

NELNET INC
Form 10-K
March 03, 2010

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

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2009

Or

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 001-31924

NELNET, INC.

(Exact name of registrant as specified in its charter)

NEBRASKA

84-0748903

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification No.)

121 SOUTH 13TH STREET, SUITE 201
LINCOLN, NEBRASKA

68508
(Zip Code)

(Address of principal executive offices)

Registrant's telephone number, including area code: (402) 458-2370

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT:
TITLE OF EACH CLASS

Class A Common Stock, Par Value \$0.01 per Share

NAME OF EACH EXCHANGE ON WHICH REGISTERED: New York Stock Exchange
SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT: None

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes [] No [X]

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 [] No [X]

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 Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of

Edgar Filing: NELNET INC - Form 10-K

this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark 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.

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

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

The aggregate market value of the Registrant's voting common stock held by non-affiliates of the Registrant on June 30, 2009 (the last business day of the Registrant's most recently completed second fiscal quarter), based upon the closing sale price of the Registrant's Class A Common Stock on that date of \$13.59 per share, was \$375,157,182. For purposes of this calculation, the Registrant's directors, executive officers, and greater than 10 percent shareholders are deemed to be affiliates.

As of January 31, 2010, there were 38,392,691 and 11,495,377 shares of Class A Common Stock and Class B Common Stock, par value \$0.01 per share, outstanding, respectively (excluding 11,317,364 shares of Class A Common Stock held by a wholly owned subsidiary).

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's definitive Proxy Statement to be filed for its 2010 Annual Meeting of Shareholders, scheduled to be held May 27, 2010, are incorporated by reference into Part III of this Form 10-K.

NELNET, INC.
FORM 10-K
TABLE OF CONTENTS

PART I

Item 1.	Business		1
Item 1A.	Risk Factors		14
Item 1B.	Unresolved Staff Comments		28
Item 2.	Properties		28
Item 3.	Legal Proceedings		29
Item 4.	Submission of Matters to a Vote of Security Holders		30

PART II

Item 5.	Market for Registrant's Common Equity, Related Stockholder Matters, and Issuer Purchases of Equity Securities	30	
Item 6.	Selected Financial Data		33
Item 7.	Management's Discussion and Analysis of Financial Condition and Results of Operations	34	
Item 7A.	Quantitative and Qualitative Disclosures About Market Risk		85
Item 8.	Financial Statements and Supplementary Data		90
Item 9.	Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	91	
Item 9A.	Controls and Procedures		91
Item 9B.	Other Information		92

PART III

Item 10.	Directors, Executive Officers, and Corporate Governance		92
Item 11.	Executive Compensation		93
Item 12.	Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	93	
Item 13.	Certain Relationships and Related Transactions and Director Independence		93
Item 14.	Principal Accounting Fees and Services		93

PART IV

Item 15.	Exhibits and Financial Statement Schedules		93
Signatures			100

This report contains forward-looking statements and information that are based on management's current expectations as of the date of this document. Statements that are not historical facts, including statements about the Company's expectations and statements that assume or are dependent upon future events, are forward-looking statements. These forward-looking statements are subject to risks, uncertainties, assumptions, and other factors that may cause the actual results to be materially different from those reflected in such forward-looking statements. These factors include, among others, the risks and uncertainties set forth in "Risk Factors" and elsewhere in this Annual Report on Form 10-K (the "Report"); increases in financing costs; limits on liquidity; any adverse outcomes in any significant litigation to which the Company is a party; changes in the terms of student loans and the educational credit marketplace arising from the implementation of, or changes in, applicable laws and regulations (including changes resulting from new laws, such as any new laws enacted to implement the Administration's 2010 budget proposals as they relate to the Federal Family Education Loan Program (the "FFEL Program" or "FFELP") of the U.S. Department of Education (the "Department")), which may reduce the volume, average term, special allowance payments, and yields on student loans under the FFELP, or result in loans being originated or refinanced under non-FFEL programs or may affect the terms upon which banks and others agree to sell FFELP loans to the Company. The Company could also be affected by changes in the demand for educational financing or in financing preferences of lenders, educational institutions, students, and their families; the Company's ability to maintain its credit facilities or obtain new facilities; the ability of lenders under the Company's credit facilities to fulfill their lending commitments under these facilities; changes to the terms and conditions of the liquidity programs offered by the Department; changes in the general interest rate environment and in the securitization markets for education loans, which may increase the costs or limit the availability of financings necessary to initiate, purchase, or carry education loans; losses from loan defaults; changes in prepayment rates, guaranty rates, loan floor rates, and credit spreads; uncertainties inherent in forecasting future cash flows from student loan assets and related asset-backed securitizations; the uncertain nature of estimated expenses that may be incurred and cost savings that may result from restructuring plans; incorrect estimates or assumptions by management in connection with the preparation of the consolidated financial statements; and changes in general economic conditions. Additionally, financial projections may not prove to be accurate and may vary materially. The reader should not place undue reliance on forward-looking statements, which speak only as of the date of this Report. The Company is not obligated to publicly release any revisions to forward-looking statements to reflect events after the date of this Report or unforeseen events. Although the Company may from time to time voluntarily update its prior forward-looking statements, it disclaims any commitment to do so except as required by securities laws.

PART I.

ITEM 1. BUSINESS

Overview

Nelnet, Inc (the "Company") is a transaction processing and finance company focused primarily on providing quality education related products and services to students, families, schools, and financial institutions nationwide. The Company was formed as a Nebraska corporation in 1977. The Company earns its revenues from fee-based processing businesses, including its loan servicing, payment processing, and lead generation businesses, and the net interest income on its student loan portfolio.

Customers

The Company's customers consist of:

- Students and families
- Colleges and universities
- Private, parochial, and other K-12 institutions

- Lenders, holders, and agencies in education finance

An increase in the size of the education market generally increases the demand for the Company's products and services. The education market continues to grow with rising student enrollment and the rising annual cost of enrollment. In addition, demand for the Company's products and services increases as education-related processes become more complex and schools have a need to become more efficient.

Product and Service Offerings

The Company offers a broad range of pre-college, in-college, and post-college products and services that help students and families plan and pay for their education and plan their careers. The Company's products and services are designed to simplify the education planning and financing process and provide value to customers throughout the education life cycle.

Operating Segments

The Company has five operating segments, as follows:

- Student Loan and Guaranty Servicing
- Tuition Payment Processing and Campus Commerce
 - Enrollment Services
 - Software and Technical Services
 - Asset Generation and Management

The Company's operating segments are defined by the products and services they offer or the types of customers they serve, and they reflect the manner in which financial information is currently evaluated by management. Management evaluates the Company's generally accepted accounting principles ("GAAP") based financial information as well as operating results on a non-GAAP performance measure referred to as "base net income." Management believes "base net income" provides additional insight into the financial performance of the core operations. For further information, see Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations." The Company includes separate financial information about its operating segments in note 22 of the notes to the consolidated financial statements included in this Report.

Operating Results - Revenue Diversification

The Company ranks among the nation's leaders in terms of total student loan assets originated, held, and serviced, principally consisting of loans originated under the FFEL Program (a detailed description of the FFEL Program is included in Appendix A to this Report). In recent years, the Company has expanded products and services generated from businesses that are not dependent upon the FFEL Program (as shown below), thereby reducing legislative and political risk related to the education lending industry. Revenues from these businesses are primarily generated from products and services offered in the Company's Tuition Payment Processing and Campus Commerce and Enrollment Services operating segments. The following chart summarizes the percent of external revenue earned by the Company's operating segments when excluding Corporate Activity and Overhead and fixed rate floor income included in the Asset Generation and Management operating segment. See Part II, Item 7A, "Quantitative and Qualitative Disclosures about Market Risk – Interest Rate Risk" for further details related to the Company's fixed rate floor income. The chart shows the increased contribution of revenue from fee-based segments.

The following tables summarize the Company's revenues by operating segment (dollars in thousands):

	Year ended December 31, 2009						
	External		Intersegment		As reported by segment		
	Dollars	Percent	Dollars	Percent	Dollars	Percent	
Student Loan and Guaranty Servicing	\$ 114,086	19.7	% \$ 85,104	63.5	% \$ 199,190	28.0	%
Tuition Payment Processing and Campus Commerce	53,956	9.4	237	0.2	54,193	7.6	
Enrollment Services	119,397	20.7	555	0.4	119,952	16.9	
Software and Technical Services	17,463	3.0	14,586	10.9	32,049	4.5	
Total revenue from fee-based segments	304,902	52.8	100,482	75.0	405,384	57.0	
Asset Generation and Management	300,004	51.9	(2,003)	(1.5)	298,001	41.8	
Corporate Activity and Overhead	(27,073)	(4.7)	35,472	26.5	8,399	1.2	
Total revenue	\$ 577,833	100.0	% \$ 133,951	100.0	% \$ 711,784	100.0	%

	Year ended December 31, 2008						
	External		Intersegment		As reported by segment		
	Dollars	Percent	Dollars	Percent	Dollars	Percent	
Student Loan and Guaranty Servicing	\$ 105,664	20.0	% \$ 75,361	51.6	% \$ 181,025	26.9	%
Tuition Payment Processing and Campus Commerce	49,844	9.5	302	0.2	50,146	7.4	
Enrollment Services	112,459	21.3	2	0.0	112,461	16.7	
Software and Technical Services	19,731	3.7	6,831	4.7	26,562	3.9	
	287,698	54.5	82,496	56.5	370,194	54.9	

Edgar Filing: NELNET INC - Form 10-K

Total revenue from fee-based segments								
Asset Generation and Management	277,971	52.6	(2,190)	(1.5)	275,781	40.9		
Corporate Activity and Overhead	(37,503)	(7.1)	65,574	45.0	28,071	4.2		
Total revenue	\$528,166	100.0 %	\$145,880	100.0 %	\$674,046	100.0 %		

Year ended December 31, 2007

	External		Intersegment		As reported by segment			
	Dollars	Percent	Dollars	Percent	Dollars	Percent		
Student Loan and Guaranty Servicing	\$133,234	23.8 %	\$74,687	73.9 %	\$207,921	31.4 %		
Tuition Payment Processing and Campus Commerce	46,568	8.3	688	0.7	47,256	7.2		
Enrollment Services	104,245	18.6	891	0.9	105,136	15.9		
Software and Technical Services	22,093	3.9	15,683	15.5	37,776	5.7		
Total revenue from fee-based segments	306,140	54.6	91,949	91.0	398,089	60.2		
Asset Generation and Management	278,671	49.8	(3,737)	(3.7)	274,934	41.6		
Corporate Activity and Overhead	(24,705)	(4.4)	12,777	12.7	(11,928)	(1.8)		
Total revenue	\$560,106	100.0 %	\$100,989	100.0 %	\$661,095	100.0 %		

Fee-Based Operating Segments

Student Loan and Guaranty Servicing

The Company's Student Loan and Guaranty Servicing operating segment provides for the servicing of the Company's student loan portfolio and the portfolios of third parties and servicing provided to guaranty agencies. The loan servicing activities include loan origination activities, loan conversion activities, application processing, borrower updates, payment processing, due diligence procedures, and claim processing. These activities are performed internally for the Company's portfolio in addition to generating fee revenue when performed for third-party clients. The guaranty servicing activities include providing software and data center services, borrower and loan updates, default aversion tracking services, claim processing services, and post-default collection services to guaranty agencies. The Company's student loan servicing division uses proprietary systems to manage the servicing process. These systems provide for automated compliance with most of the federal student loan regulations adopted under Title IV of the Higher Education Act of 1965, as amended (the "Higher Education Act").

In June 2009, the Department of Education named the Company as one of four private sector companies awarded a servicing contract to service all federally-owned student loans, including FFELP loans purchased by the Department pursuant to the Ensuring Continued Access to Student Loans Act of 2008 ("ECASLA"). ECASLA enabled the Department to purchase FFELP loans in an effort to bring liquidity and stability back to the student loan market. No later than August 2010, the Company expects to also begin servicing new loans originated under the Federal Direct Loan Program (the "Direct Loan Program"). Under the Direct Loan Program, the Federal government lends money directly to students and families. The contract spans five years with one, five-year renewal option. The Company began servicing loans for the Department under this contract in September 2009.

The four primary product offerings of this operating segment and each one's percentage of total third-party Student Loan and Guaranty Servicing revenue provided during the year ended December 31, 2009 are as follows:

- Origination and servicing of commercial FFEL Program loans (54.0%)
- Origination and servicing of non-federally insured student loans (7.5%)
 - Servicing of loans for the Department of Education (1.5%)
 - Servicing and support outsourcing for guaranty agencies (37.0%)

The following chart summarizes the Company's loan servicing volumes (dollars in millions):

- (a) As of December 31, 2009, the Company was servicing \$464.2 million of loans owned by the Company and \$809.3 million of loans for third parties that were disbursed on or after July 1, 2009 and may be eligible to be sold to the Department of Education pursuant to its 2009-2010 academic year Loan Purchase Commitment Program. The Company expects to retain the servicing on all 2009-2010 loans sold to the Department which are currently being serviced by the Company.
- (b) As of December 31, 2009 and March 1, 2010, the Company was servicing approximately \$3.4 billion and \$6.3 billion, respectively, of loans under the Department's servicing contract, which includes approximately \$1.5 billion and \$4.3 billion of loans not previously serviced by the Company that were sold by third parties to the Department as part of the ECASLA Purchase Program.

The Company performs the origination and servicing activities for FFEL Program loans for itself as well as third-party clients. The Company believes service, reputation, and/or execution are factors considered by schools in developing their lender lists and customers in selecting a servicer for their loans. Management believes it is important to provide exceptional customer service at a reasonable price in order to increase the Company's loan servicing and origination volume at schools with which the Company does business.

The Company serviced FFELP loans on behalf of approximately 80 third-party servicing customers as of December 31, 2009 and 2008. The Company's FFELP servicing customers include national and regional banks, credit unions, and various state and non-profit secondary markets. The majority of the Company's external FFELP loan servicing activities are performed under "life of loan" contracts. Life of loan servicing essentially provides that as long as the loan exists, the Company shall be the sole servicer of that loan; however, the agreement may contain "deconversion" provisions where, for a fee, the lender may move the loan to another servicer. In recent years, the Company has experienced a reduction of participating lenders for a variety of reasons, including if third-party servicing clients commence or increase internal servicing activities, shift volume to another service provider, or exit the FFEL Program completely.

The Company also provides origination and servicing activities for non-federally insured loans. Although similar in terms of activities and functions (i.e., disbursement processing, application processing, payment processing, statement distribution, and reporting), non-federally insured loan servicing activities are not required to comply with provisions of the Higher Education Act and may be more customized to individual client requirements. The Company serviced non-federally insured loans on behalf of approximately 15 third-party servicing customers as of December 31, 2009 and 2008.

The Direct Loan Program has historically used one provider for the origination and servicing of loans. For the federal fiscal year ended September 30, 2009, the estimated volume for the Direct Loan Program was approximately \$38 billion, an increase of 110% from the federal fiscal year ended September 30, 2008. This increase was the result of schools shifting from the FFELP to the Direct Loan Program as a result of lenders exiting the FFELP marketplace due to legislation and capital market disruptions. Regardless of the outcome of the currently proposed legislation (see "Recent Developments - Legislation"), the Direct Loan Program volume is expected to increase substantially in the next few years, which would lead to an increase in servicing volume for the Department's four private sector servicers. Servicing volume has initially been allocated by the Department to the four servicers and performance factors such as customer satisfaction levels and default rates will determine volume allocations over time.

The Company also provides servicing support for guaranty agencies, which are the organizations that serve as the intermediary between the U.S. federal government and FFELP lenders, and are responsible for paying the claims made on defaulted loans. The Department has designated approximately 30 guarantors that have been formed as either state agencies or non-profit corporations that provide FFELP guaranty services in one or more states. Approximately half of these guarantors contract externally for operational or technology services. The services provided by the Company include operational, administrative, financial, and technology services to guarantors participating in the FFEL Program and state agencies that run financial aid grant and scholarship programs.

The Company's four guaranty servicing customers include Tennessee Student Assistance Corporation, College Assist (which is the Colorado state-designated guarantor of FFELP student loans – formerly known as College Access Network), National Student Loan Program, and the Higher Education Assistance Commission of New York.

Competition

There is a relatively large number of lenders and servicing organizations who participate in the FFEL Program. The chart below lists the top 10 servicing organizations for FFELP loans as of December 31, 2008.

Top FFELP Loan Servicers		
Rank	Name	\$ millions (a)
1	Sallie Mae	178,191(b)
2	AES/PHEAA	60,063(b)
3	ACS Education Services (formerly reported under AFSA)	55,600
4	Great Lakes	41,554(b)
5	Nelnet	35,889(b)
6	Citibank, The Student Loan Corporation	24,889
7	Wells Fargo Education Financial Services	18,064
8	EdFinancial Services	9,779
9	Xpress Loan Servicing	8,996
10	Kentucky Higher Education Student Loan Corporation	8,186

Source: 2009 SLSA Servicing Volume Survey and company filings

- (a) As of December 31, 2008, except for ACS Education Services and Citibank, The Student Loan Corporation which are as of June 30, 2009.
- (b) Represent the four private sector companies awarded a servicing contract to service Direct Loan Program loans.

The principal competitor for existing and prospective FFELP loan and guaranty servicing business is SLM Corporation, the parent company of Sallie Mae. Sallie Mae is the largest FFELP provider of origination and servicing functions as well as one of the largest service providers of non-federally guaranteed loans.

The Company believes the number of guaranty agencies contracting for technology services will increase as states continue expanding the scope of their financial aid grant programs and as a result of existing deficient or outdated systems. Since there is a finite universe of clients, competition for existing and new contracts is considered high. Agencies may choose to contract for part or all of their services, and the Company believes its products and services

are competitive. To enhance its competitiveness, the Company continues to focus on service quality and technological enhancements.

Tuition Payment Processing and Campus Commerce

The Company's Tuition Payment Processing and Campus Commerce operating segment provides products and services to help institutions and education-seeking families manage the payment of education costs during the pre-college and college stages of the education life cycle.

The K-12 market consists of nearly 30,000 private and faith-based educational institutions nationally. In the K-12 market the Company offers tuition management services as well as assistance with financial needs assessment, enrollment management, and donor management. The Company has actively managed tuition payment plans in place at approximately 4,500 K-12 educational institutions.

Tuition management services include payment plan administration, ancillary billing, accounts receivable management, and record keeping. K-12 educational institutions contract with the Company to administer deferred payment plans where the institution allows the responsible party to make monthly payments over 6 to 12 months. The Company collects a fee from either the institution or the payer as an administration fee.

The Company offers two principal products to the higher education market: actively managed tuition payment plans and campus commerce outsourcing. The Company has actively managed tuition payment plans in place at approximately 700 colleges and universities. Higher educational institutions contract with the Company to administer deferred payment plans where the institution allows the responsible party to make monthly payments on either a semester or annual basis. The Company collects a fee from either the institution or the payer as an administration fee.

The campus commerce solution, QuikPay®, is sold as a subscription service to colleges and universities. QuikPay processes payments through the appropriate channels in the banking or credit card networks to make deposits into the client's bank account. It can be further deployed to other departments around campus as requested (e.g., application fees, alumni giving, parking, events, etc.). There are approximately 220 college and university campuses using the QuikPay system. The Company earns revenue for e-billing, hosting/maintenance, credit card convenience fees, and e-payment transaction fees.

Competition

This segment of the Company's business focuses on two separate markets: private and faith-based K-12 schools and higher education colleges and universities.

The Company is the largest provider of tuition management services to the private and faith-based K-12 market in the United States. Competitors include: banking companies, tuition management providers, financial needs assessment providers, accounting firms, and a myriad of software companies.

In the higher education market, the Company targets business offices at colleges and universities. In this market, the primary competition is limited to three tuition payment providers, as well as solutions developed in-house by colleges and universities.

The Company's principal competitive advantages are (i) the service it provides to institutions, (ii) the information management tools provided with the Company's service, and (iii) the Company's ability to interface with the institution's clients. The Company believes its clients select products primarily on technological superiority and feature functionality, but price and service also impact the selection process.

Enrollment Services

The Company's Enrollment Services operating segment offers products and services that are focused on helping colleges recruit and retain students (lead generation and recruitment services) and helping students plan and prepare for life after high school (content management and publishing and editing services). The Company's enrollment products and services include the following:

Lead Generation

- Vendor lead management services
- Admissions lead generation

Content Management

- Online courses
- Licensing of scholarship data
- Call center services

Recruitment Services

- Pay per click marketing management

Publishing and Editing Services

- Test preparation study guides

- Email marketing
- List marketing services
- Admissions consulting
- Essay editing services

As with all of the Company's products and services, the Company's focus is on the education seeking family – both college bound and in college – and the Company delivers products and services in this segment through four primary customer channels: higher education, corporate and government, K-12, and direct-to-consumer/customer service. Many of the Company's products in this segment are distributed online; however, products such as test preparation study guides are distributed as printed materials.

Competition

In this segment, the primary areas in which the Company competes are: lead generation and management, test preparation study guides and online courses, and call center services.

There are several large competitors in the areas of lead generation and test preparation, but the Company does not believe any one competitor has a dominant position in all of the product and service areas offered by the Company. The Company has seen increased competition in the area of call center operations, including outsourced admissions, as other companies have recognized the potential in this market.

The Company competes through various methods, including price, brand awareness, depth of product and service selection, and customer service. The Company has attempted to be a “one stop shop” for the education seeking family looking for career assessment, test preparation, and college information. The Company also offers its institutional clients a breadth of services unrivaled in the education industry.

Software and Technical Services

The Company’s Software and Technical Services Operating Segment develops student loan servicing software, which is used internally by the Company and also licensed to third-party student loan holders and servicers. This segment also provides information technology products and services, with core areas of business in educational loan software solutions, legacy modernization, technical consulting services, and Enterprise Content Management solutions.

The Company’s clients within the education loan marketplace include large and small financial institutions, secondary markets, loan originators, and loan servicers. A significant portion of the software and technology services business is dependent on the existence of and participants in the FFEL Program. If the federal government were to terminate the FFEL Program or the number of entities participating in the program were to decrease, the Company’s software and technical services segment would be impacted. The recent legislation and capital market disruptions have had an impact on the profitability of FFEL Program participants. As a result, the number of entities participating in the FFEL Program has and may continue to be adversely impacted. This impact could have an effect on the Company’s software and technical services segment. In order to mitigate any negative impact as a result of changes in the FFEL Program, the Company is working to diversify revenues in this segment.

Competition

The Company is one of the leaders in the education loan software processing industry. Many lenders in the FFEL Program utilize the Company’s software either directly or indirectly. Management believes the Company’s competitors in this segment are much smaller than the Company and do not have the depth of knowledge or products offered by the Company.

The Company’s primary method of competition in this segment is based upon its depth of knowledge, experience, and product offerings in the education loan industry. The Company believes it has a competitive edge in offering proven solutions, since the Company’s competition consists primarily of consulting firms that offer services and not products.

Asset Generation and Management Operating Segment

The Asset Generation and Management Operating Segment includes the origination, acquisition, management, and ownership of the Company’s student loan assets, which has historically been the Company’s largest product and service offering. The Company generates a substantial portion of its earnings from the spread, referred to as the Company’s student loan spread, between the yield it receives on its student loan portfolio and the costs associated with originating, acquiring, and financing its portfolio. The Company generates student loan assets through direct

origination or through acquisitions. The student loan assets are held in a series of education lending subsidiaries designed specifically for this purpose. During 2009, the Company also generated a significant gain from the sale of certain loans, as discussed further below. In addition to the student loan portfolio, all costs and activity associated with the generation of assets, funding of those assets, and maintenance of the debt transactions are included in this segment.

Student loans consist of federally insured student loans and non-federally insured student loans. Federally insured student loans are made under the FFEL Program. The Company's portfolio of federally insured student loans is subject to minimal credit risk as these loans are guaranteed by the Department of Education at levels ranging from 97% to 100%. Substantially all of the Company's loan portfolio (99% as of December 31, 2009) is federally insured. The Company's portfolio of non-federally insured loans is subject to credit risk similar to other consumer loan assets.

The Higher Education Act regulates every aspect of the federally guaranteed student loan program, including communications with borrowers, loan originations, and default aversion. Failure to service a student loan properly could jeopardize the guarantee on federal student loans. In the case of death, disability, or bankruptcy of the borrower, the guarantee covers 100% of the loan's principal and accrued interest.

FFELP loans are guaranteed by state agencies or non-profit companies designated as guarantors, with the Department providing reinsurance to the guarantor. Guarantors are responsible for performing certain functions necessary to ensure the program's soundness and accountability. These functions include reviewing loan application data to detect and prevent fraud and abuse and to assist lenders in preventing default by providing counseling to borrowers. Generally, the guarantor is responsible for ensuring that loans are serviced in compliance with the requirements of the Higher Education Act. When a borrower defaults on a FFELP loan, the Company submits a claim to the guarantor who provides reimbursements of principal and accrued interest subject to the applicable risk share percentage.

The Company's historical balance of student loans outstanding is summarized below.

Future cash flow from portfolio

The majority of the Company's portfolio of student loans is funded in asset backed securitizations that are structured to substantially match the maturity of the funded assets and there are minimal liquidity issues related to these facilities. In addition, due to the difference between the yield the Company receives on the loans and cost of financing within these transactions, the Company has created a portfolio that will generate earnings and significant cash flow over the life of these transactions.

Based on cash flow models developed to reflect management's current estimate of, among other factors, prepayments, defaults, deferment, forbearance, and interest rates, the Company currently expects future undiscounted cash flows from its portfolio to be approximately \$1.43 billion. See Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations – Liquidity and Capital Resources" for further details related to the estimated future cash flow from the Company's portfolio.

Impact of Legislation and Capital Market Disruptions

On September 27, 2007, the President signed into law the College Cost Reduction and Access Act of 2007 (the "College Cost Reduction Act"). Among other things, this legislation reduced special allowance payments received by lenders and increased origination fees paid by lenders. Management estimated the impact of this legislation reduced the annual yield on FFELP loans originated after October 1, 2007 by 70 to 80 basis points. As a result of this legislation, the Company modified borrower benefits and reduced loan acquisition and internal costs.

In addition, the Company has significant financing needs that it meets through the capital markets. Beginning in August 2007, the capital markets have experienced unprecedented disruptions, which have had an adverse impact on the Company's earnings and financial condition. Since the Company could not determine nor control the length of time or extent to which the capital markets would remain disrupted, it reduced its direct and indirect costs related to its asset generation activities, and was more selective in pursuing origination activity in the direct to consumer channel. Accordingly, beginning in January 2008, the Company suspended consolidation and private student loan originations and exercised contractual rights to discontinue, suspend, or defer the acquisition of student loans in connection with substantially all of its branding and forward flow relationships.

In an effort to bring liquidity and stability back to the student loan program, in August 2008, the Department implemented the Purchase and Participation Programs pursuant to ECASLA. Under the Department's Purchase Program, the Department will purchase loans at a price equal to the sum of (i) par value, (ii) accrued interest, (iii) the one percent origination fee paid to the Department, and (iv) a fixed amount of \$75 per loan. Under the Participation

Program, the Department provides interim short term liquidity to FFELP lenders by purchasing participation interests in pools of FFELP loans. Loans funded under the Participation Program for the 2008-2009 academic year were required to be either refinanced by the lender or sold to the Department pursuant to the Purchase Program prior to its expiration on October 15, 2009. To be eligible for purchase or participation under the Department's programs, loans were originally limited to FFELP Stafford or PLUS loans made for the academic year 2008-2009, first disbursed between May 1, 2008 and July 1, 2009, with eligible borrower benefits.

On October 7, 2008, legislation was enacted to extend the Department's authority to address FFELP student loans made for the 2009-2010 academic year and allowing for the extension of the Participation Program and Purchase Program from September 30, 2009 to September 30, 2010. The Department indicated that loans for the 2008-2009 academic year funded under the Department's Participation Program were required to be refinanced or sold to the Department prior to October 15, 2009. On November 8, 2008, the Department announced the replication of the terms of the Participation and Purchase Programs, in accordance with the October 7, 2008 legislation, which will include FFELP student loans made for the 2009-2010 academic year.

During 2009, the Company sold \$2.1 billion of its 2008-2009 academic year loans under the Purchase Program and recognized a gain of \$36.6 million. In addition, the Company has reliable sources of liquidity available for new FFELP Stafford and PLUS loan originations for the 2009-2010 academic year under the Department's Participation and Purchase Programs. These programs are allowing the Company to continue originating new federal student loans to all students regardless of the school they attend.

Interest Rate Risk Management

Because the Company generates a significant portion of its earnings from its student loans spread, the interest rate sensitivity of the Company's balance sheet is very important to its operations. The current and future interest rate environment can and will affect the Company's interest earnings, net interest income, and net income. The effects of changing interest rate environments are further outlined in Part II, Item 7A, "Quantitative and Qualitative Disclosures about Market Risk – Interest Rate Risk."

Floor Income

Loans originated prior to April 1, 2006 generally earn interest at the higher of a floating rate based on the Special Allowance Payment or SAP formula set by the Department and the borrower rate, which is fixed over a period of time. The SAP formula is based on an applicable index plus a fixed spread that is dependent upon when the loan was originated, the loan's repayment status, and funding sources for the loan. The Company generally finances its student loan portfolio with variable rate debt. In low and/or declining interest rate environments, when the fixed borrower rate is higher than the rate produced by the SAP formula, the Company's student loans earn at a fixed rate while the interest on the variable rate debt typically continues to decline. In these interest rate environments, the Company may earn additional spread income that it refers to as floor income.

Depending on the type of loan and when it was originated, the borrower rate is either fixed to term or is reset to an annual rate each July 1. As a result, for loans where the borrower rate is fixed to term, the Company may earn floor income for an extended period of time, which the Company refers to as fixed rate floor income, and for those loans where the borrower rate is reset annually on July 1, the Company may earn floor income to the next reset date, which the Company refers to as variable rate floor income. In accordance with new legislation enacted in 2006, lenders are required to rebate fixed rate floor income and variable rate floor income to the Department for all new FFELP loans first originated on or after April 1, 2006.

Absent the use of derivative instruments, a rise in interest rates may reduce the amount of floor income received and this may have an impact on earnings due to interest margin compression caused by increasing financing costs, until such time as the federally insured loans earn interest at a variable rate in accordance with their special allowance payment formulas. In higher interest rate environments, where the interest rate rises above the borrower rate and fixed rate loans effectively become variable rate loans, the impact of the rate fluctuations is reduced. The Company uses derivative instruments as part of its overall risk management strategy, including interest rate swaps to hedge a portion of its floor income. See Part II, Item 7A, "Quantitative and Qualitative Disclosures about Market Risk – Interest Rate Risk."

The Company's core student loan spread (variable student loan spread including fixed rate floor contribution) and variable student loan spread (net interest margin excluding fixed rate floor income) during 2008 and 2009 is summarized below.

During the years ended December 31, 2009 and 2008, loan interest income includes \$145.1 million (58 basis points of spread contribution) and \$37.5 million (14 basis points of spread contribution), respectively, of fixed rate floor income. The increase in fixed rate floor income throughout 2009 is due to a decrease in interest rates. The Company's variable student loan spread increased throughout 2009 as a result of the tightening of the commercial paper rate, which is the primary rate the Company earns on its student loan portfolio, and the LIBOR rate, which is the primary rate the Company pays to fund its student loan assets. See Part II, Item 7, "Management's Discussion and Analysis – Asset Generation and Management Operating Segment – Results of Operations – Student Loan Spread Analysis." If interest rates remain low, the Company anticipates continuing to earn significant fixed rate floor income in future periods.

Competition

There are two loan delivery programs that provide federal government guaranteed student loans: the FFELP and the Direct Loan Program. FFELP loans are provided by private sector institutions and are ultimately guaranteed by the Department, except for the risk sharing loss, as discussed previously. Direct Loan Program loans are provided to borrowers directly by the Department on terms similar to student loans provided under the FFELP.

The Direct Loan Program has reduced the origination volume available for FFEL Program participants. As a result of the recent legislation and capital market disruptions, many lenders have withdrawn from the student loan market. Substantially all other lenders have altered their student loan offerings including the elimination of certain borrower benefits and premiums paid on secondary market loan purchases. Many FFELP lenders have made other significant changes which dramatically reduced the loan volume they originated. These conditions, primarily centered on loan access and loan processing, have led a number of schools to convert from the FFELP to the Direct Loan Program or participate in the Direct Loan Program in addition to the FFELP.

Seasonality

The Company's fee-based businesses, primarily revenue earned by the Company's loan and guaranty servicing operations, tuition management services, and enrollment services operations, are subject to seasonal fluctuations which correspond, or are related, to the traditional school year. In addition, the Company's loan and guaranty servicing operation earns revenue related to rehabilitation collections on defaulted loans and servicing conversions and transfers. These types of activities occur at various times throughout the year. Thus, revenue from these services can vary from period to period.

Recent Developments - Legislation

On February 26, 2009, the President introduced a fiscal year 2010 Federal budget proposal calling for the elimination of the FFEL Program and a recommendation that all new student loan originations be funded through the Direct Loan Program. On September 17, 2009, the House of Representatives passed H.R. 3221, the Student Aid and Fiscal Responsibility Act ("SAFRA"), which would eliminate the FFEL Program and require that, after July 1, 2010, all new federal student loans be made through the Direct Loan Program. The Senate is expected to begin its consideration of similar student loan reform legislation sometime in 2010. In addition to the House-passed legislation, there are several other proposals for changes to the education financing framework that may be considered that would maintain a role for private lenders in the origination of federal student loans. These include a possible extension of ECASLA, which expires on July 1, 2010, and the Student Loan Community Proposal, a proposal endorsed by a cross-section of

FFELP service providers (including the Company) as an alternative to the 100% federal direct lending proposal included in SAFRA.

12

Elimination of the FFEL Program would impact the Company's operations and profitability by, among other things, reducing the Company's interest revenues as a result of the inability to add new FFELP loans to the Company's portfolio and reducing guarantee and third-party FFELP servicing fees as a result of reduced FFELP loan servicing and origination volume. Additionally, the elimination of the FFEL Program could reduce education loan software licensing opportunities and related consulting fees received from lenders using the Company's software products and services.

In June 2009, the Department of Education named the Company as one of four private sector companies awarded a servicing contract to service student loans. No later than August 2010, the Company expects to also begin servicing new loans originated under the Direct Loan Program. If legislation is passed mandating that all new student loan originations be funded through the Direct Loan Program, revenue from servicing loans under this contract will partially offset the loss of revenue if the FFEL Program is eliminated.

Intellectual Property

The Company owns numerous trademarks and service marks ("Marks") to identify its various products and services. As of December 31, 2009, the Company had four pending and 99 registered Marks. The Company actively asserts its rights to these Marks when it believes infringement may exist. The Company believes its Marks have developed and continue to develop strong brand-name recognition in the industry and the consumer marketplace. Each of the Marks has, upon registration, an indefinite duration so long as the Company continues to use the Mark on or in connection with such goods or services as the Mark identifies. In order to protect the indefinite duration, the Company makes filings to continue registration of the Marks. The Company owns four patent applications that have been published, but have not yet been issued and has also actively asserted its rights thereunder in situations where the Company believes its claims may be infringed upon. The Company owns many copyright-protected works, including its various computer system codes and displays, Web sites, books and other publications, and marketing collateral. The Company also has trade secret rights to many of its processes and strategies and its software product designs. The Company's software products are protected by both registered and common law copyrights, as well as strict confidentiality and ownership provisions placed in license agreements which restrict the ability to copy, distribute, or improperly disclose the software products. The Company also has adopted internal procedures designed to protect the Company's intellectual property.

The Company seeks federal and/or state protection of intellectual property when deemed appropriate, including patent, trademark/service mark, and copyright. The decision whether to seek such protection may depend on the perceived value of the intellectual property, the likelihood of securing protection, the cost of securing and maintaining that protection, and the potential for infringement. The Company's employees are trained in the fundamentals of intellectual property, intellectual property protection, and infringement issues. The Company's employees are also required to sign agreements requiring, among other things, confidentiality of trade secrets, assignment of inventions, and non-solicitation of other employees post-termination. Consultants, suppliers, and other business partners are also required to sign nondisclosure agreements to protect the Company's proprietary rights.

Employees

As of December 31, 2009, the Company had approximately 2,000 employees. Approximately 350 of these employees held professional and management positions while approximately 1,650 were in support and operational positions. None of the Company's employees are covered by collective bargaining agreements. The Company is not involved in any material disputes with any of its employees, and the Company believes that relations with its employees are good.

Available Information

Copies of the Company's annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to such reports are available on the Company's Web site free of charge as soon as reasonably practicable after such reports are filed with or furnished to the United States Securities and Exchange Commission (the "SEC"). Investors and other interested parties can access these reports and the Company's proxy statements at <http://www.nelnet.com>. The Company routinely posts important information for investors on its Web site. The SEC maintains an Internet site (<http://www.sec.gov>) that contains periodic and other reports such as annual, quarterly, and current reports on Forms 10-K, 10-Q, and 8-K, respectively, as well as proxy and information statements regarding the Company and other companies that file electronically with the SEC.

The Company has adopted a Code of Conduct that applies to directors, officers, and employees, including the Company's principal executive officer and its principal financial and accounting officer, and has posted such Code of Conduct on its Web site. Amendments to and waivers granted with respect to the Company's Code of Conduct relating to its executive officers and directors which are required to be disclosed pursuant to applicable securities laws and stock exchange rules and regulations will also be posted on its Web site. The Company's Corporate Governance Guidelines, Audit Committee Charter, Compensation Committee Charter, Nominating and Corporate Governance Committee Charter, and the Finance Committee Charter are also posted on its Web site.

Information on the Company's Web site is not incorporated by reference into this Report and should not be considered part of this Report.

ITEM 1A. RISK FACTORS

The risk factors section highlights specific risks that could affect the Company. Although this section attempts to highlight key risk factors, please be aware that other risks may prove to be important in the future. New risks may emerge at any time and the Company cannot predict such risks or estimate the extent to which they may affect the financial performance of the Company. These risk factors should be read in conjunction with the other information set forth in this Report. For convenience of reference, the sub-captions which briefly describe these risk factors are listed immediately below, followed by the discussion of each risk factor.

- The Company is exposed to interest rate risk in the form of basis risk and repricing risk because the interest rate characteristics of the Company's assets do not match the interest rate characteristics of the funding for the assets.
- The Company is exposed to interest rate risk because of the interest rate characteristics of certain of its assets and the interest rate characteristics of the related funding of such assets.
- Characteristics unique to certain asset-backed securitizations, namely auction rate securities and variable rate demand notes, may negatively affect the Company's earnings.
- The Company's derivative instruments may not be successful in managing interest and foreign currency exchange rate risks, which may negatively impact the Company's operations.
- Higher rates of prepayments of student loans, including consolidations by third parties or the Department of Education through the Direct Loan Program, could reduce the Company's profits.
 - The costs and effects of litigation, investigations, or similar matters, or adverse facts and developments related thereto, could materially affect the Company's financial position and results of operations.
 - Exposure related to certain tax issues could decrease the Company's net income.
- Changes in accounting policies or accounting standards, changes in how accounting standards are interpreted or applied, and incorrect estimates and assumptions by management in connection with the preparation of the Company's consolidated financial statements could materially affect the reported amounts of asset and liabilities, the reported amounts of income and expenses, and related disclosures.
- Security and privacy breaches in systems or system failures may damage client relations and the Company's reputation.
- Changes in student lending legislation and regulations or the elimination of the FFEL Program by the Federal Government could have a negative impact upon the Company's business and may affect its earnings and operations.
- Federal and state regulations can restrict the Company's business and noncompliance with these regulations could result in penalties, litigation, and reputation damage.
- A failure to properly manage operations and growth could have a material adverse effect on the Company's ability to retain existing customers and attract new business opportunities.
- The Company and its operating segments are highly dependent upon information technology systems and infrastructure.
 - The Company faces liquidity and funding risk to meet its financial obligations.

- The ratings of the Company or of any securities issued by the Company may change, which may increase the Company's costs of capital and may reduce the liquidity of the Company's securities.
 - There are risks inherent in owning the Company's common stock.
- Changes in industry structure and market conditions could lead to charges related to discontinuances of certain products or businesses and asset impairment, including goodwill.
 - The Company faces counterparty risk.

- The Company is subject to foreign currency exchange risk and such risk could lead to increased costs.
- Managing assets for third parties has inherent risks that, if not properly managed, could negatively affect the Company's business.
- The Company must satisfy certain requirements necessary to maintain the federal guarantees of its federally insured loans, and the Company may incur penalties or lose its guarantees if it fails to meet these requirements.
- Future losses due to defaults on loans held by the Company, or loans sold to third parties which the Company is obligated to repurchase in the event of certain delinquencies, present credit risk which could adversely affect the Company's earnings.
- A failure to attract and retain necessary technical personnel, skilled management, and qualified subcontractors may have an adverse impact on the Company's future growth.
- The Company's government contracts are subject to termination rights, audits, and investigations, and, if terminated, could negatively impact the Company's reputation and reduce its ability to compete for new contracts.
- The Company may face operational and security risks from its reliance on vendors to complete specific business operations.
- The markets in which the Company competes are highly competitive, which could affect revenue and profit margins.
- Transactions with affiliates and potential conflicts of interest of certain of the Company's officers and directors, including the Company's Chief Executive Officer, pose risks to the Company's shareholders that the Company may not enter into transactions on the same terms that the Company could receive from unrelated third-parties.
- The Company's Chairman and Chief Executive Officer owns a substantial percentage of the Company's Class A and Class B common stock and is able to control all matters subject to a shareholder vote.
- Negative publicity could damage the Company's reputation and adversely affect its operating segments and their financial results.
- A continued economic recession could reduce demand for Company products and services and lead to lower revenue and earnings.
- The Company may not be able to successfully protect its intellectual property and may be subject to infringement claims.

The Company is exposed to interest rate risk in the form of basis risk and repricing risk because the interest rate characteristics of the Company's assets do not match the interest rate characteristics of the funding for the assets.

The Company issues asset-backed securities, the vast majority being variable rate, to fund its student loan assets. The variable rate debt is generally indexed to 3-month LIBOR, set by auction, or through a remarketing process. The income generated by the Company's student loan assets is generally driven by short term indices (treasury bills and commercial paper) that are different from those which affect the Company's liabilities (generally LIBOR), which creates basis risk. Moreover, the Company faces repricing risk due to the timing of the interest rate resets on its liabilities, which may occur as infrequently as every quarter, and the timing of the interest rate resets on its assets, which generally occurs daily. In a declining interest rate environment, this may cause the Company's student loan

spread to compress, while in a rising rate environment, it may cause the spread to increase.

By using different index types and different index reset frequencies to fund assets, the Company is exposed to interest rate risk in the form of basis risk and repricing risk, which, as noted above, is the risk that the different indices may reset at different frequencies, or will not move in the same direction or with the same magnitude. While these indices are short term with rate movements that are highly correlated over a longer period of time, at points in recent history, they have been volatile and less correlated. There can be no assurance the indices will maintain a high level of correlation in the future due to capital market dislocations or other factors not within the Company's control. In such circumstances, the Company's earnings could be adversely affected, possibly to a material extent.

The Company has used derivative instruments to hedge the repricing risk due to the timing of the interest rate resets on its assets and liabilities. However, the Company does not generally hedge the basis risk due to the different interest rate indices associated with its liabilities and the majority of its assets since the derivatives needed to hedge this risk are generally illiquid or non-existent and the relationship between the indices for most of the Company's assets and liabilities has been highly correlated over a long period of time. Any spread widening could have a significant impact on the net spread of the Company's student loan portfolio.

The Company is exposed to interest rate risk because of the interest rate characteristics of certain of its assets and the interest rate characteristics of the related funding of such assets.

Loans originated prior to April 1, 2006 generally earn interest at the higher of a floating rate based on the Special Allowance Payment or SAP formula set by the Department and the borrower rate, which is fixed over a period of time. The Company generally finances its student loan portfolio with variable rate debt. In low and/or declining interest rate environments, when the fixed borrower rate is higher than the rate produced by the SAP formula, the Company's student loans earn at a fixed rate while the interest on the variable rate debt typically continues to decline. In these interest rate environments, the Company may earn additional spread income that it refers to as floor income.

Depending on the type of loan and when it was originated, the borrower rate is either fixed to term or is reset to an annual rate each July 1. As a result, for loans where the borrower rate is fixed to term, the Company may earn floor income for an extended period of time, which the Company refers to as fixed rate floor income, and for those loans where the borrower rate is reset annually on July 1, the Company may earn floor income to the next reset date, which the Company refers to as variable rate floor income. In accordance with legislation enacted in 2006, lenders are required to rebate fixed rate floor income and variable rate floor income to the Department for all new FFELP loans first originated on or after April 1, 2006.

Absent the use of derivative instruments and ignoring potential repricing benefits associated with the mismatch between the reset of the loan assets and debt securities, a rise in interest rates may reduce the amount of floor income received and this may have an impact on earnings due to interest margin compression caused by increasing financing costs, until such time as the federally insured loans earn interest at a variable rate in accordance with their special allowance payment formulas. In higher interest rate environments, where the interest rate rises above the borrower rate and fixed rate loans effectively convert to variable rate loans, the impact of the rate fluctuations is reduced.

Characteristics unique to certain asset-backed securitizations, namely auction rate securities and variable rate demand notes, may negatively affect the Company's earnings.

The interest rates on certain of the Company's asset-backed securities are set and periodically reset via a "dutch auction" ("Auction Rate Securities") or through remarketing utilizing remarketing agents ("Variable Rate Demand Notes").

For Auction Rate Securities, investors and potential investors submit orders through a broker-dealer as to the principal amount of notes they wish to buy, hold, or sell at various interest rates. The broker-dealers submit their clients' orders to the auction agent, who then determines the clearing interest rate for the upcoming period. Interest rates on these Auction Rate Securities are reset periodically, generally every 7 to 35 days, by the auction agent or agents. Beginning in the first quarter of 2008, as part of the ongoing credit market crisis, auction rate securities from various issuers have failed to receive sufficient order interest from potential investors to clear successfully, resulting in failed auction status. Since February 2008, the Company's Auction Rate Securities have failed in this manner. Under historical conditions, the broker-dealers would purchase these securities if investor demand is weak. However, since February 2008, the broker-dealers have been allowing auctions to fail. Currently, all of the Company's Auction Rate Securities are in a failed auction status and the Company believes they will remain in a failed auction status for an extended period of time and possibly permanently.

As a result of a failed auction, the Auction Rate Securities will generally pay interest to the holder at a maximum rate as defined by the indenture. While these rates will vary by class of security, they will generally be based on a spread to LIBOR, commercial paper, or treasury securities. These maximum rates are subject to increase if the credit ratings on the bonds are downgraded.

The Company cannot predict whether future auctions related to its Auction Rate Securities will be successful. The Company is currently seeking alternatives for reducing its exposure to the auction rate market, but may not be able to

achieve alternate financing for some of its Auction Rate Securities. If there is no demand for the Company's Auction Rate Securities, the Company could be subject to interest costs substantially above the anticipated and historical rates paid on these types of securities.

For Variable Rate Demand Notes, the remarketing agents set the price, which is then offered to investors. If there are insufficient potential bid orders to purchase all of the notes offered for sale, the Company could be subject to interest costs substantially above the anticipated and historical rates paid on these types of securities.

The Company's derivative instruments may not be successful in managing interest and foreign currency exchange rate risks, which may negatively impact the Company's operations.

When the Company utilizes derivative instruments, it utilizes them to manage interest and foreign currency exchange rate sensitivity. The Company's derivative instruments are intended as economic hedges but do not qualify for hedge accounting; consequently, the change in fair value, called the "mark-to-market", of these derivative instruments is included in the Company's operating results. Changes or shifts in the forward yield curve and foreign currency exchange rates can and have significantly impacted the valuation of the Company's derivatives. Accordingly, changes or shifts in the forward yield curve and foreign currency exchange rates will impact the financial position, results of operations, and cash flows of the Company. Further, the Company may incur costs or be subject to bid/ask spreads if the Company terminates a derivative instrument. The derivative instruments used by the Company are typically in the form of interest rate swaps, basis swaps, and cross-currency interest rate swaps.

Developing an effective strategy for dealing with movements in interest rates and foreign currency exchange rates is complex, and no strategy can completely insulate the Company from risks associated with such fluctuations. Although the Company believes its derivative instruments are highly effective, because many of its derivatives are not balance guaranteed to a particular pool of student loans, the Company is subject to prepayment risk that could result in the Company being under or over hedged, which could result in material losses to the Company. In addition, the Company's interest rate and foreign currency exchange risk management activities could expose the Company to substantial mark-to-market losses if interest rates or foreign currency exchange rates move materially different from the environment when the derivatives were entered into. As a result, the Company cannot offer any assurance that its economic hedging activities will effectively manage its interest and foreign currency exchange rate sensitivity, nor have the desired beneficial impact on its results of operations or financial condition.

Higher rates of prepayments of student loans, including consolidations by third parties or the Department of Education through the Direct Loan Program, could reduce the Company's profits.

Pursuant to the Higher Education Act, borrowers may prepay loans made under the FFEL Program at any time without penalty. Prepayments may result from consolidating student loans, which historically tends to occur more frequently in low interest rate environments, from borrower defaults, which will result in the receipt of a guaranty payment, and from voluntary full or partial prepayments, among other things. High prepayment rates will have the most impact on the Company's asset-backed securitization transactions, since those securities are priced according to the expected average lives of the underlying loans. The rate of prepayments of student loans may be influenced by a variety of economic, social, and other factors affecting borrowers, including interest rates and the availability of alternative financing. The Company's profits could be adversely affected by higher prepayments, which may reduce the amount of net interest income the Company receives.

The Company's portfolio of federally insured loans is subject to refinancing through the use of consolidation loans, which are expressly permitted by the Higher Education Act and the Direct Loan Program. As a result, the Company may lose student loans in its portfolio that are consolidated by the Direct Loan Program or, if market conditions were to improve, competing FFELP lenders. Increased consolidations of student loans by the Company's competitors or by the Direct Loan Program may result in a negative return on loans, when considering the origination costs or acquisition premiums paid with respect to these loans. Moreover, it may result in a reduction in net interest income.

The costs and effects of litigation, investigations, or similar matters, or adverse facts and developments related thereto, could materially affect the Company's financial position and results of operations.

The Company may be involved from time to time in a variety of lawsuits, investigations, or similar matters arising out of business operations. The Company's insurance may not cover all claims that may be asserted against it, and any claims asserted against the Company, regardless of merit or eventual outcome, may harm the Company's reputation.

Should the ultimate judgments or settlements in any litigation or investigation significantly exceed insurance coverage, they could have a material adverse effect on the Company's financial position. In addition, the Company may not be able to obtain appropriate types or levels of insurance in the future, and may not be able to obtain adequate replacement policies with acceptable terms, if at all.

The outcome of legal proceedings may differ from the Company's expectations because the resolution of such matters is often difficult to reliably predict. Various factors or developments can lead the Company to change current estimates of liabilities and related insurance receivables where applicable, or to make estimates for matters previously not susceptible of reasonable estimates, such as a significant judicial ruling or judgment, a significant settlement, significant regulatory developments, or changes in applicable law. A future adverse ruling, settlement, or unfavorable development could result in future charges that could have a material adverse effect on the Company's results of operations or cash flows in any particular period. For further information, see Part I Item 3 "Legal Proceedings."

Exposure related to certain tax issues could decrease the Company's net income.

A corporation is considered to be a "personal holding company" under the U.S. Internal Revenue Code of 1986, as amended (the "Code"), if (1) at least 60% of its adjusted ordinary gross income is "personal holding company income" (generally, passive income) and (2) at any time during the last half of the taxable year more than half, by value, of its stock is owned by five or fewer individuals, as determined under attribution rules of the Code. If both of these tests are met, a personal holding company is subject to an additional tax on its undistributed personal holding company income, currently at a 15% rate. Five or fewer individuals hold more than half the value of the Company's stock. In June 2003, the Company submitted a request for a private letter ruling from the Internal Revenue Service seeking a determination that its federally guaranteed student loans qualify as assets of a "lending or finance business," as defined in the Code. Such a determination would have assured the Company that holding such loans does not make it a personal holding company. Based on its historical practice of not issuing private letter rulings concerning matters that it considers to be primarily factual, however, the Internal Revenue Service has indicated that it will not issue the requested ruling, taking no position on the merits of the legal issue. So long as more than half of the Company's value continues to be held by five or fewer individuals, if it were to be determined that some portion of its federally guaranteed student loans does not qualify as assets of a "lending or finance business," as defined in the Code, the Company could become subject to personal holding company tax on its undistributed personal holding company income. The Company continues to believe that neither Nelnet, Inc. nor any of its subsidiaries is a personal holding company. However, even if Nelnet, Inc. or one of its subsidiaries was determined to be a personal holding company, the Company believes that by utilizing intercompany distributions, it could eliminate or substantially eliminate its exposure to personal holding company taxes, although it cannot assure that this will be the case.

The Company is subject to federal and state income tax laws and regulations. Income tax regulations are often complex and require interpretation. The nexus standards and the sourcing of receipts from intangible personal property and services have been the subject of state audits and litigation with state taxing authorities and tax policy debates by various state legislatures. As the U.S. Congress and U.S. Supreme Court have not provided clear guidance in this regard, conflicting state laws and court decisions create tremendous uncertainty and expense for taxpayers conducting interstate commerce. Changes in income tax regulations could negatively impact the Company's results of operations. If states enact legislation, alter apportionment methodologies, or aggressively apply the income tax nexus standards, the Company may become subject to additional state taxes.

From time to time, the Company engages in transactions in which the tax consequences may be subject to uncertainty. Examples of such transactions include asset and business acquisitions and dispositions, financing transactions, apportionment, nexus standards, and income recognition. Significant judgment is required in assessing and estimating the tax consequences of these transactions. The Company prepares and files tax returns based on the interpretation of tax laws and regulations. In the normal course of business, the Company's tax returns are subject to examination by various taxing authorities. Such examinations may result in future tax and interest assessments by these taxing authorities. In accordance with authoritative accounting guidance, the Company establishes reserves for tax contingencies related to deductions and credits that it may be unable to sustain. Differences between the reserves for tax contingencies and the amounts ultimately owed are recorded in the period they become known. Adjustments to the Company's reserves could have a material effect on the Company's financial statements.

Changes in accounting policies or accounting standards, changes in how accounting standards are interpreted or applied, and incorrect estimates and assumptions by management in connection with the preparation of the Company's consolidated financial statements could materially affect the reported amounts of asset and liabilities, the reported amounts of income and expenses, and related disclosures.

The Company's accounting policies are fundamental to determining and understanding financial condition and results of operations. Some of these policies require use of estimates and assumptions that could affect the reported amounts of assets and liabilities and the reported amounts of income and expenses during the reporting periods. Several of the

Company's accounting policies are critical because they require management to make difficult, subjective, and complex judgments about matters that are inherently uncertain and because it is likely that materially different amounts would be reported under different conditions or using different assumptions. See Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations — Critical Accounting Policies." From time to time the Financial Accounting Standards Board ("FASB") and the SEC change the financial accounting and reporting standards that govern the preparation of external financial statements. In addition, accounting standard setters and those who interpret the accounting standards (such as the FASB and/or the SEC) may change or even reverse their previous interpretations or positions on how these standards should be applied. Changes in financial accounting and reporting standards and changes in current interpretations may be beyond the Company's control, can be hard to predict, and could materially impact how the Company reports its financial condition and results of operations. The Company could be required to apply a new or revised standard retroactively or apply an existing standard differently, also retroactively, in each case resulting in the Company potentially restating prior period financial statements that could potentially be material.

Security and privacy breaches in systems or system failures may damage client relations and the Company's reputation.

The uninterrupted operation of processing systems and the confidentiality of the customer information is critical to the Company's business. The Company has security, backup, recovery systems, business continuity, and incident response plans in place. Additionally, several of the Company's operating segments must comply with Payment Card Industry Data Security Standards and National Institute of Standards in Technology security controls. Any failures in security, privacy, or a disruption in service could have a material adverse effect on customer contracts and the Company's reputation and financial results.

While the Company believes applications it uses are proven and designed for data security and integrity to process electronic transactions, there can be no assurance that these applications will be sufficient to counter all current and emerging technology threats designed to interrupt service or breach systems in order to gain access to confidential client information or intellectual property or assurance that these applications will be sufficient to address the security and privacy concerns of existing and potential customers.

Changes in student lending legislation and regulations or the elimination of the FFEL Program by the Federal Government could have a negative impact upon the Company's business and may affect its earnings and operations.

Funds for payment of interest subsidy payments, special allowance payments, and other payments under the FFEL Program are subject to annual budgetary appropriations by Congress. Federal budget legislation has in the past contained provisions that restricted payments made under the FFEL Program to achieve reductions in federal spending. Future federal budget legislation may adversely affect expenditures by the Department and the financial condition of the Company.

The enactment of the College Cost Reduction Act in September 2007 resulted in a reduction in the yields on student loans and, accordingly, a reduction in the amount of the premium the Company could pay lenders under its forward flow commitments and branding partner arrangements. The Company can give no assurance that it will be successful in renegotiating or renewing, on economically reasonable terms, its branding and forward flow agreements once those agreements expire. Loss of a strong branding or forward flow partner, or relationships with schools from which a significant volume of student loans is directly or indirectly acquired, could result in an adverse effect on the Company's business.

On August 14, 2008, the Higher Education Opportunity Act ("HEOA") was enacted into law and effectively reauthorized the FFEL Program through 2014, with authorization to make FFELP loans through 2018 to borrowers with existing loans. Federal regulations implementing certain requirements of this law became effective in February 2010. This law and the accompanying regulations may affect the Company's profitability by increasing costs as a result of required changes to the Company's operations. Provisions in the HEOA include, but are not limited to, the following:

- School code of conduct requirements applicable to FFELP and private education loan lending
- Disclosure and reporting requirements for lenders and schools participating in preferred lender arrangements
- Enumerated permissible and prohibited inducement activities by FFELP lenders, private education lenders, and FFELP guaranty agencies
- Additional loan origination and repayment disclosures that FFELP and private education lenders must provide to borrowers
 - Additional FFELP loan servicing requirements

Furthermore, Congressional amendments to the Higher Education Act, or other relevant federal laws, and rules and regulations promulgated by the Secretary of Education, may adversely impact holders and originators of FFELP loans.

For example, changes could be made to the rate of interest or special allowance payments paid on FFELP loans, the level of insurance provided by guaranty agencies, the fees assessed to FFEL Program lenders, or the servicing requirements for FFELP loans.

In addition to changes to the Higher Education Act and FFEL Program, various state laws and regulations targeted at student lending companies have been enacted. These laws placed additional restrictions on lending and business practices between schools and lenders of FFELP and private education loans and required changes to the Company's business practices and operations. As with possible actions in the future by Congress and the Secretary of Education at the federal level, state legislatures may enact laws and state agencies may institute rules or take actions which adversely impact holders of FFELP or private education loans.

The Company has also entered into separate agreements with the Nebraska and New York State Attorneys General in relation to its student lending activities. The Company pledges full disclosure and transparency in its marketing, origination, and servicing of education loans. Failure to meet the terms and conditions of an agreement could subject the Company to legal action by the respective Attorney General.

The impact of the legislative changes and federal and state investigations, coupled with financial market disruption has caused the Company and other FFELP lenders to re-evaluate the markets in which they originate loans and the value of the FFEL Program loan assets they hold.

On September 17, 2009, SAFRA was passed by the House of Representatives. This bill prohibits the disbursement, making, or insuring on or after July 1, 2010 of any new FFEL Program loans. If SAFRA becomes law, new student loan originations would be funded through the Direct Loan Program and loan servicing would be provided by private sector companies through performance-based contracts with the Department. The Senate has not yet proposed its own version of a student loan reform bill. In addition to the House-passed legislation, there are several other proposals for changes to the education financing framework that may be considered that would maintain a role for private lenders in the origination of federal student loans. These include a possible extension of ECASLA, which expires on July 1, 2010, and the Student Loan Community Proposal, a proposal endorsed by a cross-section of FFELP service providers (including the Company) as an alternative to the 100% federal direct lending proposal included in SAFRA. The Company cannot currently predict whether this or any other proposals to eliminate the FFEL Program will ultimately be enacted.

Elimination of the FFEL Program would significantly impact the Company's operations and profitability by, among other things, reducing the Company's interest revenues as a result of the inability to add new FFELP loans to the Company's portfolio and reducing guarantee fees as a result of reduced FFELP loan servicing and origination volume. Additionally, the elimination of the FFEL Program would reduce education loan software licensing opportunities and related consulting fees received from lenders using the Company's software products and services. In addition, without an extension of ECASLA, the Company's ability to fund federal student loan originations would be limited.

Federal and state regulations can restrict the Company's business and noncompliance with these regulations could result in penalties, litigation, and reputation damage.

The Company, its operating segments, and commercial customers are heavily regulated by federal and state governments and regulatory agencies. This regulation and legislation is proposed or enacted to protect consumers and the financial industry as a whole, not necessarily the Company and its stockholders. Consequently, this regulation and legislation can significantly alter the regulatory environment, limit business operations, increase costs of doing business, and could lead to the Company being fined or penalized if the Company is found to be out of compliance.

The Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley) limits the types of non-audit services the Company's outside auditors may provide to the Company in order to preserve their independence. If the Company's auditors were found not to be "independent" under SEC rules, the Company could be required to engage new auditors and file new financial statements and audit reports with the SEC. The Company could be out of compliance with SEC rules until new financial statements and audit reports were filed, limiting the Company's ability to raise capital and resulting in other adverse consequences. Sarbanes-Oxley also requires the Company's management to evaluate the Company's disclosure controls and procedures and its internal control over financial reporting and requires auditors to issue a report on the Company's internal control over financial reporting. The Company is required to disclose, in its annual report on Form 10-K filed with the SEC, the existence of any "material weaknesses" in its internal controls. The Company cannot provide assurance that it will not find one or more material weaknesses as of the end of any given year, nor can the Company predict the effect on its stock price of disclosure of a material weakness.

The Patriot Act, which was enacted in the wake of the September 2001 terrorist attacks, requires the Company and its financial customers to implement new or revised policies and procedures relating to anti-money laundering, compliance, suspicious activities, and currency transaction reporting and due diligence on customers. Complying with this regulation could increase operating costs and restrict business operations.

Historically, the Company's principal business has been comprised of originating, acquiring, holding, and servicing student loans made and guaranteed pursuant to the FFEL Program. The Higher Education Act generally prohibits a lender from providing certain inducements to educational institutions or individuals in order to secure applicants for FFELP loans. In addition, under contract with the Department, the Company services loans pursuant to the FFEL, Federal Direct Loan, Federal Perkins Loan, and TEACH Grant programs. The Higher Education Act created these

programs and governs many aspects of the Company's operations. The Company is also subject to rules of the agencies that act as guarantors of the student loans, known as guaranty agencies. The Company has structured its relationships and product offerings in a manner intended to comply with the Higher Education Act, supporting regulations, and the available communications and guidance from the Department. Failure to comply, irrespective of the reason, could subject the Company to loss of the federal guaranty on federally insured loans, costs of curing servicing deficiencies or remedial servicing, suspension or termination of the Company's right to participate in the FFEL Program or to participate as a servicer, negative publicity, and potential legal claims or actions brought by the Company's servicing customers and borrowers. If the Department were to change its position on any of these matters, the Company may have to change the way it markets products and services and a new marketing strategy may not be as effective. If the Company fails to respond to the Department's change in position, the Department could potentially impose sanctions upon the Company that could negatively impact the Company's business.

In addition, the Company is subject to certain federal and state banking laws, regulations, and examinations, as well as federal and state consumer protection laws and regulations, including, without limitation, laws and regulations governing privacy protection, information security, restrictions on access to customer information, and, specifically with respect to the Company's non-federally insured loan portfolio, certain state usury laws and related regulations and the Federal Truth in Lending Act. All or most of these laws and regulations impose substantial requirements upon lenders and servicers involved in consumer finance. Failure to comply with these laws and regulations could result in liability for the Company as a result of the imposition of civil penalties and potential class action law suits.

The Company is subject to federal and state credit card industry laws, regulations, association rules, or industry standards. Changes to statutes, regulations, or industry standards, including interpretation and implementation of statutes, regulations, or standards, could increase the cost of doing business or affect the competitive balance. The Company cannot predict whether new legislation will be enacted or whether any credit card association rule or other industry standard will change, and if enacted or changed, the effect that it would have on the Company's financial position or results of operations. These changes may require the Company to incur significant expenses to redevelop products. Also, failure to comply with laws, rules, and regulations or standards could result in fines, sanctions, or other penalties, which could have a material adverse affect on the Company's reputation, financial position, and operating results.

Laws and regulations that apply to Internet communications, lead generations, school recruitment, privacy, commerce, and advertising are becoming more prevalent. These regulations could increase the costs of conducting business on the Internet and could decrease demand for the Company's interactive marketing and subscription services.

The Company maintains systems and procedures designed to ensure compliance with applicable laws and regulations. However, some legal and regulatory frameworks provide for the imposition of fines or penalties for noncompliance even though the noncompliance was inadvertent or unintentional and even though systems and procedures designed to ensure compliance were in place at the time of noncompliance. Therefore, the establishment and maintenance of systems and procedures reasonably designed to ensure compliance cannot guarantee fines or penalties will be avoided. There may be other negative consequences resulting from a finding of noncompliance, including restrictions on certain activities or reputation damage.

A failure to properly manage operations and growth could have a material adverse effect on the Company's ability to retain existing customers and attract new business opportunities.

While recently the Company has focused on managing costs and expenses, over the long term, the Company intends to add personnel and other resources to meet the requirements of customer contracts and expand products and services into new and existing markets. The Company is likely to recognize costs associated with these investments earlier than some of the anticipated benefits and the return on these investments may be lower, or may develop more slowly, than is expected. If the anticipated benefits of these investments are delayed or are not realized, operating results may be adversely affected.

In order to manage growth effectively, the Company must design, develop, implement and improve operational systems, which may include the design, development, and implementation of software and timely development and implementation of procedures and controls. If the Company fails to design, develop, and implement and improve systems, it may not be able to maintain required customer service levels, hire and retain new employees, pursue new business opportunities, complete future acquisitions or operate its businesses effectively. Failure to properly transition new clients to systems, properly budget transition costs, or accurately estimate new contract operational costs, could result in delays in contract performance, impair long-lived assets, or result in contracts with profit margins which do not meet Company or market expectations.

Additionally, the Company's success depends on its ability to develop and implement services and solutions that anticipate and respond to continuing changes in technology, industry developments, and client needs. The Company may not successfully anticipate or respond to these developments in a timely manner, and offerings may not be successful in the marketplace. Also, services, solutions, and technologies offered by current or future competitors may make Company services or solutions uncompetitive or obsolete. As a result of any of these complications associated with expansion, the Company's financial condition, results of operations, and cash flow could be materially and adversely affected.

The Company and its operating segments are highly dependent upon information technology systems and infrastructure.

The success of the Company depends, in part, on the ability to successfully and cost-effectively improve its system infrastructure and deliver products and services to customers. The widespread adoption of new technologies and market demands could require substantial expenditures to enhance system infrastructure and existing products and services. If the Company fails to enhance its system infrastructure or products and services, its operating segments may lose their competitive advantage and this could adversely affect financial and operating results.

Additionally, the Company faces the risk of business disruption if failures in its information systems occur as a result of changes in infrastructure, relocation of infrastructure, or failure to perform required services, which could have a material impact upon its business and operations. The Company regularly backs up its data and maintains detailed disaster recovery plans. A major physical disaster or other calamity that causes significant damage to information systems could adversely affect the Company's business. Additionally, loss of information systems for a sustained period of time could have a negative impact on the Company's performance and ultimately on cash flow in the event the Company were unable to process transactions and/or provide services to customers.

The Company faces liquidity and funding risk to meet its financial obligations.

Liquidity and funding risk refers to the risk that the Company will be unable to finance its operations due to a loss of access to the capital markets or other financing alternatives, or difficulty in raising financing needed for its assets. Liquidity and funding risk also encompasses the ability of the Company to meet its financial obligations without experiencing significant business disruption or reputational damage that may threaten its viability as a going concern.

The recent unprecedented disruptions in the credit and financial markets and the general economic crisis have had and may continue to have an adverse effect on the cost and availability of financing for the Company's student loan portfolios and, as a result, have had and may continue to have an adverse effect on the Company's liquidity, results of operations, and financial condition. Such adverse conditions may continue or worsen in the future.

The Company's primary funding needs are those required to finance new student loan originations and acquisitions and satisfy certain debt obligations, specifically its unsecured senior notes and unsecured line of credit. In general, the amount, type, and cost of the Company's funding, including securitizations and unsecured financing from the capital markets and borrowings from financial institutions, have a direct impact on the Company's operating expenses and financial results and can limit the Company's ability to increase its student loan assets. The Company relies upon secured financing vehicles as its most significant source of funding for student loans. The Company's primary secured financing vehicles are loan warehouse facilities and asset-backed securitizations.

Historically, the Company funded new loan originations using loan warehouse facilities and asset-backed securitizations. Student loan warehousing has historically allowed the Company to buy and manage student loans prior to transferring them into more permanent financing arrangements.

In August 2008, the Company began funding FFELP Stafford and PLUS student loan originations for the 2008-2009 academic year through the Department's Participation and Purchase Programs pursuant to the ECASLA. Under the Department's Purchase Program, the Department purchases loans at a price equal to the sum of (i) par value, (ii) accrued interest, (iii) the one percent origination fee paid to the Department, and (iv) a fixed amount of \$75 per loan. Under the Participation Program, the Department provides interim short term liquidity to FFELP lenders by purchasing participation interests in pools of FFELP loans. FFELP lenders are charged a rate of commercial paper plus 50 basis points on the principal amount of participation interests outstanding. Loans funded under the Participation Program for the 2008-2009 academic year were required to be either refinanced by the lender or sold to the Department pursuant to the Purchase Program prior to its expiration on October 15, 2009. To be eligible for purchase or participation under the Department's programs, loans were originally limited to FFELP Stafford or PLUS loans made for the academic year 2008-2009, first disbursed between May 1, 2008 and July 1, 2009, with eligible borrower benefits.

On October 7, 2008, legislation was enacted to extend the Department's authority to finance and acquire FFELP student loans made for the 2009-2010 academic year by extending the Participation and Purchase Programs from September 30, 2009 to September 30, 2010. The Department indicated that loans for the 2008-2009 academic year which were funded under the Department's Participation Program had to be refinanced or sold to the Department prior to October 15, 2009. On November 8, 2008, the Department announced the replication of the terms of the Participation and Purchase Programs, in accordance with the October 7th legislation, to include FFELP student loans made for the 2009-2010 academic year. Loans for the 2009-2010 academic year must be refinanced or sold to the Department prior to October 15, 2010. With respect to the origination of new FFELP student loans for the 2008-2009 and 2009-2010 academic years, the Company has utilized the Department's Participation and Purchase Programs.

On August 3, 2009, the Company entered into a FFELP warehouse facility (the "2009 FFELP Warehouse Facility"). The 2009 FFELP Warehouse Facility has a maximum financing amount of \$500.0 million, with a revolving financing structure supported by 364-day liquidity provisions, which expire on August 2, 2010. The final maturity date of the

facility is August 3, 2012. In the event the Company is unable to renew the liquidity provisions by August 2, 2010, the facility would become a term facility at a stepped-up cost, with no additional student loans being eligible for financing, and the Company would be required to refinance the existing loans in the facility by August 3, 2012.

The 2009 FFELP Warehouse Facility provides for formula based advance rates depending on FFELP loan type, up to a maximum of 92 percent to 98 percent of the principal and interest of loans financed. The advance rates for collateral may increase or decrease based on market conditions. The facility contains financial covenants relating to levels of the Company's consolidated net worth, ratio of adjusted EBITDA to corporate debt interest, and unencumbered cash. Any violation of these covenants could result in a requirement for the immediate repayment of any outstanding borrowings under the facility. Unlike the Company's prior FFELP warehouse facility, the new facility does not require the Company to refinance or remove a percentage of the pledged student loan collateral on an annual basis. Continued disruptions in the credit and financial markets may cause additional volatility in the loan valuation formula under the warehouse facility and a decline in advance rates may adversely affect the Company's liquidity position.

In January 2009, the Department published summary terms for its program under which it will finance eligible FFELP Stafford and PLUS loans in a conduit vehicle established to provide funding for student lenders (the “Conduit Program”). Loans eligible for the Conduit Program had to be first disbursed on or after October 1, 2003, but not later than June 30, 2009, and fully disbursed before September 30, 2009, and meet certain other requirements. The Conduit Program was launched on May 11, 2009. Funding for the Conduit Program is provided by the capital markets at a cost based on market rates, with the Company being advanced 97 percent of the student loan face amount. Excess amounts needed to fund the remaining 3 percent of the student loan balances are contributed by the Company. The Conduit Program has a term of five years and expires on May 8, 2014. The Student Loan Short-Term Notes (“Student Loan Notes”) issued by the Conduit Program are supported by a combination of (i) notes backed by FFELP loans, (ii) a liquidity agreement with the Federal Financing Bank, and (iii) a put agreement provided by the Department. If the conduit does not have sufficient funds to pay all Student Loan Notes, then those Student Loan Notes will be repaid with funds from the Federal Financing Bank. The Federal Financing Bank will hold the notes for a short period of time and, if at the end of that time, the Student Loan Notes still cannot be paid off, the underlying FFELP loans that serve as collateral to the Conduit Program will be sold to the Department through the Put Agreement at a price of 97 percent of the face amount of the loans.

The Company has a \$750.0 million unsecured line of credit that terminates in May 2012. Upon termination in 2012, there can be no assurance that the Company will be able to maintain this line of credit, find alternative funding, or increase the amount outstanding under the line, if necessary. The line of credit agreement contains certain financial covenants that, if not met, lead to an event of default under the agreement. The covenants include maintaining a minimum consolidated net worth, minimum adjusted EBITDA to corporate debt interest (over the last four rolling quarters), limitation on subsidiary indebtedness, and limitation on the percentage of non-guaranteed loans in the Company’s portfolio. A default on the 2009 FFELP Warehouse Facility would result in an event of default on the Company’s unsecured line of credit that would result in the outstanding balance on the line becoming immediately due and payable.

If the Company is unable to obtain cost-effective and stable funding alternatives, its funding capabilities and liquidity would be negatively impacted and its cost of funds could increase, adversely affecting the Company’s results of operations. In addition, the Company’s ability to originate and acquire student loans would be limited or could be eliminated.

The ratings of the Company or of any securities issued by the Company may change, which may increase the Company’s costs of capital and may reduce the liquidity of the Company’s securities.

Ratings are based primarily on the creditworthiness of the Company, the underlying assets of asset-backed securitizations, the amount of credit enhancement in any given transaction, and the legal structure of any given transaction. Ratings are not a recommendation to purchase, hold, or sell any of the Company’s securities inasmuch as the ratings do not address the market price or suitability for investors. There is no assurance that ratings will remain in effect for any given period of time or that current ratings will not be lowered or withdrawn by any rating agency. Ratings for the Company or any of its securities may be increased, lowered, or withdrawn by any rating agency if, in the rating agency’s judgment, circumstances so warrant. If the Company’s credit ratings are lowered or withdrawn, the Company may experience an increase in the interest rate paid on the Company’s unsecured line of credit or the interest rates or other costs associated with other capital raising activities by the Company, which may negatively affect the Company’s operations. Moreover, if the unsecured ratings of the Company are lowered or withdrawn, it may affect the terms of the Company’s outstanding derivative contracts and could result in requirements for the Company to post additional collateral under those contracts. Additionally, a lowered or withdrawn credit rating may negatively affect the liquidity of the Company’s securities.

There are risks inherent in owning the Company’s common stock.

From January 1, 2009 to March 1, 2010, the closing daily sales price of the Company's Class A common stock as reported by the New York Stock Exchange ranged from a low of \$4.25 per share to a high of \$17.78 per share. The Company expects the Class A common stock to continue to be subject to fluctuations as a result of a variety of factors, including factors beyond the Company's control. These factors include:

- Changes in interest rates and credit market conditions affecting the cost and availability of financing for the Company's student loan assets
 - Changes in the education financing regulatory framework
- Changes in the education financing or other products and services that the Company offers
 - Variations in the Company's quarterly operating results
 - Changes in financial estimates by securities analysts
 - Changes in market valuations of comparable companies
- Changes in the amounts and frequency of share repurchases or dividends

In December 2009, Company announced that it was reinstating its quarterly dividend payments of \$0.07 per share on its Class A and Class B common stock. The Company will continue to evaluate its dividend policy, but the payment of future dividends remains in the discretion of the Company's board of directors and will continue to depend on the Company's earnings, capital requirements, financial condition, and other factors. In addition, the payment of dividends is subject to the terms of the Company's outstanding junior subordinated hybrid securities, which generally provide that if the Company defers interest payments on those securities it cannot pay dividends on its capital stock.

The Company may not meet the expectations of shareholders and/or of securities analysts at some time in the future, and the market price of the Company's Class A common stock could decline as a result.

Changes in industry structure and market conditions could lead to charges related to discontinuances of certain products or businesses and asset impairment, including goodwill.

In response to changes in industry and market conditions, the Company may be required to strategically realign its resources and consider restructuring, disposing of, or otherwise exiting businesses. Any decision to limit investment in or dispose of or otherwise exit businesses may result in the recording of special charges, such as workforce reduction costs, charges relating to consolidation of excess facilities, or impairments of intangible assets. Estimates with respect to the useful life or ultimate recoverability of the carrying basis of assets, including purchased intangible assets, could change as a result of such assessments and decisions. Additionally, the Company is required to perform goodwill impairment tests on an annual basis and between annual tests in certain circumstances, and future goodwill impairment tests may result in a charge to earnings.

The Company faces counterparty risk.

The Company has exposure to the financial condition of its various lending, investment, and derivative counterparties. If any of the Company's counterparties is unable to perform its obligations, the Company would, depending on the type of counterparty arrangement, experience a loss of liquidity or an economic loss.

The lending commitment for the Company's unsecured line of credit is provided by a total of thirteen banks, with no individual bank representing more than 11% of the total lending commitment. The bank lending group includes Lehman Brothers Bank ("Lehman"), a subsidiary of Lehman Brothers Holdings Inc., which represents approximately 7% of the lending commitment under the line of credit. On September 15, 2008, Lehman Brothers Holdings Inc. filed a voluntary petition for relief under Chapter 11 of the United States Bankruptcy Code. The Company does not expect Lehman to fund future borrowing requests.

As a source of liquidity for funding new FFELP student loan originations, the Company maintains a participation agreement with the related party Union Bank and Trust Company ("Union Bank"), as trustee for various grantor trusts, under which Union Bank has agreed to purchase from the Company participation interests in student loans. The Company currently participates loans to Union Bank to the extent of availability under the grantor trusts. In the event that Union Bank experiences adverse changes to its financial condition, such participation agreement liquidity may not be available to the Company in the future.

The restricted cash in many of the Company's asset backed securitizations is invested in guaranteed investment contracts ("GICs"), These GICs are primarily with three financial institutions, although the Company's risk is concentrated with one institution which is the provider of approximately 85% of the Company's investment contracts. All of the institutions are currently at least A rated. These agreements may be terminated by the Company if the GIC providers' unsecured credit rating falls below a certain threshold. A default by the counterparties under the GICs could lead to a loss of the Company's investment and have a material adverse effect on the Company's results of operations and financial condition.

Related to derivative exposure, the Company may not be able to cost effectively replace the derivative position depending on the type of derivative and the current economic environment. If the Company was not able to replace the derivative position, the Company would be exposed to a greater level of interest rate and/or foreign currency exchange rate risk which could lead to additional losses.

When the mark-to-market value of a derivative instrument is negative, the Company owes the counterparty and, therefore, has no immediate counterparty risk. Additionally, if the negative mark-to-market value of derivatives with a

counterparty exceeds a specified threshold, the Company may have to make a collateral deposit with the counterparty. The threshold at which the Company posts collateral may depend on the Company's unsecured credit rating. If interest and foreign currency exchange rates move materially, the Company could be required to deposit a significant amount of collateral with its derivative instrument counterparties. The collateral deposits, if significant, could negatively impact the Company's capital resources.

When the fair value of a derivative contract is positive, this generally indicates that the counterparty owes the Company. If the counterparty fails to perform, credit risk with such counterparty is equal to the extent of the fair value gain in the derivative less any collateral held by the Company.

The Company attempts to manage market and credit risks associated with interest and foreign currency exchange rates by establishing and monitoring limits as to the types and degree of risk that may be undertaken, and by entering into transactions with high-quality counterparties that are reviewed periodically by the Company's risk committee. The Company also has a policy requiring that all derivative contracts be governed by an International Swaps and Derivatives Association, Inc. Master Agreement.

The Company is subject to foreign currency exchange risk and such risk could lead to increased costs.

As a result of the Company's offerings in Euro-denominated notes, the Company is exposed to market risk related to fluctuations in foreign currency exchange rates between the U.S. dollar and the Euro. The principal and accrued interest on these notes is re-measured at each reporting period and recorded on the Company's balance sheet in U.S. dollars based on the foreign currency exchange rate on that date. When foreign currency exchange rates between the U.S. dollar and the Euro change significantly, earnings may fluctuate significantly. The Company entered into cross-currency interest rate swaps that hedge these risks but, as discussed previously, such swaps may not always be effective.

Managing assets for third parties has inherent risks that, if not properly managed, could negatively affect the Company's business.

The Company manages loan portfolios and transfers funds for third party customers. A compromise of security surrounding loan portfolio and cash management processes or mismanagement of customer assets could lead to litigation, fraud, reputation damage, and unanticipated operating costs that could affect the Company's overall business.

The Company must satisfy certain requirements necessary to maintain the federal guarantees of its federally insured loans, and the Company may incur penalties or lose its guarantees if it fails to meet these requirements.

The Company must meet various requirements in order to maintain the federal guaranty on its federally insured loans. These requirements include establishing servicing requirements and procedural guidelines and specify school and loan eligibility criteria. The federal guaranty on the Company's federally insured loans is conditional based on the Company's compliance with origination, servicing, and collection policies set by the Department and guaranty agencies. Federally insured loans that are not originated, disbursed, or serviced in accordance with the Department's and guaranty agency regulations may risk partial or complete loss of the guaranty. If the Company experiences a high rate of servicing deficiencies (including any deficiencies resulting from the conversion of loans from one servicing platform to another, errors in the loan origination process, establishment of the borrower's repayment status, and due diligence or claim filing processes), it could result in the loan guarantee being revoked or denied. In most cases the Company has the opportunity to cure these deficiencies by following a prescribed cure process which usually involves obtaining the borrower's reaffirmation of the debt. The lender becomes ineligible for special allowance interest benefits from the time of the first error leading to the loan rejection through the date that the loan is cured.

The Company is allowed three years from the date of the loan rejection to cure most loan rejections. If a cure cannot be achieved during this three year period, insurance is permanently revoked and the Company maintains its right to collect the loan proceeds from the borrower.

A guaranty agency may also assess an interest penalty upon claim payment if the error(s) does not result in a loan rejection. These interest penalties are not subject to cure provisions, and are typically related to isolated instances of due diligence deficiencies.

Failure to comply with Federal and guarantor regulations may result in loss of insurance or assessment of interest penalties at the time of claim reimbursement by the Company. A future increase in either the loans claim rejections and/or interest penalties could become material to the Company's fiscal operations.

Future losses due to defaults on loans held by the Company, or loans sold to third parties which the Company is obligated to repurchase in the event of certain delinquencies, present credit risk which could adversely affect the Company's earnings.

Over 99% of the Company's student loan portfolio is comprised of federally insured loans. These loans currently benefit from a federal guaranty of their principal balance and accrued interest. The allowance for loan losses from the federally insured loan portfolio is based on periodic evaluations of the Company's loan portfolios considering past experience, trends in student loan claims rejected for payment by guarantors, changes to federal student loan programs, current economic conditions, and other relevant factors. The federal government currently guarantees 97% of the principal of and the interest on federally insured student loans disbursed on and after July 1, 2006 (and 98% for those loans disbursed prior to July 1, 2006), which limits the Company's loss exposure on the outstanding balance of the Company's federally insured portfolio. Student loans disbursed prior to October 1, 1993 are fully insured for both principal and interest.

The Company's non-federally insured loans are unsecured and are not guaranteed or reinsured under any government or private insurance program. Accordingly, the Company bears the full risk of loss on these loans if the borrower and co-borrower, if applicable, default. In determining the adequacy of the allowance for loan losses on the non-federally insured loans, the Company considers several factors including: loans in repayment versus those in a nonpaying status, delinquency status, loan program type, and trends in defaults in the portfolio based on company and industry data. The Company places a non-federally insured loan on nonaccrual status when the collection of principal and interest is 30 days past due and charges off the loan when the collection of principal and interest is 120 days past due.

The evaluation of the allowance for loan losses is inherently subjective, as it requires material estimates that may be subject to significant changes. The provision for loan losses reflects the activity for the applicable period and provides an allowance at a level that the Company's management believes is adequate to cover probable losses inherent in the loan portfolio. However, future defaults can be higher than anticipated due to a variety of factors such as downturns in the economy, regulatory or operational changes, debt management operational effectiveness, and other unforeseen future trends. If actual performance is worse than estimated, it could materially affect the Company's estimate of the allowance for loan losses and the related provision for loan losses in the Company's statement of operations.

The Company has participated non-federally insured loans to third parties. Loans participated under these agreements have been accounted for by the Company as loan sales. Accordingly, the participation interests sold are not included on the Company's consolidated balance sheet. Per the terms of the servicing agreements, the Company's servicing operations are obligated to repurchase loans subject to the participation interests when such loans become 60 or 90 days delinquent. The evaluation of the reserve related to these participated loans is inherently subjective, as it requires estimates that may be subject to changes. If actual performance is worse than estimated, it could negatively affect the Company's results of operations.

A failure to attract and retain necessary technical personnel, skilled management, and qualified subcontractors may have an adverse impact on the Company's future growth.

Because the Company operates in intensely competitive markets, its success depends, to a significant extent, upon its ability to attract, retain, and motivate highly skilled and qualified personnel and to subcontract with qualified, competent subcontractors. If the Company fails to attract, train, and retain sufficient numbers of qualified engineers, technical and operational staff, and sales and marketing representatives or is unable to contract with qualified, competent subcontractors, the Company's business, financial condition, and results of operations could be materially and adversely affected. The Company's success also depends on the skills, experience, and performance of key members of its management team. The loss of any key employee or the loss of a key subcontractor relationship could have an adverse effect on the Company's business, financial condition, cash flow, results of operations, and future prospects.

The Company's government contracts are subject to termination rights, audits, and investigations, and, if terminated, could negatively impact the Company's reputation and reduce its ability to compete for new contracts.

The Company has entered into new contracts with government agencies and has plans to expand its government agency services. For example, in June 2009, the Department of Education named the Company as one of four private sector companies awarded a servicing contract to service all federally-owned student loans. Federal and state governments and their agencies may have the right to terminate contracts at any time, without cause. These contracts, upon their expiration or termination, are typically subject to bidding processes in which the Company may not be successful. Also, the Department of Education and other federal contracts are subject to the approval of appropriations by the United States Congress to fund the expenditures of the federal government under these contracts. Additionally, government contracts are generally subject to audits and investigations by government agencies. If the government discovers improper or illegal activities in the course of audits or investigations, the Company may be subject to various civil and criminal penalties and administrative sanctions, which may include termination of contracts, forfeiture of profits, suspension of payments, fines and suspensions, or debarment from doing business with the government. Further, the negative publicity that arises from findings in such audits or investigations, or the penalties or sanctions which result, could have an adverse effect on the Company's reputation in the industry and reduce the ability to compete for new contracts. Any resulting reputation damage, penalties, or sanctions could have a material adverse effect on the Company's financial condition, results of operations, and cash flows.

The Company may face operational and security risks from its reliance on vendors to complete specific business operations.

The Company relies on outside vendors to provide some of the key components of business operations. Several of these key vendors are provided access to the Company's customer data to complete the operations required by their contracts, such as banking services, electronic and paper correspondence, credit reporting, skip tracing, and secure storage of proprietary and customer information. The Company's vendors must comply with the Company's defined servicing levels, security policies, and the Company's industry regulations. However, disruptions in vendor services, changes in servicing contracts, security, or non-compliance with industry regulations could hinder the Company's ability to meet customer obligations, service levels, or lead to financial or reputation damage. Financial or operational difficulties of an outside vendor could also hurt operations if those difficulties interfere with the vendor's services.

The markets in which the Company competes are highly competitive, which could affect revenue and profit margins.

As the Company seeks to further expand its business, the Company will face numerous competitors who may be well established in the markets the Company's operating segments seek to penetrate, or who may have better brand recognition and greater financial resources. Demand for the Company's products and services can be affected by following competitive factors:

- Development and timely introduction of competitive products and services
 - Ability to reduce operating costs
 - Product and servicing performance
 - Ability to provide value-added features
 - Response to pricing pressures
 - Changes in customer discretionary spending
- Changes in customers' preferences, including the success of products and services offered by competitors
 - Availability of capital

Additionally, if the Company fails to deliver results that are superior to its competitors, the Company could lose clients and experience a decline in revenue and profit margins.

Transactions with affiliates and potential conflicts of interest of certain of the Company's officers and directors, including the Company's Chief Executive Officer, pose risks to the Company's shareholders that the Company may not enter into transactions on the same terms that the Company could receive from unrelated third-parties.

The Company has entered into certain contractual arrangements with entities controlled by Michael S. Dunlap, the Company's Chairman, Chief Executive Officer, and a principal shareholder, and members of his family and, to a lesser extent, with entities in which other directors and members of management hold equity interests or board or management positions. Such arrangements constitute a significant portion of the Company's business and include cash management activities and sales of student loans and student loan origination rights by such affiliates to the Company. These arrangements may present potential conflicts of interest. Many of these arrangements are with Union Bank, in which Mr. Dunlap owns an indirect interest and of which he serves as a member of the Board of Directors. The Company intends to maintain its relationship with Union Bank, which management believes provides substantial benefits to the Company, although there can be no assurance that any transactions between the Company and entities controlled by Mr. Dunlap, his family, and/or other officers and directors of the Company are, or in the future will be, on terms that are no less favorable than what could be obtained from an unrelated third party.

The Company's Chairman and Chief Executive Officer owns a substantial percentage of the Company's Class A and Class B common stock and is able to control all matters subject to a shareholder vote.

Michael S. Dunlap, the Company's Chairman, Chief Executive Officer, and a principal shareholder, beneficially owns a substantial percentage of the Company's outstanding shares of Class A common stock and Class B common stock. Each share of Class A common stock has one vote and each share of Class B common stock has 10 votes on all matters to be voted upon by the Company's shareholders. As a result, Mr. Dunlap is able to control all matters requiring approval by the Company's shareholders, including the election of all members of the Board of Directors, and may do so in a manner with which other shareholders may not agree or which they may not consider to be in the best interest of other shareholders. Stephen F. Butterfield, the Company's Vice Chairman, also owns a substantial number of shares of Class B common stock.

Negative publicity could damage the Company's reputation and adversely affect its operating segments and their financial results.

Reputation risk, or the risk to earnings and capital from negative public opinion, is inherent in the Company's business. Negative public opinion could adversely affect the Company's ability to keep and attract customers and expose the Company to adverse legal and regulatory consequences. Negative public opinion could result from actual or alleged conduct in any number of activities, including lending practices, corporate governance, regulatory compliance, mergers and acquisitions, and disclosure, sharing or inadequate protection of customer information, and from actions taken by government regulators and community organizations in response to that conduct. Because the Company conducts most of its businesses under the "Nelnet" brand, negative public opinion about one operating segment could affect other operating segments.

Over the last several years, the student lending industry has been the subject of various investigations and reports. The publicity associated with these investigations and reports may have a negative impact on the Company's reputation and its operating segments. To the extent that potential or existing customers decide not to utilize the Company's products or services as a result of such publicity, the Company's overall operating results may be adversely affected.

A continued economic recession could reduce demand for Company products and services and lead to lower revenue and earnings.

The Company generates revenue from the interest earned on loans and fees charged for other products and services it sells. When the economy slows, the demand for products and services can fall, reducing fee revenue and earnings. An economic downturn can also impede on the ability of customers to repay their loans or to afford fee-based products and services. Additionally, the Company may be exposed to credit risk from business customers. Several factors could cause the economy to slow down or even recede, including higher energy costs, higher interest rates, reduced consumer or corporate spending, declining home values, natural disasters, terrorist activities, military conflicts, and the normal cyclical nature of the economy.

The Company may not be able to successfully protect its intellectual property and may be subject to infringement claims.

The Company relies on a combination of contractual rights and copyrights, trademarks, patents, and trade secret laws to establish and protect its proprietary technology and other intellectual property. Despite the Company's efforts to protect its intellectual property, third parties may infringe or misappropriate intellectual property or may develop software or technology competitive to the Company's products. The Company's competitors may independently develop similar technology, duplicate products or services, or design around intellectual property rights. The Company may have to litigate to enforce and protect its intellectual property rights, trade secrets, and know-how or to determine their scope, validity, or enforceability, which is expensive and could cause a diversion of resources and may not prove successful. The loss of intellectual property protection or the inability to secure or enforce intellectual property protection could harm the Company's operating segments and ability to compete.

The Company may also be subject to costly litigation in the event its products and technology infringe upon another party's proprietary rights. Third parties may have, or may eventually be issued, patents or other proprietary rights that would be infringed by the Company's products or technology. Any of these third parties could make a claim of infringement against the Company. The Company may also be subject to claims by third parties for breach of copyright, trademark, or license usage rights. Any such claims and any resulting litigation could subject the Company to significant liability for damages. An adverse determination in any litigation of this type could require the Company to design around a third party's intellectual property or to license alternative technology from another party. In addition, litigation is time consuming and expensive to defend and could divert management's attention away from other critical business operations. Any claim by third parties may result in limitations on the Company's ability to use the intellectual property subject to these claims.

ITEM 1B. UNRESOLVED STAFF COMMENTS

The Company has no unresolved comments from the staff of the Securities and Exchange Commission regarding its periodic or current reports under the Securities Exchange Act of 1934.

ITEM 2. PROPERTIES

The following table lists the principal facilities for office space owned or leased by the Company. The Company owns the building in Lincoln, Nebraska where its principal office is located. The building is subject to a lien securing the outstanding mortgage debt on the property.

Location	Primary Function or Segment	Approximate square feet	Lease expiration date
		154,000	–

Edgar Filing: NELNET INC - Form 10-K

Lincoln, NE	Corporate Headquarters, Asset Generation and Management, Student Loan and Guaranty Servicing, Tuition Payment Processing and Campus Commerce		
Aurora, CO	Student Loan and Guaranty Servicing, Software and Technical Services	96,000	February 2015
Jacksonville, FL	Student Loan and Guaranty Servicing, Software and Technical Services	106,000	January 2014
Lawrenceville, NJ	Enrollment Services	62,000	April 2011

The square footage amounts above exclude a total of approximately 43,000 square feet of owned office space in Lincoln, Nebraska that the Company leases to third parties. The Company also leases approximately 62,000 square feet of office space in Indianapolis, Indiana where Asset Generation and Management and Student Loan and Guaranty Servicing operations were previously conducted, of which 56,000 square feet was subleased to third parties as of December 31, 2009. The sublease expired in January 2010. The Company leases other office facilities located throughout the United States. These properties are leased on terms and for durations that are reflective of commercial standards in the communities where these properties are located. The Company believes that its respective properties are generally adequate to meet its long term business goals. The Company's principal office is located at 121 South 13th Street, Suite 201, Lincoln, Nebraska 68508.

ITEM 3. LEGAL PROCEEDINGS

General

The Company is subject to various claims, lawsuits, and proceedings that arise in the normal course of business. These matters principally consist of claims by student loan borrowers disputing the manner in which their student loans have been processed and disputes with other business entities. In addition, from time to time the Company receives information and document requests from state or federal regulators concerning its business practices. The Company cooperates with these inquiries and responds to the requests. While the Company cannot predict the ultimate outcome of any inquiry or investigation, the Company believes its activities have materially complied with applicable law, including the Higher Education Act, the rules and regulations adopted by the Department of Education thereunder, and the Department's guidance regarding those rules and regulations. On the basis of present information, anticipated insurance coverage, and advice received from counsel, it is the opinion of the Company's management that the disposition or ultimate determination of these claims, lawsuits, and proceedings will not have a material adverse effect on the Company's business, financial position, or results of operations.

Regulatory Reviews

The Department of Education periodically reviews participants in the FFELP for compliance with program provisions. On June 28, 2007, the Department notified the Company that it would be conducting a review of the Company's practices in connection with the prohibited inducement provisions of the Higher Education Act and the associated regulations that allow borrowers to have a choice of lenders. The Company understands that the Department selected several schools and lenders for review. The Company responded to the Department's requests for information and documentation and cooperated with their review. On May 1, 2009, the Company received the Department's preliminary program review report, which covered the Department's review of the period from October 1, 2002 to September 30, 2007. The preliminary program review report contained certain initial findings of noncompliance with the Higher Education Act's prohibited inducement provisions and required that the Company provide an explanation for the basis of the arrangements noted in the preliminary program review report. The Company has responded and provided an explanation of the arrangements noted in the Department of Education's initial findings and follow-up requests. The Department of Education is expected to issue a final program review determination letter and advise the Company whether it intends to take any additional action. To the extent any findings are contained in a final letter, the additional action may include the assessment of fines or penalties, or the limitation, suspension, and termination of the Company's participation in the FFELP.

In connection with the Company's settlement agreement with the Department of Education in January 2007 to resolve an audit report by the Office of Inspector General of the Department of Education (the "OIG") with respect to the Company's student loan portfolio receiving special allowance payments at a minimum 9.5% interest rate (the "Settlement Agreement"), the Company was informed in February 2007 by the Department of Education that a civil attorney with the Department of Justice had opened a file regarding the issues set forth in the OIG report, which the Company understands is common procedure following an OIG audit report. The Company has engaged in discussions

with and provided information to the Department of Justice in connection with the review.

While the Company is unable to predict the ultimate outcome of these reviews, the Company believes its practices complied with applicable law, including the provisions of the Higher Education Act, the rules and regulations adopted by the Department of Education thereunder, and the Department's guidance regarding those rules and regulations.

United States ex rel Oberg v. Nelnet, Inc. et al

On September 28, 2009, the Company was served with a Summons and First Amended Complaint naming the Company as one of ten defendants in a "qui tam" action brought by Jon H. Oberg on behalf of the United States of America. Qui tam actions assert claims by an individual on behalf of the federal government, and are filed under seal until the government decides, if at all, to intervene in the case.

An original complaint in the action was filed under seal in the U.S. District Court for the Eastern District of Virginia on September 21, 2007, and was unsealed on August 26, 2009 upon the government's filing of a Notice of Election to Decline Intervention in the matter. The First Amended Complaint (the "Oberg Complaint") was filed on August 24, 2009 and alleges the defendant student loan lenders submitted false claims for payment to the Department of Education in order to obtain special allowance payments on certain student loans at a rate of 9.5%, which the Oberg Complaint alleges is in excess of amounts permitted by law. The Oberg Complaint seeks the imposition of civil penalties and treble the amount of damages sustained by the government in connection with the alleged overbilling by the defendants for special allowance payments. The Oberg Complaint alleges that approximately \$407 million in unlawful 9.5% special allowance payment claims were submitted by the Company to the Department of Education.

The 9.5% special allowance payments received by the Company were disclosed by the Company on multiple occasions beginning in 2003. In January, 2007, the Company entered into the Settlement Agreement. The Settlement Agreement resolved the issues now raised by the Oberg Complaint, and contains an acknowledgment by the Department of Education that the Company acted in good faith in connection with its billings for 9.5% special allowance payments.

The Company believes the allegations in the above qui tam action to be frivolous and without merit and intends to vigorously defend the claim. However, the Company cannot currently predict the ultimate outcome of this matter or any liability which may result, which could have a material adverse effect on the Company's results of operations and financial condition.

United States ex rel Vigil v. Nelnet, Inc. et al

On November 4, 2009, the Company was served with a Summons and Third Amended Complaint naming the Company as one of three defendants in an unrelated qui tam action brought by Rudy Vigil (the "Vigil Complaint"). This matter was filed under seal in the U.S. District Court for the District of Nebraska on July 11, 2007 and was unsealed on October 15, 2009 following the government's notice that it declined to intervene in the matter. The Vigil Complaint, filed by a former employee of the Company, appears to allege that the Company engaged in false advertising and offered prohibited inducements to student loan borrowers in order to increase the Company's loan holdings, and subsequently submitted false claims to the Department of Education in order to obtain special allowance payments and default claim payments on such loans.

The Company believes the allegations in the above qui tam action to be frivolous and without merit and intends to vigorously defend the claim. However, the Company cannot currently predict the ultimate outcome of this matter or any liability which may result, which could have a material adverse effect on the Company's results of operations and financial condition.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of security holders during the fourth quarter of fiscal 2009.

PART II.

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS, AND ISSUER PURCHASES OF EQUITY SECURITIES

The Company's Class A Common Stock is listed and traded on the New York Stock Exchange under the symbol "NNI," while its Class B Common Stock is not publicly traded. The number of holders of record of the Company's Class A Common Stock and Class B Common Stock as of January 31, 2010 was 777 and nine, respectively. Because many shares of the Company's Class A Common stock are held by brokers and other institutions on behalf of shareholders,

the Company is unable to estimate the total number of beneficial owners represented by these record holders. The following table sets forth the high and low sales prices for the Company's Class A Common Stock for each full quarterly period in 2009 and 2008.

	2009				2008			
	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
High	\$ 14.87	\$ 13.61	\$ 15.41	\$ 17.78	\$ 13.66	\$ 14.11	\$ 16.06	\$ 14.80
Low	4.25	5.51	12.44	12.15	9.00	10.35	9.37	9.21

In the first quarter of 2007, the Company began paying dividends of \$0.07 per share on the Company's Class A and Class B Common Stock which were paid quarterly through the first quarter of 2008. On May 21, 2008, the Company announced that it was temporarily suspending its quarterly dividend program. On November 5, 2009, the Company's Board of Directors voted to reinstate the quarterly dividend program. Accordingly, a dividend of \$0.07 per share on the Company's Class A and Class B Common Stock was paid on December 15, 2009 to all holders of record as of December 1, 2009. The Company currently plans to continue making quarterly dividend payments, subject to future earnings, capital requirements, financial condition, and other factors. In addition, the payment of dividends is subject to the terms of the Company's outstanding junior subordinated hybrid securities, which generally provide that if the Company defers interest payments on those securities it cannot pay dividends on its capital stock.

Performance Graph

The following graph compares the change in the cumulative total shareholder return on the Company's Class A Common Stock to that of the cumulative return of the Dow Jones U.S. Total Market Index and the Dow Jones U.S. Financial Services Index. The graph assumes that the value of an investment in the Company's Class A Common Stock and each index was \$100 on December 31, 2004 and that all dividends, if applicable, were reinvested. The performance shown in the graph represents past performance and should not be considered an indication of future performance.

COMPARISON OF CUMULATIVE TOTAL RETURN
AMONG NELNET, INC., THE DOW JONES US TOTAL MARKET INDEX,
AND THE DOW JONES US FINANCIAL SERVICES INDEX

Company/Index	12/31/2004	12/31/2005	12/31/2006	12/31/2007	12/31/2008	12/31/2009
Nelnet, Inc.	\$ 100.00	\$ 151.06	\$ 101.60	\$ 47.90	\$ 54.34	\$ 65.60
Dow Jones U.S. Total Market Index	100.00	106.32	122.88	130.26	81.85	105.42
Dow Jones U.S. Financial Services Index	100.00	108.38	138.46	116.16	48.27	73.13

The preceding information under the caption "Performance Graph" shall be deemed to be "furnished" but not "filed" with the Securities and Exchange Commission.

Stock Repurchases

The following table summarizes the repurchases of Class A common stock during the fourth quarter of 2009 by the Company or any "affiliated purchaser" of the Company, as defined in Rule 10b-18(a)(3) under the Securities Exchange Act of 1934.

Period	Total number of shares purchased (1)	Average price paid per share	Total number of shares purchased as part of publicly announced plans or programs (2) (3)	Maximum number of shares that may yet be purchased under the plans or programs (4)
October 1 - October 31, 2009	1,156	\$ 13.63	1,156	7,433,639
November 1 - November 30, 2009	2,056	16.71	1,610	6,932,471
December 1 - December 31, 2009	3,986	17.45	118	6,949,403
Total	7,198	\$ 16.62	2,884	

- (1) The total number of shares includes: (i) shares purchased pursuant to the 2006 Plan discussed in footnote (2) below; (ii) shares owned and tendered by employees to satisfy tax withholding

obligations on the vesting of restricted shares; and (iii) shares purchased pursuant to the 2006 ESLP discussed in footnote (3) below, of which there were none for the months of October, November, or December 2009. Shares of Class A common stock purchased pursuant to the 2006 Plan included 1,156 shares, 1,610 shares, and 118 shares in October, November, and December, respectively, that had been issued to the Company's 401(k) plan and allocated to employee participant accounts pursuant to the plan's provisions for Company matching contributions in shares of Company stock, and were purchased by the Company from the plan pursuant to employee participant instructions to dispose of such shares. Shares of Class A common stock tendered by employees to satisfy tax withholding obligations included 446 shares and 3,868 shares in November and December, respectively. Unless otherwise indicated, shares owned and tendered by employees to satisfy tax withholding obligations were purchased at the closing price of the Company's shares on the date of vesting.

- (2) On May 25, 2006, the Company publicly announced that its Board of Directors had authorized a stock repurchase program to repurchase up to a total of five million shares of the Company's Class A common stock (the "2006 Plan"). On February 7, 2007, the Company's Board of Directors increased the total shares the Company is allowed to repurchase to 10 million. The 2006 Plan had an initial expiration date of May 24, 2008, which was extended until May 24, 2010 by the Company's Board of Directors on January 30, 2008.
- (3) On May 25, 2006, the Company publicly announced that the shareholders of the Company approved an Employee Stock Purchase Loan Plan (the "2006 ESLP") to allow the Company to make loans to employees for the purchase of shares of the Company's Class A common stock either in the open market or directly from the Company. A total of \$40 million in loans may be made under the 2006 ESLP, and a total of one million shares of Class A common stock are reserved for issuance under the 2006 ESLP. Shares may be purchased directly from the Company or in the open market through a broker at prevailing market prices at the time of purchase, subject to any conditions or restrictions on the timing, volume, or prices of purchases as determined by the Compensation Committee of the Board of Directors and set forth in the Stock Purchase Loan Agreement with the participant. The 2006 ESLP shall terminate May 25, 2016.
- (4) The maximum number of shares that may yet be purchased under the plans is calculated below. There are no assurances that any additional shares will be repurchased under either the 2006 Plan or the 2006 ESLP. Shares under the 2006 ESLP may be issued by the Company rather than purchased in open market transactions.

As of	Maximum number of shares that may yet be purchased under the 2006 Plan (A)	Approximate dollar value of shares that may yet be purchased under the 2006 ESLP (B)	Closing price on the last trading day of the Company's Class A Common Stock (C)	Approximate number of shares that may yet be purchased under the 2006 ESLP (D)	(A + D) Approximate number of shares that may yet be purchased under the 2006 Plan and 2006 ESLP
October 31, 2009	4,835,635	\$ 36,450,000	\$ 14.03	2,598,004	7,433,639
November 30, 2009	4,834,025	36,450,000	17.37	2,098,446	6,932,471
December 31, 2009	4,833,907	36,450,000	17.23	2,115,496	6,949,403

Equity Compensation Plans

For information regarding the Company's equity compensation plans, see Part III, Item 12 of this Report.

ITEM 6. SELECTED FINANCIAL DATA

The following table sets forth selected financial and other operating information of the Company. The selected financial data in the table is derived from the consolidated financial statements of the Company. The following selected financial data should be read in conjunction with the consolidated financial statements, the related notes, and “Management’s Discussion and Analysis of Financial Condition and Results of Operations” included in this Report. Management evaluates the Company’s GAAP-based financial information as well as operating results on a non-GAAP performance measure referred to as “base net income.” Management believes “base net income” provides additional insight into the financial performance of the core operations.

	Year ended December 31,				
	2009	2008	2007	2006	2005
	(dollars in thousands, except share data)				
Operating Data:					
Net interest income before provision for loan losses	\$235,345	187,892	244,614	308,459	328,999
Loan and guaranty servicing revenue	108,747	99,942	122,380	121,593	93,332
Tuition payment processing and campus commerce revenue	53,894	48,155	42,766	34,784	14,088
Enrollment services revenue	119,397	112,405	103,905	55,361	12,349
Software services revenue	21,164	24,115	27,764	15,890	9,170
Derivative settlements, net	39,286	55,657	18,677	23,432	(17,008)
Total revenue	577,833	528,166	560,106	559,519	440,930
Other income	68,152	22,775	30,423	19,405	16,561
Gain (loss) on sale of loans	35,148	(51,414)	3,597	16,133	301
Total operating expense	(405,633)	(440,614)	(535,609)	(446,279)	(267,731)
Income tax expense	(76,573)	(17,896)	(21,716)	(36,237)	(100,581)
Income from continuing operations	139,125	26,844	35,429	65,916	178,074
Income (expense) from discontinued operations	—	1,818	(2,575)	2,239	3,048
Net income	139,125	28,662	32,854	68,155	181,122
Earnings (loss) per common share:					
Basic:					
Continuing operations	\$2.79	0.54	0.71	1.23	3.31
Discontinued operations	—	0.04	(0.05)	0.04	0.06
Net earnings	2.79	0.58	0.66	1.27	3.37
Diluted:					
Continuing operations	\$2.78	0.54	0.71	1.23	3.31
Discontinued operations	—	0.04	(0.05)	0.04	0.06
Net earnings	2.78	0.58	0.66	1.27	3.37
Dividends per common share	\$0.07	0.07	0.28	—	—
Other Data:					
Revenue from fee-based segments as a percentage of total revenue (excluding fixed rate floor income and Corporate Activity and					
Overhead)	66.3	% 54.5	% 53.3	% 44.0	% 33.8
Fixed rate floor income	\$145,098	37,457	10,347	30,234	44,694
Core student loan spread	1.18	% 0.99	% 1.13	% 1.42	% 1.51

Edgar Filing: NELNET INC - Form 10-K

Origination and acquisition volume										
(a)										
	\$2,779,873		2,809,082		5,152,110		6,696,118		8,471,121	
Student loans serviced (at end of period) (b)										
	37,549,563		35,888,693		33,817,458		30,593,592		26,988,839	
As of December 31,										
	2009		2008		2007		2006		2005	
(dollars in thousands, except share data)										
Balance Sheet Data:										
Cash and cash equivalents	\$338,181		189,847		111,746		102,343		96,678	
Student loans receivables, net	23,926,957		25,413,008		26,736,122		23,789,552		20,260,807	
Goodwill and intangible assets	197,255		252,232		277,525		353,008		243,630	
Total assets	25,876,427		27,854,897		29,162,783		26,796,873		22,798,693	
Bonds and notes payable	24,805,289		26,787,959		28,115,829		25,562,119		21,673,620	
Shareholders' equity	784,563		643,226		608,879		671,850		649,492	
Tangible shareholders' equity	587,308		390,994		331,354		318,842		405,862	
Book value per common share	15.73		13.05		12.31		12.79		12.03	
Tangible book value per common share	11.77		7.93		6.70		6.07		7.52	
Ratios:										
Shareholders' equity to total assets	3.03	%	2.31	%	2.09	%	2.51	%	2.85	%

- (a) Initial loans originated or acquired through various channels, including originations through the direct channel; acquisitions through the branding partner channel, the forward flow channel, and the secondary market (spot purchases); and loans acquired in portfolio and business acquisitions.
- (b) The student loans serviced does not include loans serviced by EDULINX for all periods presented. The Company sold EDULINX in May 2007. As a result of this transaction, EDULINX is reported as discontinued operations.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

(Management's Discussion and Analysis of Financial Condition and Results of Operations is for the years ended December 31, 2009, 2008, and 2007. All dollars are in thousands, except per share amounts, unless otherwise noted. Certain amounts previously reported have been reclassified to conform to the current period presentation. The reclassifications were made to change the income statement presentation to provide the users of the financial statements additional information related to the operating results of the Company's fee-based businesses, which are becoming more significant to the Company's operations.) These reclassifications include reclassifying "tuition payment processing and campus commerce revenue" and "enrollment services revenue," which were previously included in "other fee-based income." In addition, the "cost to provide enrollment services" was reclassified from various operating expense accounts, primarily "advertising and marketing."

OVERVIEW

The Company is a transaction processing and finance company focused primarily on providing quality education related products and services to students, families, schools, and financial institutions nationwide. The Company earns its revenue from fee-based processing businesses, including its loan servicing, payment processing, and lead generation businesses, and the net interest income on its student loan portfolio.

The Company has certain business objectives in place that include:

- Grow and diversify revenue from fee generating businesses
 - Manage operating costs
 - Maximize the value of existing portfolio
- Eliminate exposure to liquidity risk and unfunded debt burden

Achieving these business objectives has impacted the financial condition and operating results of the Company during the year ended December 31, 2009. In addition, legislation concerning the student loan industry has impacted and will continue to impact the financial condition and operating results of the Company. Each of these items are discussed below.

Grow and Diversify Revenue from Fee-Based Businesses

In recent years, the Company has expanded products and services generated from businesses that are not dependent upon the FFEL Program, thereby reducing legislative and political risk related to the education lending industry. Revenues from these businesses are primarily generated from products and services offered in the Company's Tuition Payment Processing and Campus Commerce and Enrollment Services operating segments. As shown below, revenue earned from businesses less dependent upon the FFEL Program has grown \$22.1 million (18.3%) for the year ended December 31, 2009 compared to the same period in 2008.

	Year ended December 31,			
	2009	2008	\$ Change	% Change
Tuition Payment Processing and Campus Commerce	\$53,894	48,155	5,739	
Enrollment Services - Lead Generation	88,851	72,513	16,338	
	142,745	120,668	\$22,077	18.3 %

Edgar Filing: NELNET INC - Form 10-K

Enrollment Services - Other	30,546	39,929
Student Loan and Guaranty Servicing	113,974	104,287
Software and Technical Services	17,463	19,707
Net interest income from fee-based segments	174	3,107
Total revenue from fee-based segments	\$304,902	287,698

34

Department of Education Servicing Contract

In June 2009, the Department of Education named the Company as one of four private sector servicers awarded a servicing contract to service all federally-owned student loans, including FFELP loans purchased by the Department pursuant to ECASLA. No later than August 2010, the Company expects to also begin servicing new loans originated under the Direct Loan Program. Servicing volume has initially been allocated by the Department to the four servicers and performance factors such as customer satisfaction levels and default rates will determine volume allocations over time. The contract spans five years with one, five-year renewal option. Servicing loans under this contract will further diversify the Company's revenue and customer base.

For the federal fiscal year ended September 30, 2009, the estimated volume for the Direct Loan Program was approximately \$38 billion, an increase of 110% from the federal fiscal year ended September 30, 2008. This increase was the result of schools shifting from the FFELP to the Direct Loan Program as a result of lenders exiting the FFELP marketplace due to legislation and capital market disruptions. See discussion under "– Legislation – Recent Developments." Regardless of the outcome of the currently proposed legislation, the Direct Loan Program volume is expected to increase substantially in the next few years, which would lead to an increase in servicing volume for the Department's four private sector servicers.

The Company began servicing loans for the Department in September 2009 and recognized approximately \$1.7 million of revenue under this contract in 2009. As of December 31, 2009 and March 1, 2010, the Company was servicing approximately \$3.4 billion and \$6.3 billion, respectively, of loans under the Department's servicing contract, which includes approximately \$1.5 billion and \$4.3 billion, respectively, of loans not previously serviced by the Company that were sold by third parties to the Department as part of the ECASLA Purchase Program.

Manage Operating Costs

The Company has continued to focus on managing costs and gaining efficiencies and has continued to benefit from restructuring activities. As shown below, excluding the cost to provide enrollment services and restructuring and impairment charges, operating expenses decreased \$46.2 million (13.7%) for the year ended December 31, 2009 compared to the same period in 2008.

Operating Expenses

	2009	2008	\$ Change	% Change
Salaries and benefits (a)	\$ 151,285	177,724	(26,439)	(14.9)%
Other expenses (b)	138,712	158,499	(19,787)	(12.5)
Operating expenses, excluding the cost to provide enrollment services and restructure and impairment expenses	289,997	336,223	\$ (46,226)	(13.7)%
Cost to provide enrollment services	74,926	64,965		
Restructure expense (c)	7,982	7,067		
Impairment expense	32,728	18,834		
Liquidity contingency planning fees (d)	—	13,525		
Total operating expenses	\$ 405,633	440,614		

- (a) Excludes restructure expenses related to employee termination benefits.
- (b) Excludes liquidity contingency planning fees and restructure expenses related to lease terminations.
- (c) Restructure expense is included in “salaries and benefits” and “occupancy and communications” in the consolidated statements of income.
- (d) Liquidity contingency planning fees were incurred by the Company to minimize exposure related to the equity support provisions of the Company’s FFELP loan warehouse facility. These fees are included in “other” under “other operating expense” in the consolidated statements of income.

Included in operating expenses for the year ended December 31, 2009 is an impairment charge of \$32.7 million related to the impairment of goodwill and intangible assets related to the Company’s direct marketing and list management business. This business has been negatively affected by the economic recession and deterioration of the direct-to-consumer student loan market. As of December 31, 2009, the Company has \$143.7 million of goodwill remaining on its consolidated balance sheet. See note 6 of the notes to the consolidated financial statements included in this Report, which provides a summary of the remaining goodwill by operating segment.

Maximize the Value of Existing Portfolio

Fixed rate floor income

Loans originated prior to April 1, 2006 generally earn interest at the higher of a floating rate based on the Special Allowance Payment or the SAP formula set by the Department and the borrower rate, which is fixed over a period of time. The SAP formula is based on an applicable index plus a fixed spread that is dependent upon when the loan was originated, the loan's repayment status, and funding sources for the loan. The Company generally finances its student loan portfolio with variable rate debt. In low and/or declining interest rate environments, when the fixed borrower rate is higher than the rate produced by the SAP formula, the Company's student loans earn at a fixed rate while the interest on the variable rate debt typically continues to decline. In these interest rate environments, the Company earns additional spread income that it refers to as floor income. For loans where the borrower rate is fixed to term, the Company earns floor income for an extended period of time, which the Company refers to as fixed rate floor income.

The Company's core student loan spread (variable student loan spread including fixed rate floor contribution) and variable student loan spread (net interest margin excluding fixed rate floor income) during 2008 and 2009 is summarized below.

During the years ended December 31, 2009 and 2008, loan interest income includes \$145.1 million (58 basis points of spread contribution) and \$37.5 million (14 basis points of spread contribution), respectively, of fixed rate floor income. The increase in fixed rate floor income throughout 2009 is due to a decrease in interest rates. The Company's variable student loan spread increased throughout 2009 as a result of the tightening of the commercial paper rate, which is the primary rate the Company earns on its student loan portfolio, and the LIBOR rate, which is the primary rate the Company pays to fund its student loan assets. See Part II, Item 7, "Management's Discussion and Analysis – Asset Generation and Management Operating Segment – Results of Operations – Student Loan Spread Analysis." If interest rates remain low, the Company anticipates continuing to earn significant fixed rate floor income in future periods.

Future Cash Flow from Portfolio

The majority of the Company's portfolio of student loans is funded in asset backed securitizations that are structured to substantially match the maturity of the funded assets and there are minimal liquidity issues related to these facilities. In addition, due to the difference between the yield the Company receives on the loans and cost of financing within these transactions, the Company has created a portfolio that will generate earnings and significant cash flow over the life of these transactions.

Based on cash flow models developed to reflect management's current estimate of, among other factors, prepayments, defaults, deferment, forbearance, and interest rates, the Company currently expects future undiscounted cash flows from its portfolio to be approximately \$1.43 billion. See Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations – Liquidity and Capital Resources" for further details related to the estimated future cash flow from the Company's portfolio.

Eliminate Exposure to Liquidity Risk and Unfunded Debt Burden

Reducing Liquidity Risk

The Company had a FFELP warehouse facility that was due to expire in May 2010 that provided for formula-based advance rates based on current market conditions, which required equity support to be posted to the facility under certain circumstances. As of December 31, 2008, the Company had \$1.6 billion of student loans in this facility, \$1.4 billion borrowed under the facility, and \$280.6 million in cash posted as equity funding support for the facility. During 2009, the Company reduced its liquidity exposure under this facility as a result of the following transactions:

- In March 2009, the Company completed a \$294.6 million asset-backed securitization and refinanced loans previously financed in the facility.
- In June 2009, the Company accessed the Department's Conduit Program and refinanced loans previously financed in the facility.
- In August 2009, the Company entered into a new \$500.0 million FFELP warehouse facility that expires in August 2012. In August 2009, the Company utilized the new warehouse facility to refinance all remaining loans in the old warehouse facility. Refinancing these loans allowed the Company to terminate the prior facility and withdraw all remaining equity funding support.

In the fourth quarter of 2009, the Company completed asset-backed securities transactions totaling \$852.9 million. On February 17, 2010, the Company also completed an asset-backed securities transaction of \$523.3 million. The Company used the proceeds from the sale of these notes to purchase student loans that were previously financed in the new FFELP warehouse facility and certain other existing asset-backed securitizations. As of March 1, 2010, \$30.5 million was outstanding under the new FFELP warehouse and \$469.5 million was available for future use.

In addition to the new FFELP warehouse, the Company has reliable sources of liquidity available for new FFELP Stafford and PLUS loan originations for the 2009-2010 academic year under the Department's Participation and Purchase Programs. In addition, the Company maintains an agreement with Union Bank, as trustee for various grantor trusts, under which Union Bank has agreed to purchase from the Company participation interests in student loans.

Debt Repurchases

During 2009, the Company repurchased outstanding debt as summarized below. Gains recorded by the Company from the repurchase of debt are included in "other income" on the Company's consolidated statements of income.

	Year ended December 31, 2009			Remaining balance as of December 31, 2009
	Notional amount	Purchase price	Gain	
5.125% Senior Notes due 2010	\$ 208,284	196,529	11,755	\$ 66,716
Junior Subordinated Hybrid Securities	1,750	350	1,400	\$ 198,250

Asset-backed securities	348,155	319,627	28,528
	\$ 558,189	516,506	41,683

Subsequent to December 31, 2009 (through March 1, 2010), the Company has repurchased an additional \$174.5 million (notional amount) of asset-backed securities resulting in a gain of approximately \$6 million.

Legislation

ECASLA

In August 2008, the Department implemented the Loan Purchase Commitment Program and the Loan Purchase Participation Program pursuant to ECASLA. During the year ended December 31, 2009, the Company sold \$2.1 billion of student loans to the Department under the Purchase Program, resulting in a gain of \$36.6 million. As of December 31, 2009, the Company had \$463.9 million of FFELP loans funded using the Participation Program. The Company plans to continue to use the Participation Program to fund certain loans originated for the 2009-2010 academic year.

Recent Developments

On February 26, 2009, the President introduced a fiscal year 2010 Federal budget proposal calling for the elimination of the FFEL Program and a recommendation that all new student loan originations be funded through the Federal Direct Loan Program. On September 17, 2009, the House of Representatives passed H.R. 3221, the Student Aid and Fiscal Responsibility Act ("SAFRA"), which would eliminate the FFEL Program and require that, after July 1, 2010, all new federal student loans be made through the Federal Direct Loan Program. The Senate is expected to begin its consideration of similar student loan reform legislation sometime in 2010. In addition to the House-passed legislation, there are several other proposals for changes to the education financing framework that may be considered that would maintain a role for private lenders in the origination of federal student loans. These include a possible extension of ECASLA, which expires on July 1, 2010, and the Student Loan Community Proposal, a proposal endorsed by a cross-section of FFELP service providers (including the Company) as an alternative to the 100% federal direct lending proposal included in SAFRA.

Elimination of the FFEL Program would impact the Company's operations and profitability by, among other things, reducing the Company's interest revenues as a result of the inability to add new FFELP loans to the Company's portfolio and reducing guarantee and third-party FFELP servicing fees as a result of reduced FFELP loan servicing and origination volume. Additionally, the elimination of the FFEL Program could reduce education loan software licensing opportunities and related consulting fees received from lenders using the Company's software products and services.

In June 2009, the Department of Education named the Company as one of four private sector companies awarded a servicing contract to service student loans. No later than August 2010, the Company expects to begin servicing new loans originated under the Direct Loan Program. If legislation is passed mandating that all new student loan originations be funded through the Direct Loan Program, revenue from servicing loans under this contract will partially offset the loss of revenue if the FFEL Program is eliminated.

RESULTS OF OPERATIONS

The Company's operating results are primarily driven by the performance of its existing portfolio, the cost necessary to generate new assets, the revenues generated by its fee based businesses, and the cost to provide those services. The performance of the Company's portfolio is driven by net interest income and losses related to credit quality of the assets along with the cost to administer and service the assets and related debt.

Net Interest Income

The Company generates a significant portion of its earnings from the spread, referred to as its student loan spread, between the yield the Company receives on its student loan portfolio and the cost of funding these loans. This spread income is reported on the Company's consolidated statements of income as net interest income. The amortization of loan premiums, including capitalized costs of origination, the 1.05% per year consolidation loan rebate fee paid to the Department, and yield adjustments from borrower benefit programs, are netted against loan interest income on the Company's consolidated statements of income. The amortization of debt issuance costs is included in interest expense on the Company's consolidated statements of income.

The Company's portfolio of FFELP loans originated prior to April 1, 2006 earns interest at the higher of a variable rate based on the special allowance payment or SAP formula set by the Department of Education and the borrower rate. The SAP formula is based on an applicable index plus a fixed spread that is dependent upon when the loan was originated, the loan's repayment status, and funding sources for the loan. As a result of one of the provisions of the Higher Education Reconciliation Act of 2005 ("HERA"), the Company's portfolio of FFELP loans originated on or after April 1, 2006 earns interest at a variable rate based on the SAP formula. For the portfolio of loans originated on or after April 1, 2006, when the borrower rate exceeds the variable rate based on the SAP formula, the Company must return the excess to the Department.

In September 2007, the College Cost Reduction Act was enacted into law. This legislation reduced the annual yield on FFELP loans originated after October 1, 2007 and should be considered when reviewing the Company's results of operations. The Company has mitigated some of the reduction in annual yield by creating efficiencies and lowering costs, modifying borrower benefits, and reducing loan acquisition costs.

Because the Company generates a significant portion of its earnings from its student loan spread, the interest rate sensitivity of the Company's balance sheet is very important to its operations. The current and future interest rate environment can and will affect the Company's interest earnings, net interest income, and net income. The effects of changing interest rate environments are further outlined in Item 7A, "Quantitative and Qualitative Disclosures about Market Risk — Interest Rate Risk."

Investment interest income, which is a component of net interest income, includes income from unrestricted interest-earning deposits and funds in the Company's special purpose entities which are utilized for its asset-backed securitizations.

Net interest income also includes interest expense on unsecured debt offerings. The proceeds from these unsecured debt offerings were used by the Company to fund general business operations, certain asset and business acquisitions, and the repurchase of stock under the Company's stock repurchase plan.

Provision for Loan Losses

Management estimates and establishes an allowance for loan losses through a provision charged to expense. Losses are charged against the allowance when management believes the collection of the loan principal is unlikely. Recovery of amounts previously charged off is credited to the allowance for loan losses. Management maintains the allowance for federally insured and non-federally insured loans at a level believed to be adequate to provide for estimated probable credit losses inherent in the loan portfolio. This evaluation is inherently subjective because it requires estimates that may be susceptible to significant changes. The Company analyzes the allowance separately for its federally insured loans and its non-federally insured loans.

The allowance for the federally insured loan portfolio is based on periodic evaluations of the Company's loan portfolios considering past experience, trends in student loan claims rejected for payment by guarantors, changes to federal student loan programs, current economic conditions, and other relevant factors. The federal government currently guarantees 97% of the principal of and the interest on federally insured student loans disbursed on and after July 1, 2006 (and 98% for those loans disbursed prior to July 1, 2006), which limits the Company's loss exposure on the outstanding balance of the Company's federally insured portfolio. Student loans disbursed prior to October 1, 1993 are fully insured.

In determining the adequacy of the allowance for loan losses on the non-federally insured loans, the Company considers several factors including: loans in repayment versus those in a nonpaying status, delinquency status, type of program, and trends in defaults in the portfolio based on Company and industry data. The Company places a non-federally insured loan on nonaccrual status when the collection of principal and interest is 30 days past due and charges off the loan when the collection of principal and interest is 120 days past due.

Other Income

The Company also earns fees and generates revenue from other sources as summarized below.

Student Loan and Guaranty Servicing Revenue – Loan servicing fees are determined according to individual agreements with customers and are calculated based on the dollar value of loans, number of loans, or number of borrowers serviced for each customer. Guaranty servicing fees, generally, are calculated based on the number of loans serviced, volume of loans serviced, or amounts collected. Revenue is recognized when earned pursuant to applicable agreements, and when ultimate collection is assured.

Tuition Payment Processing and Campus Commerce Revenue – Tuition payment processing and campus commerce revenue includes actively managed tuition payment solutions, online payment processing, detailed information reporting, and data integration services. Fees for these payment management services are recognized over the period in which services are provided to customers.

Enrollment Services Revenue – Enrollment services revenue primarily consists of the following items:

- **Lead generation** – Revenue from lead generation is derived primarily from fees which are earned through the delivery of qualified leads or clicks. The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable and collectability is reasonably assured. Delivery is deemed to have occurred at the time a qualified lead or click is delivered to the customer provided that no significant obligations remain. From time to time, the Company may agree to credit certain leads or clicks if they fail to meet the contractual or other guidelines of a particular client. The Company has established a sales reserve based on historical experience. To date, such credits have been immaterial and within management's expectations.

For a portion of its lead revenue, the Company has agreements with providers of online media or traffic (“Publishers”) used in the generation of leads or clicks. The Company receives a fee from its customers and pays a fee to Publishers either on a cost per lead, cost per click, or cost per number of impressions basis. The Company is the primary obligor in the transaction. As a result, the fees paid by the Company’s customers are recognized as revenue and the fees paid to its Publishers are included in “cost to provide enrollment services” in the Company’s consolidated statements of income.

- Publishing and editing services - Revenue from the sale of print products and editing services is generally earned and recognized, net of estimated returns, upon shipment or delivery.
- Content management and recruitment services – Content management and recruitment services includes the sale of subscription and performance based products and services, as well as list sales. Revenues from sales of subscription and performance based products and services are recognized ratably over the term of the contract. Subscription and performance based revenues received or receivable in advance of the delivery of services is included in deferred revenue. Revenue from the sale of lists is generally earned and recognized, net of estimated returns, upon delivery.

Software Services Revenue – Software services revenue is determined from individual agreements with customers and includes license and maintenance fees associated with student loan software products. Computer and software consulting services are recognized over the period in which services are provided to customers.

Operating Expenses

Operating expenses includes indirect costs incurred to generate and acquire student loans, costs incurred to manage and administer the Company's student loan portfolio and its financing transactions, costs incurred to service the Company's student loan portfolio and the portfolios of third parties, the cost to provide enrollment services, costs incurred to provide tuition payment processing, campus commerce, content management, recruitment, software and technical services to third parties, the depreciation and amortization of capital assets and intangible assets, investments in products, services, and technology to meet customer needs and support continued revenue growth, and other general and administrative expenses. The cost to provide enrollment services, as discussed previously, consists of costs incurred to provide lead generation and publishing and editing services in the Company's Enrollment Services operating segment. Operating expenses also includes employee termination benefits, lease termination costs, and the write-down of certain assets related to the Company's restructuring initiatives.

Year ended December 31, 2009 compared to year ended December 31, 2008

Net Interest Income (Net of settlements on derivatives)

	Year ended December 31,		Change	
	2009	2008	\$	%
Interest income:				
Loan interest	\$ 609,920	1,176,383	(566,463)	(48.2)%
Investment interest	10,287	37,998	(27,711)	(72.9)
Total interest income	620,207	1,214,381	(594,174)	(48.9)
Interest expense:				
Interest on bonds and notes payable	384,862	1,026,489	(641,627)	(62.5)
Net interest income	235,345	187,892	47,453	25.3
Provision for loan losses	29,000	25,000	4,000	16.0
Net interest income after provision for loan losses	206,345	162,892	43,453	26.7
Derivative settlements, net (a)	39,286	55,657	(16,371)	(29.4)
Net interest income after provision for loan losses (net of settlements on derivatives)	\$ 245,631	218,549	27,082	12.4 %

- (a) The Company maintains an overall risk management strategy that incorporates the use of derivative instruments to reduce the economic effect of interest rate volatility. Management has structured all of the Company's derivative transactions with the intent that each is economically effective; however, the Company's derivative instruments do not qualify for hedge accounting. Derivative settlements for each applicable period should be evaluated with the Company's net interest income, as discussed below.

Net interest income after provision for loan losses, net of settlements on derivatives, changed for the year ended December 31, 2009 compared to 2008 as follows:

	Year ended December 31,		Change	
	2009	2008	\$	%
Variable student loan interest margin, net				
of settlements on derivatives (a)	\$ 148,181	210,217	(62,036)	(29.5)%
Fixed rate floor income, net of settlements on derivatives (b)	145,098	37,457	107,641	287.4
Investment interest (c)	10,287	37,998	(27,711)	(72.9)
Corporate debt interest expense (d)	(28,935)	(42,123)	13,188	(31.3)
Provision for loan losses (e)	(29,000)	(25,000)	(4,000)	16.0
Net interest income after provision for loan losses (net of settlements on derivatives)	\$ 245,631	218,549	27,082	12.4 %

- (a) Variable student loan spread decreased to 0.63% for the year ended December 31, 2009 compared to 0.91% in 2008 as further discussed in this Item 7 under “Asset Generation and Management Operating Segment – Results of Operations – Student Loan Spread Analysis.”
- (b) The Company has a portfolio of student loans that are earning interest at a fixed borrower rate which exceeds the statutorily defined variable lender rate creating fixed rate floor income. Due to lower interest rates in the year ended December 31, 2009 compared to 2008, the Company received additional fixed rate floor income on a portion of its student loan portfolio. See Item 7A, “Quantitative and Qualitative Disclosures about Market Risk – Interest Rate Risk” for additional information.
- (c) Investment interest decreased for the year ended December 31, 2009 compared to 2008 due to lower interest rates in 2009.
- (d) Corporate debt interest expense decreased for the year ended December 31, 2009 compared to 2008 as a result of a decrease in interest rates, as well as a reduction in debt outstanding due to the purchase of unsecured fixed rate debt. The weighted average interest rate and notes outstanding on the Company’s unsecured line of credit was 0.73% and \$691.5 million, respectively, as of December 31, 2009 compared to 1.25% and \$691.5 million, respectively, as of December 31, 2008. During 2009, the Company repurchased \$208.3 million of its 5.125% Senior Notes due 2010.
- (e) The provision for loan losses increased in 2009 compared to 2008 primarily due to increases in delinquencies.

Other Income

Year ended December 31,

	2009	2008	\$	Change %	
Loan and guaranty servicing revenue (a)	\$ 108,747	99,942	8,805	8.8	%
Tuition payment processing and campus commerce revenue (b)	53,894	48,155	5,739	11.9	
Enrollment services revenue (c)	119,397	112,405	6,992	6.2	
Software services revenue (d)	21,164	24,115	(2,951)	(12.2)	
Other income (e)	68,152	22,775	45,377	199.2	
Gain (loss) on sale of loans, net (f)	35,148	(51,414)	86,562	(168.4)	
Derivative market value, foreign currency, and put option adjustments (g)	(30,802)	10,827	(41,629)	(384.5)	
Derivative settlements, net (h)	39,286	55,657	(16,371)	(29.4)	
Total other income	\$ 414,986	322,462	92,524	28.7	%

- (a) “Loan and guaranty servicing revenue” increased due to an increase in FFELP loan servicing revenue. This increase was offset by a decrease in guaranty servicing revenue related to rehabilitation collections on defaulted loan assets. See Item 7 under “Student Loan and Guaranty Servicing Operating Segment – Results of Operations” for additional information.
- (b) “Tuition payment processing and campus commerce revenue” increased due to an increase in the number of managed tuition payment plans and an increase in campus commerce transactions processed as discussed in this Item 7 under “Tuition Payment Processing and Campus Commerce Operating Segment – Results of Operations.”

- (c) “Enrollment services revenue” increased due to an increase in lead generation revenue offset by a reduction in revenue related to other enrollment products and services as further discussed in this Item 7 under “Enrollment Services Operating Segment – Results of Operations.”
- (d) “Software and technical services revenue” decreased due to a reduction in the number of projects for existing customers and the loss of customers due to the legislative developments in the student loan industry throughout 2008 as further discussed in this Item 7 under “Software and Technical Services Operating Segment – Results of Operations.”
- (e) The following table summarizes the components of “other income”.

	Year ended December 31,	
	2009	2008
Gains on debt repurchases	\$ 41,683	—
Borrower late fee income	11,305	11,515
Gain on sale of equity method investment	3,500	—
Other	11,664	11,260
Other income	\$ 68,152	22,775

The change in other income is primarily the result of gains on debt repurchases. In addition, during 2009, the Company earned \$3.5 million related to the sale of an equity method investment.

- (f) “Gain (loss) on sale of loans” includes a gain of \$36.6 million related to the sale of \$2.1 billion of student loans to the Department under the Purchase Program during the year ended December 31, 2009. In addition, the Company recognized a loss of \$51.4 million during 2008 as a result of the sale of \$1.8 billion of student loans as further discussed in this Item 7 under “Asset Generation and Management Operating Segment – Results of Operations.”
- (g) The change in “derivative market value, foreign currency, and put option adjustments” was primarily the result of the change in the fair value of the Company’s derivative portfolio and transaction gains/losses resulting from the remeasurement of the Company’s Euro-denominated bonds to U.S. dollars. These changes are summarized below.

	Year ended December 31,	
	2009	2008
Change in fair value of derivatives	\$ 6,852	(38,576)
Foreign currency transaction adjustment	(37,654)	52,886
Change in fair value of put options issued in business acquisitions	—	(3,483)
Derivative market value, foreign currency, and put option adjustments	\$ (30,802)	10,827

- (h) Further detail of the components of derivative settlements is included in Item 7A, “Quantitative and Qualitative Disclosures about Market Risk.” The Company maintains an overall risk management strategy that incorporates the use of derivative instruments to reduce the economic

effect of interest rate volatility. Management has structured all of the Company's derivative transactions with the intent that each is economically effective; however, the Company's derivative instruments do not qualify for hedge accounting. Derivative settlements for each applicable period should be evaluated with the Company's net interest income, as discussed previously.

Operating Expenses

	2009	Year ended December 31, 2008	\$ Change	% Change
Salaries and benefits (a)	\$ 151,285	177,724	(26,439)	(14.9)%
Other expenses (b)	138,712	158,499	(19,787)	(12.5)
Operating expenses, excluding the cost to provide enrollment services and restructure and impairment expenses	289,997	336,223	\$ (46,226)	(13.7)%
Cost to provide enrollment services	74,926	64,965		
Restructure expense (c)	7,982	7,067		
Impairment expense	32,728	18,834		
Liquidity contingency planning fees (d)	—	13,525		
Total operating expenses	\$ 405,633	440,614		

- (a) Excludes restructure expenses related to employee termination benefits.
- (b) Excludes liquidity contingency planning fees and restructure expenses related to lease terminations.
- (c) Restructure expense is included in “salaries and benefits” and “occupancy and communications” in the consolidated statements of income.
- (d) Liquidity contingency planning fees were incurred by the Company to minimize exposure related to the equity support provisions of the Company’s FFELP loan warehouse facility. These fees are included in “other” under “other operating expense” in the consolidated statements of income.

Excluding the cost to provide enrollment services, restructuring and impairment charges, and liquidity contingency planning fees, operating expenses decreased \$46.2 million (13.7%) for the year ended December 31, 2009 compared to 2008. This decrease was the result of continued focus by the Company on managing costs and gaining efficiencies and continued benefits from restructuring activities.

Included in operating expenses for the years ended December 31, 2009 and 2008 are impairment charges of \$32.7 million and \$18.8 million, respectively. The 2009 impairment charge relates to the impairment of goodwill and intangible assets related to the Company’s direct marketing and list management business. This business has been negatively affected by the economic recession and deterioration of the direct-to-consumer student loan market. The 2008 impairment charge related to the student loan business model modifications the Company implemented due to the disruptions in the debt and secondary markets.

Income Taxes

The Company’s effective tax rate was 35.5% and 40.0% for the years ended December 31, 2009 and 2008, respectively. The effective tax rate during 2009 decreased compared to 2008 due to expenses incurred in 2008 that were not deductible for tax purposes and a decrease in a valuation allowance in 2009.

Additional information on the Company's results of operations is included with the discussion of the Company's operating segments in this Item 7 under "Operating Segments".

43

Year ended December 31, 2008 compared to year ended December 31, 2007

Net Interest Income (Net of settlements on derivatives)

	Year ended December 31,		Change	
	2008	2007	\$	%
Interest income:				
Loan interest	\$ 1,176,383	1,667,057	(490,674)	(29.4)%
Investment interest	37,998	80,219	(42,221)	(52.6)
Total interest income	1,214,381	1,747,276	(532,895)	(30.5)
Interest expense:				
Interest on bonds and notes payable	1,026,489	1,502,662	(476,173)	(31.7)
Net interest income	187,892	244,614	(56,722)	(23.2)
Provision for loan losses	25,000	28,178	(3,178)	(11.3)
Net interest income after provision for loan losses	162,892	216,436	(53,544)	(24.7)
Derivative settlements, net (a)	55,657	18,677	36,980	198.0
Net interest income after provision for loan losses (net of settlements on derivatives)	\$ 218,549	235,113	(16,564)	(7.0)%

- (a) The Company maintains an overall risk management strategy that incorporates the use of derivative instruments to reduce the economic effect of interest rate volatility. Management has structured all of the Company's derivative transactions with the intent that each is economically effective; however, the Company's derivative instruments do not qualify for hedge accounting. Derivative settlements for each applicable period should be evaluated with the Company's net interest income, as discussed below.

Net interest income after provision for loan losses, net of settlements on derivatives, changed for the year ended December 31, 2008 compared to 2007 as follows:

	Year ended December 31,		Change	
	2008	2007	\$	%
Variable student loan interest margin, net				
of settlements on derivatives (a)	\$ 210,217	213,227	(3,010)	(1.4)%
Fixed rate floor income, net of				
settlements on derivatives (b)	37,457	10,347	27,110	262.0
Investment interest (c)	37,998	80,219	(42,221)	(52.6)
Corporate debt interest expense (d)	(42,123)	(40,502)	(1,621)	4.0
Provision for loan losses (e)	(25,000)	(28,178)	3,178	(11.3)
Net interest income after provision for loan losses (net of settlements on derivatives)				
	\$ 218,549	235,113	(16,564)	(7.0)%

- (a) Variable student loan spread decreased to 0.91% for the year ended December 31, 2008 compared to 1.10% in 2007 as discussed in this Item 7 under “Asset Generation and Management Operating Segment – Results of Operations – Student Loan Spread Analysis.”
- (b) The Company has a portfolio of student loans that are earning interest at a fixed borrower rate which exceeds the statutorily defined variable lender rate creating fixed rate floor income. Due to lower interest rates in the year ended December 31, 2008 compared to 2007, the Company received additional fixed rate floor income on a portion of its student loan portfolio. See Item 7A, “Quantitative and Qualitative Disclosures about Market Risk – Interest Rate Risk” for additional information.
- (c) Investment interest decreased for the year ended December 31, 2008 compared to 2007 due to lower interest rates in 2008.
- (d) Corporate debt interest expense increased for the year ended December 31, 2008 compared to 2007 as a result of an increase in the notes outstanding on the Company’s unsecured line of credit, offset by a decrease in interest rates. The weighted average interest rate and notes outstanding on the Company’s unsecured line of credit was 1.25% and \$691.5 million, respectively, as of December 31, 2008 compared to 5.48% and \$80.0 million, respectively, as of December 31, 2007.

- (e) Excluding an expense of \$15.7 million to increase the Company's allowance for loan losses related to the increase in risk share as a result of the elimination of the Exceptional Performer program in the third quarter of 2007, the provision for loan losses increased for the year ended December 31, 2008 compared to 2007. The provision for loan losses for federally insured loans increased as a result of the increase in risk share as a result of the loss of Exceptional Performer. The provision for loan losses for non-federally insured loans increased primarily due to increases in delinquencies as a result of the weakening of the U.S. economy.

Other Income

	Year ended December 31,			
	2008	2007	\$	Change %
Loan and guaranty servicing revenue (a)	\$ 99,942	122,380	(22,438)	(18.3)%
Tuition payment processing and campus commerce revenue (b)	48,155	42,766	5,389	12.6
Enrollment services revenue (c)	112,405	103,905	8,500	8.2
Software services revenue (d)	24,115	27,764	(3,649)	(13.1)
Other income (e)	22,775	30,423	(7,648)	(25.1)
Gain (loss) on sale of loans, net (f)	(51,414)	3,597	(55,011)	(1,529.4)
Derivative market value, foreign currency, and put option adjustments (g)	10,827	26,806	(15,979)	(59.6)
Derivative settlements, net (h)	55,657	18,677	36,980	198.0
Total other income	\$ 322,462	376,318	(53,856)	(14.3)%

- (a) "Loan and guaranty servicing revenue" decreased due to decreases in FFELP loan servicing revenue, non-federally insured loan servicing revenue, and guaranty servicing revenue as further discussed in this Item 7 under "Student Loan and Guaranty Servicing Operating Segment – Results of Operations."
- (b) "Tuition payment processing and campus commerce revenue" increased due to an increase in the number of managed tuition payment plans and an increase in campus commerce transactions processed as discussed in this Item 7 under "Tuition Payment Processing and Campus Commerce Operating Segment – Results of Operations."
- (c) "Enrollment services revenue" increased due to an increase in lead generation revenue offset by a reduction in revenue related to other enrollment products and services as further discussed in this Item 7 under "Enrollment Services Operating Segment – Results of Operations."
- (d) "Software and technical services revenue" decreased due to a reduction in the number of projects for existing customers and the loss of customers due to the legislative developments in the student loan industry throughout 2008 as further discussed in this Item 7 under "Software and Technical Services Operating Segment – Results of Operations."
- (e) The following table summarizes the components of "other income".

	Year ended December 31,	
	2008	2007

Borrower late fee income	\$ 11,515	8,207
Gain on sale of equity method investment	—	3,942
Administrative service fee income	—	2,605
Other	11,260	15,669
Other income	\$ 22,775	30,423

The change in other income is primarily the result of a gain of \$3.9 million from the sale of an entity accounted for under the equity method in 2007. In addition, the Company recognized \$2.6 million in 2007 related to an agreement with a third party under which the Company provided administrative services to the third party for a fee. This agreement was terminated in the third quarter of 2007. The decrease in “other” above is a result of a decrease in income earned on certain investment activities in 2008 compared to 2007.

- (f) “Gain (loss) on sale of loans” includes a loss of \$51.4 million related to the sale of \$1.8 billion of student loans during the year ended December 31, 2008 as further discussed in this Item 7 under “Asset Generation and Management Operating Segment – Results of Operations.”
- (g) The change in “derivative market value, foreign currency, and put option adjustments” was primarily the result of the change in the fair value of the Company’s derivative portfolio and transaction gains/losses resulting from the remeasurement of the Company’s Euro-denominated bonds to U.S. dollars. These changes are summarized below.

	Year ended December 31,	
	2008	2007
Change in fair value of derivatives	\$ (38,576)	139,146
Foreign currency transaction adjustment	52,886	(108,712)
Change in fair value of put options issued in business acquisitions	(3,483)	(3,628)
Derivative market value, foreign currency, and put option adjustments	\$ 10,827	26,806

- (h) Further detail of the components of derivative settlements is included in Item 7A, “Quantitative and Qualitative Disclosures about Market Risk.” The Company maintains an overall risk management strategy that incorporates the use of derivative instruments to reduce the economic effect of interest rate volatility. Management has structured all of the Company’s derivative transactions with the intent that each is economically effective; however, the Company’s derivative instruments do not qualify for hedge accounting. Derivative settlements for each applicable period should be evaluated with the Company’s net interest income, as discussed previously.

Operating expenses

	Year ended December 31,			
	2008	2007	\$ Change	% Change
Salaries and benefits (a)	\$ 177,724	230,316	(52,592)	(22.8) %
Other expenses (b)	158,499	200,150	(41,651)	(20.8)
Operating expenses, excluding the cost to provide enrollment services, restructure and impairment expenses, and liquidity contingency planning fees	336,223	430,466	\$ (94,243)	(21.9) %
Cost to provide enrollment services	64,965	45,408		
Restructure expense (c)	7,067	10,231		
Impairment expense	18,834	49,504		
Liquidity contingency planning fees (d)	13,525	—		
Total operating expenses	\$ 440,614	535,609		

- (a) Excludes restructure expenses related to employee termination benefits.
- (b) Excludes liquidity contingency planning fees and restructure expenses related to lease terminations.
- (c) Restructure expense is included in “salaries and benefits” and “occupancy and communications” in the consolidated statements of income.
- (d) Liquidity contingency planning fees were incurred by the Company to minimize exposure related to the equity support provisions of the Company’s FFELP loan warehouse facility. These fees are included in “other” under “other operating expense” in the consolidated statements of income.

Excluding the cost to provide enrollment services, restructuring and impairment charges, and liquidity contingency planning fees, operating expenses decreased \$94.2 million (21.9%) for the year ended December 31, 2008 compared to 2007. This decrease was the result of cost savings from the September 2007 and January 2008 restructuring plans implemented by the Company. These plans resulted in the net reduction of approximately 700 positions in the Company’s overall workforce, leading to decreases in salaries and benefits and other expenses. The decrease is also a result of the Company capitalizing on the operating leverage of its business structure and strategies.

Included in operating expenses for the years ended December 31, 2008 and 2007 are impairment charges of \$18.8 million and \$49.5 million, respectively. The 2008 impairment charge related to the student loan business model modifications the Company implemented due to the disruptions in the debt and secondary markets. The 2007 impairment charge related to the student loan business model modifications the Company implemented due to the passage of the College Cost Reduction Act.

Income Taxes

The Company's effective tax rate was 40% for the year ended December 31, 2008 compared to 38% for the same period in 2007. The effective tax rate increased due to the permanent tax impact of stock compensation and outstanding put options related to prior acquisitions and a reduction of federal and state tax credits as a percentage of pre-tax book income. This increase was partially offset by a benefit from resolution of uncertain tax matters and a reduction in state taxes.

Financial Condition as of December 31, 2009 compared to December 31, 2008

	As of December 31,		Change	
	2009	2008	Dollars	Percent
Assets:				
Student loans receivable, net	\$ 23,926,957	25,413,008	(1,486,051)	(5.8) %
Cash, cash equivalents, and investments	1,055,414	1,348,104	(292,690)	(21.7)
Goodwill	143,717	175,178	(31,461)	(18.0)
Intangible assets, net	53,538	77,054	(23,516)	(30.5)
Fair value of derivative instruments	193,899	175,174	18,725	10.7
Other assets	502,902	666,379	(163,477)	(24.5)
Total assets	\$ 25,876,427	27,854,897	(1,978,470)	(7.1) %
Liabilities:				
Bonds and notes payable	\$ 24,805,289	26,787,959	(1,982,670)	(7.4) %
Fair value of derivative instruments	2,489	1,815	674	37.1
Other liabilities	284,086	421,897	(137,811)	(32.7)
Total liabilities	25,091,864	27,211,671	(2,119,807)	(7.8)
Shareholders' equity	784,563	643,226	141,337	22.0
Total liabilities and shareholders' equity	\$ 25,876,427	27,854,897	(1,978,470)	(7.1) %

Total assets decreased during 2009 primarily due to decreases in student loans receivable and restricted cash and investments. Student loans receivable decreased as the result of the sale of \$2.1 billion of student loans to the Department under the Purchase Program during the year ended December 31, 2009. Total liabilities decreased during 2009 primarily due to a decrease in bonds and notes payable as a result of fewer loans to finance and payments on debt and debt repurchases, which resulted in a decrease in restricted cash and investments.

OPERATING SEGMENTS

The Company has five operating segments as follows: Student Loan and Guaranty Servicing, Tuition Payment Processing and Campus Commerce, Enrollment Services, Software and Technical Services, and Asset Generation and Management. The Company's operating segments are defined by the products and services they offer or the types of customers they serve, and they reflect the manner in which financial information is currently evaluated by management. The accounting policies of the Company's operating segments are the same as those described in note 3 in the notes to the consolidated financial statements included in this Report. Intersegment revenues are charged by a segment to another segment that provides the product or service. Intersegment revenues and expenses are included

within each segment consistent with the income statement presentation provided to management. Changes in management structure or allocation methodologies and procedures may result in changes in reported segment financial information.

The management reporting process measures the performance of the Company's operating segments based on the management structure of the Company as well as the methodology used by management to evaluate performance and allocate resources. Management, including the Company's chief operating decision maker, evaluates the performance of the Company's operating segments based on their profitability. As discussed further below, management measures the profitability of the Company's operating segments on the basis of "base net income." Accordingly, information regarding the Company's operating segments is provided based on "base net income." The Company's "base net income" is not a defined term within GAAP and may not be comparable to similarly titled measures reported by other companies. Unlike financial accounting, there is no comprehensive, authoritative guidance for management reporting.

In May 2007, the Company sold EDULINX, a Canadian student loan service provider and subsidiary of the Company. As a result of this transaction, the results of operations for EDULINX are reported as discontinued operations for all periods presented. The operating results of EDULINX were included in the Student Loan and Guaranty Servicing operating segment. The Company presents “base net income” excluding discontinued operations since the operations and cash flows of EDULINX have been eliminated from the ongoing operations of the Company. Therefore, the results of operations for the Student Loan and Guaranty Servicing segment exclude the operating results of EDULINX for all periods presented. See note 2 in the notes to the consolidated financial statements included in this Report for additional information concerning EDULINX’s detailed operating results that have been segregated from continuing operations and reported as discontinued operations.

Historically, the Company generated the majority of its revenue from net interest income earned in its Asset Generation and Management operating segment. The Company made several acquisitions that have expanded the Company’s products and services and have diversified its revenue – primarily from fee-based businesses. The Company currently offers a broad range of pre-college, in-college, and post-college products and services to students, families, schools, and financial institutions. These products and services help students and families plan and pay for their education and students plan their careers. The Company’s products and services are designed to simplify the education planning and financing process and are focused on providing value to students, families, and schools throughout the education life cycle. The Company continues to look for ways to diversify its sources of revenue, including those generated from businesses that are not dependent upon government programs, reducing legislative and political risk.

“Base net income” is the primary financial performance measure used by management to develop the Company’s financial plans, track results, and establish corporate performance targets and incentive compensation. While “base net income” is not a substitute for reported results under GAAP, the Company relies on “base net income” in operating its business because “base net income” permits management to make meaningful period-to-period comparisons of the operational and performance indicators that are most closely assessed by management. Management believes this information provides additional insight into the financial performance of the core business activities of the Company’s operating segments.

Accordingly, the tables presented below reflect “base net income” which is reviewed and utilized by management to manage the business for each of the Company’s operating segments. Reconciliation of the segment totals to the Company’s consolidated operating results in accordance with GAAP are also included in the tables below. Included below under “Non-GAAP Performance Measures” is further discussion regarding “base net income” and its limitations, including a table that details the differences between “base net income” and GAAP net income by operating segment.

Certain amounts previously reported have been reclassified to conform to the current period presentation. The reclassifications were made to change the income statement presentation to provide the users of the financial statements additional information related to the operating results of the Company’s fee-based businesses, which are becoming more significant to the Company’s operations. These reclassifications include reclassifying “tuition payment processing and campus commerce revenue” and “enrollment services revenue,” which were previously included in “other fee-based income.” In addition, the “cost to provide enrollment services” was reclassified from various operating expense accounts, primarily “advertising and marketing.”

Segment Results and Reconciliations to GAAP

Year ended December 31, 2009

	Student Loan and Guaranty Servicing	Fee-Based Tuition Payment Processing and Campus Commerce	Enrollment Services	Software and Technical Services	Total Fee- Based	Asset Generation and Management	Corporate Activity and Overhead	Eliminations and Reclass- ifications	"Base net income" Adjustment to GAAP Results
Total interest income	\$112	62	—	—	174	609,143	5,391	(2,003)	7,502
Interest expense	—	—	—	—	—	357,930	28,935	(2,003)	—
Net interest income (loss)	112	62	—	—	174	251,213	(23,544)	—	7,502
Less provision for loan losses	—	—	—	—	—	29,000	—	—	—
Net interest income (loss) after provision for loan losses	112	62	—	—	174	222,213	(23,544)	—	7,502
Other income (expense):									
Loan and guaranty servicing revenue	110,273	—	—	—	110,273	—	(1,526)	—	—
Tuition payment processing and campus commerce revenue	—	53,894	—	—	53,894	—	—	—	—
Enrollment services revenue	—	—	119,397	—	119,397	—	—	—	—
Software services revenue	3,701	—	—	17,463	21,164	—	—	—	—
Other income	644	—	—	—	644	45,697	21,811	—	—
	—	—	—	—	—	35,148	—	—	—

Edgar Filing: NELNET INC - Form 10-K

Gain (loss) on sale of loans, net									
Intersegment revenue	85,104	237	555	14,586	100,482	—	33,469	(133,951)	—
Derivative market value, foreign currency, and put option adjustments	—	—	—	—	—	—	—	—	(30,802)
Derivative settlements, net	—	—	—	—	—	39,286	—	—	—
Total other income (expense)	199,722	54,131	119,952	32,049	405,854	120,131	53,754	(133,951)	(30,802)
Operating expenses:									
Salaries and benefits	54,289	25,549	23,222	21,978	125,038	6,767	24,777	(1,209)	159
Restructure expense-severance and contract termination costs	5,964	—	—	936	6,900	—	1,082	(7,982)	—
Impairment expense	—	—	32,728	—	32,728	—	—	—	—
Cost to provide enrollment services	—	—	74,926	—	74,926	—	—	—	—
Other expenses	35,391	9,642	13,226	3,330	61,589	19,566	35,307	3,736	22,249
Intersegment expenses	37,039	2,800	2,121	2,867	44,827	81,335	2,334	(128,496)	—
Total operating expenses	132,683	37,991	146,223	29,111	346,008	107,668	63,500	(133,951)	22,408
Income (loss) before income taxes	67,151	16,202	(26,271)	2,938	60,020	234,676	(33,290)	—	(45,708)
Income tax (expense) benefit (a)	(25,518)	(6,156)	9,984	(1,118)	(22,808)	(89,178)	19,186	—	16,227
Net income (loss) from continuing	41,633	10,046	(16,287)	1,820	37,212	145,498	(14,104)	—	(29,481)

operations										
Income from discontinued operations, net of tax	—	—	—	—	—	—	—	—	—	—
Net income (loss)	\$41,633	10,046	(16,287)	1,820	37,212	145,498	(14,104)	—	(29,481)	

(a) Income taxes are applied based on 38% of income (loss) before taxes for the individual operating segments.

Before tax operating margin (1):

Year ended December 31, 2009	36.6	%	29.9	%	5.4	%	12.1	%	24.5	%	45.4	%
------------------------------	------	---	------	---	-----	---	------	---	------	---	------	---

Year ended December 31, 2008	26.6	%	31.1	%	4.7	%	13.8	%	19.6	%	16.9	%
------------------------------	------	---	------	---	-----	---	------	---	------	---	------	---

(1) Before tax operating margin excludes impairment and restructuring charges and fixed rate floor income.

Edgar Filing: NELNET INC - Form 10-K

Year ended December 31, 2008

	Fee-Based Tuition			Software and	Total	Asset Generation and Management	Corporate Activity and Overhead	Eliminations and Reclassifications	"Base net income" Adjustments to GAAP Results
	Student Loan and Guaranty Servicing	Payment Processing and Campus Commerce	Enrollment Services	Technical Services	Fee-Based				
Total interest income	\$1,377	1,689	17	24	3,107	1,164,329	6,810	(2,190)	42,32
Interest expense	—	—	—	—	—	986,556	42,123	(2,190)	—
Net interest income (loss)	1,377	1,689	17	24	3,107	177,773	(35,313)	—	42,32
Less provision for loan losses	—	—	—	—	—	25,000	—	—	—
Net interest income (loss) after provision for loan losses	1,377	1,689	17	24	3,107	152,773	(35,313)	—	42,32
Other income (expense):									
Loan and guaranty servicing revenue	99,916	—	—	—	99,916	26	—	—	—
Tuition payment processing and campus commerce revenue	—	48,155	—	—	48,155	—	—	—	—
Enrollment services revenue	—	—	112,405	—	112,405	—	—	—	—
Software services revenue	4,371	—	37	19,707	24,115	—	—	—	—
Other income	51	—	—	—	51	17,401	5,323	—	—
Gain (loss) on sale of loans	—	—	—	—	—	(53,035)	1,621	—	—

Edgar Filing: NELNET INC - Form 10-K

Intersegment revenue	75,361	302	2	6,831	82,496	—	63,384	(145,880)	—
Derivative market value, foreign currency, and put option adjustments	—	—	—	—	—	466	—	—	10,366
Derivative settlements, net	—	—	—	—	—	65,622	—	—	(9,965)
Total other income (expense)	179,699	48,457	112,444	26,538	367,138	30,480	70,328	(145,880)	396
Operating expenses:									
Salaries and benefits	51,320	23,290	24,379	18,081	117,070	8,316	54,910	98	2,999
Restructure expense - severance and contract termination costs	747	—	282	487	1,516	1,845	3,706	(7,067)	—
Impairment expense	5,074	—	—	—	5,074	9,351	4,409	—	—
Cost to provide enrollment services	—	—	64,965	—	64,965	—	—	—	—
Other expenses	33,922	9,879	11,224	2,489	57,514	35,679	53,975	24	26,230
Intersegment expenses	47,737	1,397	6,641	2,323	58,098	77,105	3,732	(138,935)	—
Total operating expenses	138,800	34,566	107,491	23,380	304,237	132,296	120,732	(145,880)	29,222
Income (loss) before income taxes	42,276	15,580	4,970	3,182	66,008	50,957	(85,717)	—	13,499
Income tax (expense) benefit (a)	(14,321)	(5,175)	(1,730)	(1,021)	(22,247)	(18,356)	28,499	—	(5,792)
Net income (loss) from continuing operations	27,955	10,405	3,240	2,161	43,761	32,601	(57,218)	—	7,707
Income from discontinued	—	—	—	—	—	—	—	—	1,818

operations,
net of tax
Net income
(loss)

\$27,955	10,405	3,240	2,161	43,761	32,601	(57,218)	—	9,518
----------	--------	-------	-------	--------	--------	-----------	---	-------

(a) Income taxes are applied to each operating segment based on the consolidated effective tax rate for the period.

50

Year ended December 31, 2007

Fee-Based
Tuition