

NELNET INC  
Form 10-K  
March 03, 2011

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, 2010

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 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 [ ]

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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, 2010 (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 \$19.28 per share, was \$535,442,039. 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, 2011, there were 36,842,762 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 2011 Annual Meeting of Shareholders, scheduled to be held May 26, 2011, are incorporated by reference into Part III of this Form 10-K.

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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 plans and expectations for future financial condition, results of operations or economic performance, or that address management's plans and objectives for future operations, and statements that assume or are dependent upon future events, are forward-looking statements. The words "may," "should," "could," "would," "predict," "potential," "continue," "anticipate," "future," "intend," "plan," "believe," "estimate," "assume," "forecast," "will," and similar expressions, as well as in future tense, are intended to identify forward-looking statements.

The forward-looking statements are based on assumptions and analyses made by management in light of management's experience and its perception of historical trends, current conditions, expected future developments, and other factors that management believes are appropriate under the circumstances. These statements are subject to known and unknown risks, uncertainties, and other factors that may cause the actual results and performance to be materially different from any future results or performance expressed or implied by such forward-looking statements. These factors include, among others, the risks and uncertainties set forth in "Risk Factors" and elsewhere in this report, and include such risks and uncertainties as:

- risks related to the Company's student loan portfolio, such as interest rate basis and repricing risk resulting from the fact that the interest rate characteristics of the Company's student loan assets do not match the interest rate characteristics of the funding for those assets, the risk of loss of floor income on certain student loans originated under the Federal Family Education Loan Program (the "FFEL Program" or "FFELP") of the U.S. Department of Education (the "Department"), risks related to the use of derivatives to manage exposure to interest rate fluctuations, and potential losses from loan defaults, changes in prepayment rates, guaranty rates, loan floor rates, and credit spreads;

- risks related to the Company's liquidity and funding requirements, including the Company's ability to maintain credit facilities or obtain new facilities, the ability of lenders under the Company's credit facilities to fulfill their lending commitments under these facilities, the Company's ability to satisfy debt obligations secured by student loan assets and related collateral, and 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 purchase, refinance, or continue to carry education loans;

- risks from changes in the student loan and educational credit marketplace resulting from the implementation of, or changes in, applicable laws and regulations, including the discontinuance of private sector student loan originations under the FFEL Program effective July 1, 2010, and the Company's ability to maintain its loan servicing contract with the Department of Education to service federally-owned student loans and to comply with servicing agreements with third party customers for the service of loans under the Federal Direct Loan and FFEL Programs;

- risks from changes in the demand or preferences for educational financing and related services by educational institutions, students, and their families;

- uncertainties inherent in forecasting future cash flows from student loan assets and related asset-backed securitizations;

- risks associated with litigation, complex government regulations, changes in general economic and credit market conditions, and related party transactions; and

- uncertainties inherent in the estimates and assumptions about future events that management is required to make in the preparation of the Company's consolidated financial statements.

All forward-looking statements contained in this report are qualified by these cautionary statements and are made only as of the date of this document. Although the Company may from time to time voluntarily update or revise its prior forward-looking statements to reflect actual results or changes in the Company's expectations, the Company disclaims any commitment to do so except as required by securities laws.

PART I.

ITEM 1. BUSINESS

Overview

Nelnet, Inc. (the "Company") is an innovative education services company focused primarily on providing fee-based processing services and quality education-related products and services in four core areas: loan financing, loan servicing, payment processing, and enrollment services (education planning). These products and services help students and families plan, prepare, and pay for their education and make the administrative and financial processes more efficient for schools and financial organizations. In addition, the Company earns net interest income on a portfolio of federally insured student loans. Substantially all revenue from external customers is earned, and all long-lived assets are located, in the United States.

The Company was formed as a Nebraska corporation in 1977 to service federal student loans for two local banks. The Company built on this initial foundation as a servicer to become a leading originator, holder, and servicer of federal student loans, principally consisting of loans originated under the FFEL Program (a detailed description of the FFEL Program is included in Appendix A to this report). To reduce its reliance on the net interest margin on student loans, the Company has significantly diversified and increased its fee-based education-related services.

The Company had certain business objectives in place during 2010 that included:

- Continuing to grow and diversify fee-based revenue
- Managing operating costs
- Maximizing the value of its existing student loan portfolio
- Using financial strength and liquidity to capitalize on market opportunities

Achieving these business objectives, as well as significant legislation changes in the student loan industry as discussed below, has impacted and will continue to impact the financial condition and operating results of the Company. See Part II, Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations – Overview,” for additional information on the financial impact related to these items.

#### Customers

The Company serves several different groups of customers including:

- Students and families
- Colleges and universities, specifically financial aid, business, and admissions offices
  - Private, faith-based, and other K-12 institutions
- Lenders, servicers, and state agencies in education finance
  - Government entities

An increase in the size of the education market generally increases the demand for the Company’s products and services. As shown in the chart below, total student enrollment is projected to continue to grow for many years. An increasing number of students are pursuing a higher education, often with the help of financial aid by the federal government, for whom the Company services loans. In addition, as the education market continues to grow, often with budget and funding concerns, schools have an increasing need to become more efficient, offer consistent and quality services, and recruit and retain students.

(1)Source: Digest of Education Statistics 2009, National Center for Education Statistics, U.S. Department of Education, March 2010, NCES 2010-020

## Operating Segments

The Company operates as four distinct operating segments with several different brands. The Company's operating segments offer a broad range of services designed to simplify education planning and financing for students and families and the administrative and financial processes for schools and financial institutions. The Company's operating segments include:

- Student Loan and Guaranty Servicing
  - Referred to as Nelnet Diversified Solutions ("NDS")
- Focused on student loan servicing, student loan servicing-related technology solutions, and outsourcing services for guaranty agencies
- Includes the brands Nelnet Loan Servicing, Firstmark Services, Nelnet Guarantor Solutions, and 5280 Solutions
- Tuition Payment Processing and Campus Commerce
  - Commonly known as Nelnet Business Solutions ("NBS")
  - Focused on payment processing
  - Includes the brand FACTS Management
- Enrollment Services
  - Commonly called Nelnet Enrollment Solutions ("NES")
- Focused on education planning and enrollment-related services, including interactive marketing
- Includes the brands CUnet, Peterson's, EssayEdge, and Student Marketing Group
- Asset Generation and Management
  - Includes the acquisition and management of the Company's student loan assets

## Recent Developments – Legislation

The Company has historically ranked 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.

On March 30, 2010, President Obama signed into law the Health Care and Education Reconciliation Act of 2010 (the "Reconciliation Act of 2010"). Effective July 1, 2010, this law prohibits new loan originations under the FFEL Program and requires that all new federal loan originations be made through the Federal Direct Loan Program. The new law does not alter or affect the terms and conditions of existing FFELP loans.

As a result of the Reconciliation Act of 2010, the Company no longer originates new FFELP loans. In addition, net interest income on the Company's existing FFELP loan portfolio, as well as fee-based revenue from guarantee and third party FFELP servicing and education loan software licensing and consulting fees related to the FFEL Program, will decline over time as the Company's and the Company's customers' FFELP loan portfolios are paid down.

Due to the legislative changes in the student loan industry, the Company believes there will be opportunities to purchase FFELP loan portfolios and/or expand its current level of guarantee and third party FFELP servicing volume on behalf of current FFELP participants looking to adjust their FFELP businesses. In addition, as discussed below, in June 2009, the Department awarded a servicing contract to the Company to service federally-owned student loans originated under the Federal Direct Loan Program. In addition, the Company is offering a hosted servicing software solution to third parties that can be used by third parties to service various types of student loans including Federal Direct Program and FFEL Program loans. Currently, the Company has agreements with third parties, including a contract with an incumbent Direct Loan Program service provider, to add more than 12 million borrowers to its hosted

servicing software solution by the end of 2011.

#### Segment Operating Results

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, including revenues, net income or loss, and total assets for each of the Company's segments, for the last three fiscal years in note 15 of the notes to the consolidated financial statements included in this report.



In recent years, the Company has expanded products and service offerings from businesses that are not dependent upon the FFEL Program, thereby reducing legislative and political risk related to the education lending industry. These products and services generate fee-based revenue. 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. Excluding Corporate Activity and Overhead and fixed rate floor income provides better comparability of revenue recognized from the Company's operating segments' external customers during the years presented. The majority of external revenue included in Corporate Activity and Overhead is interest expense on unsecured corporate debt offset by income earned on certain investment activities. Fixed rate floor income is subject to changes in interest rates, which is a factor beyond the Company's control. The amount of fixed rate floor income was significant during each of 2010 and 2009 due to historically low interest rates. (See Part II, Item 7A, "Quantitative and Qualitative Disclosures about Market Risk – Interest Rate Risk," for further detail related to the Company's fixed rate floor income.)

The following chart also shows the contribution of revenue earned from operating segments that generate fee-based revenue and includes a reconciliation to total external revenue by operating segment as presented on the following page.

External revenue (dollars in thousands):

	Year ended December 31,								
	2010			2009			2008		
Fee-based segments	\$359,172	57.8	%	\$305,546	64.0	%	\$287,749	52.7	%
Asset Generation and Management (excluding fixed rate floor income)	262,189	42.2		172,075	36.0		257,915	47.3	
<b>Subtotal</b>	<b>621,361</b>	<b>100.0</b>	<b>%</b>	<b>477,621</b>	<b>100.0</b>	<b>%</b>	<b>545,664</b>	<b>100.0</b>	<b>%</b>
Fixed rate floor income	132,243			145,098			37,457		
Corporate Activity and Overhead	(7,182 )			(18,417 )			(32,180 )		
<b>Total</b>	<b>\$746,422</b>			<b>\$604,302</b>			<b>\$550,941</b>		

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

	Year ended December 31, 2010					
	External		Intersegment		As reported by segment	
	Dollars	Percent	Dollars	Percent	Dollars	Percent
Student Loan and Guaranty Servicing	\$ 159,419	21.4 %	\$ 85,342	100.0 %	\$ 244,761	29.4 %
Tuition Payment Processing and Campus Commerce	59,856	8.0	—	—	59,856	7.2
Enrollment Services	139,897	18.7	—	—	139,897	16.8
Total revenue from fee-based segments	359,172	48.1	85,342	100.0	444,514	53.4
Asset Generation and Management	394,432	52.8	(4,370 )	(5.1 )	390,062	46.8
Corporate Activity and Overhead	(7,182 )	(0.9 )	4,370	5.1	2,812	(0.2 )
Total revenue	\$ 746,422	100.0 %	\$ 85,342	100.0 %	\$ 831,764	100.0 %

	Year ended December 31, 2009					
	External		Intersegment		As reported by segment	
	Dollars	Percent	Dollars	Percent	Dollars	Percent
Student Loan and Guaranty Servicing	\$ 132,193	21.9 %	\$ 85,048	100.0 %	\$ 217,241	31.6 %
Tuition Payment Processing and Campus Commerce	53,956	8.9	—	—	53,956	7.8
Enrollment Services	119,397	19.8	—	—	119,397	17.3
Total revenue from fee-based segments	305,546	50.6	85,048	100.0	390,594	56.7
Asset Generation and Management	317,173	52.4	(2,003 )	(2.4 )	315,170	45.7
Corporate Activity and Overhead	(18,417 )	(3.0 )	2,003	2.4	(16,414 )	(2.4 )
Total revenue	\$ 604,302	100.0 %	\$ 85,048	100.0 %	\$ 689,350	100.0 %

Year ended December 31, 2008

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	External		Intersegment		As reported by segment	
	Dollars	Percent	Dollars	Percent	Dollars	Percent
Student Loan and Guaranty Servicing	\$ 125,446	22.8 %	\$ 77,957	100.0 %	\$ 203,403	32.4 %
Tuition Payment Processing and Campus Commerce	49,844	9.0	—	—	49,844	7.9
Enrollment Services	112,459	20.4	—	—	112,459	17.9
Total revenue from fee-based segments	287,749	52.2	77,957	100.0	365,706	58.2
Asset Generation and Management	295,372	53.6	(2,190 )	(2.8 )	293,182	46.6
Corporate Activity and Overhead	(32,180 )	(5.8 )	2,190	2.8	(29,990 )	(4.8 )
Total revenue	\$ 550,941	100.0 %	\$ 77,957	100.0 %	\$ 628,898	100.0 %

Fee-Based Operating Segments

Student Loan and Guaranty Servicing

The five primary service offerings of this operating segment and each one's percentage of total Student Loan and Guaranty Servicing revenue during 2010, are as follows:

- Originating and servicing FFEL Program loans (50%)
- Servicing federally-owned student loans for the Department of Education (12%)
  - Originating and servicing non-federally insured student loans (4%)
  - Servicing and outsourcing services for guaranty agencies (26%)
- Student loan servicing software and other information technology products and services (8%)

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

<b>Company</b>										
Owned	\$24,136	\$23,139	\$24,378	\$26,351	\$26,183	\$23,727				
% of total	67.3	% 61.6	% 56.7	% 55.3	% 47.0	% 38.6	%			
<b>Number of borrowers:</b>										
<b>Government</b>										
servicing:	—	441,913	1,055,896	1,530,308	2,510,630	2,804,502				
<b>FFELP</b>										
servicing:	2,266,866	2,311,558	2,327,016	2,329,150	2,227,288	1,912,748				
<b>Total:</b>										
	2,266,866	2,753,471	3,382,912	3,859,458						