial contracts are deferred and then amortized on a straight-line basis over a period of benefit that we have determined to be three to seven years. Deferred commissions were $20.2 million and $19.3 million as of March 31, 2018, and December 31, 2017, respectively. Amortization expense was $3.5 million and $2.6 million for the three months ended March 31, 2018, and 2017, respectively. There was no impairment loss in relation to the costs capitalized for the periods presented. Deferred commissions have been included with prepaid expenses in the accompanying condensed consolidated balance sheets. Amortization expense related to deferred commissions is included in selling, general and administrative expenses in the accompanying condensed consolidated statements of income.

(5) Other Assets

Cash and cash equivalents consist of cash on deposit with several domestic banks and money market funds.
As of March 31, 2018, we have $96.5 million in investment grade corporate and municipal bonds with maturity dates ranging from 2017 through early 2020. 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 values of these securities are considered Level II as they are based on inputs from quoted prices in markets that are not active or other observable market data. These investments are included in short-term investments and non-current investments and other assets.

We have a $15.0 million investment in convertible preferred stock representing a 20% interest in Record Holdings Pty Limited, a privately held Australian company specializing in digitizing the spoken word in court and legal proceedings. The investment in convertible preferred stock is accounted under the cost method because we do not have the ability to exercise significant influence over the investee and the securities do not have readily determinable fair values. Our investment is carried at cost less any impairment write-downs. Annually, our cost method investments are assessed for impairment. We do not reassess the fair value of cost method investments if there are no identified events or changes in circumstances that may have a significant adverse effect on the fair value of the investments. This investment is included in non-current investments and other assets.

(6) Revolving Line of Credit

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

Borrowings under the Credit Facility bear interest at a rate of either (1) Wells Fargo Bank’s prime rate (subject to certain higher rate determinations) plus a margin of 0.25% to 1.00% or (2) the 30, 60, 90 or 180 day LIBOR rate plus a margin of 1.25% to 2.00%. As of March 31, 2018, the interest rates were 5.00% under the Wells Fargo Bank's prime rate and 2.50% under a 30-day LIBOR contract. The Credit Facility is secured by substantially all of our assets. The Credit Facility requires us to maintain certain financial ratios and other financial conditions and prohibits us from making certain investments, advances, cash dividends or loans, and limits incurrence of additional indebtedness and liens. As of March 31, 2018, we were in compliance with those covenants.

As of March 31, 2018, we had no outstanding borrowings and one outstanding letter of credit totaling $500,000. Available borrowing capacity under the Credit Facility was $299.5 million.

(7) Income Tax Provision

For the three months ended March 31, 2018, we had an effective income tax rate, as adjusted, of 4.1% compared to 10.6% for the three months ended March 31, 2017. The effective income tax rates for the periods presented were different from the statutory United States federal income tax rate of 21% and 35%, respectively, principally due to excess tax benefits related to stock option exercises. The excess tax benefits related to stock option exercises realized was $9.1 million for the three months ended March 31, 2018, compared to $10.1 million for the three months ended March 31, 2017. Excluding the excess tax benefits, the effective rate was 27.2% for the three months ended March 31, 2018, compared to 38.2% (as adjusted) for the three months ended March 31, 2017. Other differences from our federal statutory income tax rate included state income taxes, non-deductible business expenses, the tax benefit of research tax credits, and in 2017, the tax benefit of the domestic production activities deduction.

The decrease in effective tax rate for the three months ended March 31, 2018 as compared to the same period in 2017 was due primarily to the reduction of the U.S. corporate tax rate from 35% to 21% as a result of the Tax Act and the increase in the research tax credit benefit, offset by the elimination of the domestic production activities deduction and the increased limitations on the deduction for executive compensation. In the fourth quarter of 2017, we recorded a $26.0 million (as adjusted under Topic 606) tax benefit due to the remeasurement of deferred tax assets and liabilities at a lower tax rate. As of March 31, 2018, we have not reported any adjustments to the provisional amounts for the income tax effects of the Tax Act recorded in 2017. However, based on a continued analysis of the estimates and further guidance on the application of the law, it is anticipated that additional revisions may occur throughout the allowable measurement period. Overall, the changes due to the Tax Act will favorably affect income tax expense and future U.S. earnings.
We made tax payments of $218,000 and $161,000 in the three months ended March 31, 2018 and 2017, respectively.

(8) Earnings Per Share

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

| | Three Months Ended March 31, | |
|---|---|---|
| | 2018 | 2017 As Adjusted |
| Numerator for basic and diluted earnings per share: | | |
| Net income | $37,825 | $32,769 |
| Denominator: | | |
| Weighted-average basic common shares outstanding | 38,002 | 36,845 |
| Assumed conversion of dilutive securities: | | |
| Stock options | 1,834 | 2,087 |
| Denominator for diluted earnings per share - Adjusted weighted-average shares | 39,836 | 38,932 |
| Earnings per common share: | | |
| Basic | $1.00 | $0.89 |
| Diluted | $0.95 | |