NEOGENOMICS INC
Form 10-K
March 13, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 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, 2017

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: 001-35756

NEOGENOMICS, INC.

(Exact name of registrant as specified in its charter)

Nevada	74-2897368
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

12701 Commonwealth Drive, Suite 9, Fort Myers, FL 33913

(Address of principal executive offices, Zip code)

(239) 768-0600

(Registrant’s telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:	Name of each exchange on which registered:
Common Stock, par value $0.001 per share	NASDAQ Capital Market

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

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

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

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 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

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, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer		Accelerated filer
Non-accelerated filer	(Do not check if a smaller reporting company)	Smaller Reporting Company
		Emerging Growth Company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of June 30, 2017, the aggregate market value of the registrant's common stock held by non-affiliates of the registrant was approximately $653.1 million, based on the closing price of the registrant's common stock of $8.96 per share on June 30, 2017.

The number of shares outstanding of the registrant's Common Stock, par value $0.001 per share, as of March 5, 2018: 80,507,094

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's Proxy Statement for its 2018 Annual Meeting of stockholders are incorporated by reference into Part III of this Annual Report on Form 10-K.

NEOGENOMICS, INC.

FORM 10-K ANNUAL REPORT

For the Fiscal Year Ended December 31, 2017

Table of Contents

NeoGenomics, NeoLAB and NeoTYPE are our registered trademarks, and FlexREPORT is our trademark. Any other trademarks, registered marks and trade names appearing in this annual report on Form 10-K are the property of their respective holders.

NEOGENOMICS, INC.

PART I

FORWARD-LOOKING STATEMENTS

The information in this Annual Report on Form 10-K contains “forward-looking statements” and information within the meaning of Section 27A of the Securities Act of 1933, as amended, or the “Securities Act”, and Section 21E of the Securities Exchange Act of 1934, as amended, or the “Exchange Act”, which are subject to the “safe harbor” created by those sections. These forward-looking statements include, but are not limited to, statements concerning our strategy, future operations, future financial position, future revenues, changing reimbursement levels from government payers and private insurers, projected costs, prospects and plans and objectives of management. The words “anticipates,” “believes,” “estimates,” “expects,” “intends,” “may,” “plans,” “projects,” “will,” “would” and similar expressions are intended forward-looking statements, although not all forward-looking statements contain these identifying words. We may not actually achieve the plans, intentions or expectations disclosed in our forward-looking statements and you should not place undue reliance on our forward-looking statements. These forward-looking statements involve known and unknown risks and uncertainties that could cause our actual results, performance or achievements to differ materially from those expressed or implied by the forward-looking statements, including, without limitation, the risks set forth in Part I, Item 1A, “Risk Factors” in this Annual Report on Form 10-K and in our other filings with the Securities and Exchange Commission, or “SEC”.

Forward-looking statements include, but are not limited to, statements about:

- Our ability to implement our business strategy;
- The expected reimbursement levels from governmental payers and private insurers and proposed changes to those levels;
- The application, to our business and the services we provide, of existing laws, rules and regulations, including without limitation, Medicare laws, anti-kickback laws, Health Insurance Portability and Accountability Act of 1996 regulations, state medical privacy laws, federal and state false claims laws and corporate practice of medicine laws;
- Regulatory developments in the United States including downward pressure on health care reimbursement;
- Our ability to maintain our license under the Clinical Laboratory Improvement Amendments of 1988 (“CLIA”);
- Food and Drug Administration, or FDA regulation of Laboratory Developed Tests (“LDTs”);
- Failure to timely or accurately bill for our services;
- Our ability to expand our operations and increase our market share;
- Our ability to expand our service offerings by adding new testing capabilities;
- Our ability to meet our future capital requirements;
- Our ability to manage our indebtedness;
- Our ability to protect our intellectual property from infringement;
- Our ability to integrate future acquisitions and costs related to such acquisitions;
- The impact of internalization of testing by customers;
- Our ability to maintain service levels and compete with other diagnostic laboratories;
- Our ability to hire and retain sufficient managerial, sales, clinical and other personnel to meet our needs;
- Our ability to successfully scale our business, including expanding our facilities, our backup systems and infrastructure; and
- The accuracy of our estimates regarding reimbursement, expenses, future revenues and capital requirements.

These forward-looking statements represent our management’s beliefs and assumptions only as of the date of this Annual Report. You should read this Annual Report and the documents that we reference in this Annual Report and have filed as exhibits, completely and with the understanding that our actual future results may be materially different from what we expect.

Except as required by law, we assume no obligation to update these forward-looking statements publicly, or to update the reasons actual results could differ materially from those anticipated in these forward-looking statements, even if new information becomes available in the future.

NEOGENOMICS, INC

ITEM 1. BUSINESS

NeoGenomics, Inc., a Nevada corporation (referred to individually as the "Parent Company" or collectively with its subsidiaries as "NeoGenomics", "we", "us", "our" or the "Company" in this Annual Report) is the registrant for SEC reporting purposes. Our common stock is listed on the NASDAQ Capital Market under the symbol "NEO".

Overview

We operate a network of cancer-focused genetic testing laboratories in the United States as well as a laboratory in Switzerland. Our mission is to improve patient care through exceptional genetic and molecular testing services. Our vision is to become the World's leading cancer testing and information company by delivering uncompromising quality, exceptional service and innovative solutions.

As of December 31, 2017, the Company has laboratory locations in Ft. Myers and Tampa, Florida; Aliso Viejo and Fresno California; Houston, Texas; Nashville, Tennessee; and Rolle, Switzerland, and currently offers the following types of genetic and molecular testing services:

a) Cytogenetics - the study of normal and abnormal chromosomes and their relationship to disease. It involves looking at the chromosome structure to identify changes from patterns seen in normal chromosomes. Cytogenetic studies are often utilized to answer diagnostic, prognostic and predictive questions in the treatment of hematological malignancies.
b) Fluorescence In-Situ Hybridization ("FISH") - a branch of cancer genetics that focuses on detecting and locating the presence or absence of specific DNA sequences and genes on chromosomes. FISH helps bridge abnormality detection between the chromosomal and DNA sequence levels. The technique uses fluorescent probes that bind to only those parts of the chromosome with which they show a high degree of sequence similarity. Fluorescence microscopy is used to visualize the fluorescent probes bound to the chromosomes. FISH can be used to help identify a number of gene alternations, such as amplification, deletions, and translocations.
c) Flow cytometry - a rapid way to measure the characteristics of cell populations. Cells from peripheral blood, bone marrow aspirate, lymph nodes, and other areas are labeled with selective fluorescent antibodies and analyzed as they flow in a fluid stream through a beam of light. The properties measured in these antibodies include the relative size, relative granularity or internal complexity, and relative fluorescence intensity. These fluorescent antibodies bind to specific cell surface antigens and are used to identify malignant cell populations. Flow cytometry is typically performed in diagnosing a wide variety of leukemia and lymphoma neoplasms. Flow cytometry is also used to monitor patients through therapy to determine whether the disease burden is increasing or decreasing, otherwise known as minimal residual disease monitoring.
d) Immunohistochemistry ("IHC") and Digital Imaging – Refers to the process of localizing proteins in cells of a tissue section and relies on the principle of antibodies binding specifically to antigens in biological tissues. IHC is widely used in the diagnosis of abnormal cells such as those found in cancerous tumors. Specific surface cytoplasmic or nuclear markers are characteristic of cellular events such as proliferation or cell death (apoptosis). IHC is also widely used to understand the distribution and localization of differentially expressed proteins. Digital imaging allows clients to see and utilize scanned slides and perform quantitative analysis for certain stains. Scanned slides are received online in real time and can be previewed often a full day before the glass slides can be shipped back to clients.
e) Molecular testing - a rapidly growing cancer diagnostic tool focusing on the analysis of DNA and RNA, as well as the structure and function of genes at the molecular level. Molecular testing employs multiple technologies including DNA fragment length analysis, real-time polymerase chain reaction ("RT-PCR") RNA analysis, bi-directional Sanger sequencing analysis, and Next-Generation Sequencing ("NGS").

f) Pathology consultation - services provided for clients in which our pathologists review surgical samples on a consultative basis. NeoGenomics expert pathologists often assist our client pathologists on their most difficult and complex cases.

NEOGENOMICS, INC.

ITEM 1. BUSINESS (CONTINUED)

Operating Segments

We analyzed our reporting structure in 2017, including the information available to our Chief Operating Decision Maker and the information used to make strategic decisions. Prior to 2017, our operations were reported as one consolidated segment. Based on our 2017 analysis and due to changes made in the fourth quarter of 2017, we began reporting our operations in two segments; Clinical Services and Pharma Services.

In 2017, our Clinical Services segment accounted for 90% of consolidated revenues and our Pharma Services segment accounted for 10% of our consolidated revenues. For further financial information about these segments, see Note Q to our Consolidated Financial Statements included in this Annual Report.

Clinical Services Segment

The clinical cancer testing services we offer to community-based pathologists are designed to be a natural extension of, and complementary to, the services that they perform within their own practices. We believe our relationship as a non-competitive partner to community-based pathology practices, hospital pathology labs and academic centers empowers them to expand their breadth of testing and provide a menu of services that matches or exceeds the level of service found in any center of excellence around the world. Community-based pathology practices and hospital pathology labs may order certain testing services on a technical component only (“TC” or “tech-only”) basis, which allows them to participate in the diagnostic process by performing the professional component (“PC”) interpretation services without having to hire laboratory technologists or purchase the sophisticated equipment needed to perform the technical component of the tests. We also support our pathology clients with interpretation and consultative services using our own specialized team of pathologists for difficult or complex cases and provide overflow interpretation services when requested by clients.

In addition, we may directly serve oncology, dermatology, urology and other clinician practices that prefer to have a direct relationship with a laboratory for cancer-related genetic and molecular testing services. We typically service these types of clients with a comprehensive service offering where we perform both the technical and professional components of the tests ordered. In certain instances larger clinician practices have begun to internalize pathology interpretation services, and our “tech-only” service offering allows these larger clinician practices to also participate in the diagnostic process by performing the PC interpretation services on TC testing performed by NeoGenomics. In these instances NeoGenomics will typically provide all of the more complex, Molecular testing services.

Pharma Services Segment

Our Pharma Services segment supports pharmaceutical firms in their drug development programs by supporting various clinical trials and research. This portion of our business often involves working with the pharmaceutical firms (sponsors) on study design as well as performing the required testing. Our medical team often advises the sponsor and works closely with them as specimens are received from the enrolled sites. We also work on developing tests that will be used as part of a companion diagnostic to determine patients’ response to a particular drug. As studies unfold, our clinical trials team reports the data and often provide key analysis and insights back to the sponsors.

Our Pharma Services segment provides comprehensive testing services in support of our pharmaceutical clients' oncology programs from discovery to commercialization. In biomarker discovery, our aim is to help our customers discover the right content. We help our customers develop a biomarker hypothesis by recommending an optimal platform for molecular screening and backing our discovery tools with the informatics to capture meaningful data. In other pre and non-clinical work, we can use our platforms to characterize markers of interest. Moving from discovery to development, we help our customers refine their biomarker strategy and, if applicable, develop a companion diagnostic pathway using the optimal technology for large-scale clinical trial testing.

Whether serving as the single contract research organization or partnering with one, our Pharma Services team provides significant technical expertise, working closely with our customers to support each stage of clinical trial

NEOGENOMICS, INC.

ITEM 1. BUSINESS (CONTINUED)

development. Each trial we support comes with rapid turnaround time, dedicated project management and quality assurance oversight. We have experience in supporting submissions to the Federal Drug Administration ("FDA") for companion diagnostics. Our Pharma Services strategy is focused on helping bring more effective oncology treatments to market through providing world class laboratory services in oncology to key pharmaceutical companies in the industry.

Our Pharma Services revenue consists of three revenue streams:

- Clinical trials and research;
- Validation laboratory services; and
- Data services

Markets

The medical testing laboratory market can be broken down into three primary markets:

- Clinical Pathology testing;
- Anatomic Pathology testing; and
- Genetic and Molecular testing

Clinical Pathology testing covers high volume, highly automated, lower complexity tests on easily procured specimens such as blood and urine. Clinical lab tests often involve testing of a less urgent nature, for example, cholesterol testing and testing associated with routine physical exams.

Anatomic Pathology testing involves evaluation of tissue, as in surgical pathology, or cells as in cytopathology. The most widely performed Anatomic Pathology procedures include the preparation and interpretation of pap smears, skin biopsies, and tissue biopsies.

Genetic and molecular testing typically involves analyzing chromosomes, genes, proteins and/or DNA/RNA sequences for abnormalities. Genetic and molecular testing requires highly specialized equipment and credentialed individuals (typically M.D. or Ph.D. level) to certify results and typically yields the highest reimbursement levels of the three market segments.

NeoGenomics operates primarily in the Genetic and Molecular testing market. We also act as a reference laboratory supplying anatomic pathology testing. NeoGenomics typically does not compete in the Clinical Pathology testing market.

The field of cancer genetics is evolving rapidly and new tests are being developed at an accelerated pace. Based on medical and scientific discoveries over the last decade, cancer testing falls into one of three categories: diagnostic testing, prognostic testing and predictive testing. Of the three, the fastest growing area is predictive testing, which is utilized by clinicians to predict a patient's response to the various treatment options in order to deliver "personalized or precision medicine" that is optimized to that patient's particular circumstances. Personalized or precision medicine allows clinicians to know if a patient will or will not respond to certain medications like Herceptin, Keytruda and Opdivo. This saves the healthcare system money by ensuring that expensive cancer drugs are only given to those who will benefit from them. This type of testing improves patient care and potentially saves lives by identifying optimized

therapies much more rapidly than what was possible in previous years.

The United States market for genetic and molecular testing is divided among numerous laboratories. Many of these laboratories are attached to academic institutions and primarily provide clinical services to their affiliated university hospitals and associated physicians.

We believe several key factors are influencing the rapid growth in the market for cancer testing: (i) every year, more and more genes and genomic pathways are implicated in the development and/or clinical course of cancer; (ii) cancer is primarily a disease of the elderly - one in four senior citizens is likely to develop some form of cancer during the rest of their lifetime once they turn sixty, and now that the baby boomer generation has started to reach

NEOGENOMICS, INC.

ITEM 1. BUSINESS (CONTINUED)

this age range, the incidence rates of cancer are rising; (iii) increasingly, new drugs are being targeted to certain cancer subtypes and pathways which require companion diagnostic testing; (iv) patient and payer awareness of the value of genetic and molecular testing; (v) decreases in the cost of performing genetic and molecular testing; (vi) increased coverage from third party payers and Medicare for such testing; and (vii) the health insurance coverage to uninsured Americans under the Patient Protection and Affordable Care Act as amended by the Health Care and Education Reconciliation Act, each enacted in March 2010. These factors have driven significant growth in the market for this type of testing. We estimate a $12-14 billion total market opportunity for cancer testing in the United States, and we estimate that about $5-7 billion of this market is made up of genetic and molecular testing with the remaining portion derived from more traditional anatomic pathology testing services that are complementary to and often ordered with the genetic and molecular testing services we offer.

2018 Focus Areas: Strengthen Our World-Class Culture, Provide Uncompromising Quality and Pursue Exceptional Service and Growth

We are committed to being an innovative leader in our industry. Over the past year, we have grown our business domestically and have expanded our presence internationally. Our plans for 2018 include many initiatives to continue our strong organic growth by gaining market share and introducing new tests. In addition, we expect to realize growth from the expansion of our Pharma business in Europe as well as in the United States. We expect these initiatives to continue to position our Company to be the World's leading cancer testing and information company.

Strengthen Our World-Class Culture

Our belief is that a culture of motivated and engaged employees will deliver superior service to our clients. We are focused on continuing to strengthen our culture by improving teamwork, which will enable our Company to work more coherently and efficiently. We will also emphasize effective communication techniques through cross functional initiatives. We introduced initiatives and implemented targeted dialogue between management and employees in 2017 and will continue this going forward. Part of this initiative included selecting employees who were given the opportunity to talk to our CEO in a small group setting designed to foster two-way communication.

Communication is a key element in our high performance culture. Through effective communication we facilitate our employees' understanding of our Company's priorities and how they contribute to the Company's overall objectives. We believe our employee retention rate is above average for the laboratory industry and continuing to strengthen our culture will enable us to continually recruit and retain talented employees.

Enhancing our culture to closely align with the values of our Company is a key priority. We plan to implement Talent Success Profiles to develop leaders and ensure that we are creating opportunities for the development and mobility of our employees. We will focus on mentoring and training opportunities to enhance and capitalize on the talent within our Company. We believe these initiatives will foster a culture of accountability and empowerment. We also believe these initiatives are necessary to ensure the success of our Company.

Provide Uncompromising Quality

Maintaining the highest quality laboratory operations and service levels has enabled us to consistently grow our business. We have been successful in retaining clients while also gaining market share. Our initiatives for 2018 will promote continuous process improvement to ensure that we maintain our high level of quality within our organization.

We plan to continue to grow a culture of quality through company-wide leadership, training and employee engagement initiatives. Through training, we aim to empower our employees to understand the importance of quality and how to ensure quality in their respective function. We will challenge employees to identify quality issues and find solutions and will recognize individuals and teams for providing quality service. Through employee engagement, we will motivate our employees to exceed our client's expectations.

NEOGENOMICS, INC.

ITEM 1. BUSINESS (CONTINUED)

Our laboratory teams will focus on quality by improving corrective and preventative metrics in the laboratory. This is expected to result in increased product and process understanding, improvements in processes and increased efficiency. We also believe these improvements will enable us to continue reducing our cost per test.

In 2016, we began work on our next generation Laboratory Information System, or LIS, and have implemented this system in our Pharma Services business in 2017. We will continue to develop this system in 2018 and believe it will increase efficiency and productivity. It also improves the quality of our services by enabling our Pharma services clients the ability to track each step through the laboratory process.

Pursue Exceptional Service and Growth

We will continue to pursue market share gains by providing high complexity, cancer-related laboratory testing services to hospitals, community-based pathology practices, academic centers, clinicians, and Pharmaceutical companies in the United States and Europe. We will strive to improve our services and achieve long term profitable growth by developing cross functional teams to analyze the unique requirements of key market segments. We will engage our customers within these segments and analyze our strengths, weaknesses and threats to find ways to further drive growth and pursue excellent service. We will continue to seek customer feedback through our rigorous survey process, assess our customer's satisfaction with our services, and develop plans for improvement.

While our client retention rate is excellent, in 2018 we will focus on continuing to provide consistently high service levels while engaging our customers. In addition, we will work to maintain our broad and innovative test menu of molecular, immunohistochemistry, and other testing, which has helped make us a "one stop shop" for many clients who value that all of their testing can be sent to one laboratory.

Our plans for 2018 include reimbursement and legislative strategies to drive profitable growth. We are closely monitoring changes in legislation, are taking specific actions and establishing detailed plans to be prepared for possible changes in legislation.

We expect that our expansion into Europe will fuel profitable growth in our Pharma Services business in the long-term. In addition, we are currently expanding our laboratory facility in Houston, Texas due to increased demand for Pharma Services.

We will continue to look for growth opportunities through mergers and/or acquisitions and are focused on strategic opportunities that would be complementary to our menu of services and would increase our earnings and cash flow in the short to medium timeframe.

Competitive Strengths

Turnaround Times

In our Clinical Services segment, we strive to provide industry leading turnaround times for test results to our clients nationwide. By providing information to our clients in a rapid manner, physicians can begin treating their patients as soon as possible. We believe our historical average 4-5 day turnaround time for our cytogenetics testing services, 3-4

day turnaround time for FISH testing services, 7 day turnaround time for molecular testing, and 1 day turnaround time for flow cytometry and pathology testing services are industry leading benchmarks for national laboratories.

Our consistent timeliness of results is a competitive strength and a driver of additional testing requests by our referring physicians. Rapid turnaround times allow for the performance of other adjunctive tests within an acceptable diagnosis window in order to augment or confirm results and more fully inform treatment options. We believe that fast turnaround times are a key differentiator versus other national laboratories, and our clients often cite them as a key factor in their relationship with us.

Fast response time is also critical to customer satisfaction in our Pharma Services segment. We work with the sponsors to set up the studies quickly and to provide rapid turnaround on the testing results once the samples from the study enrollees arrive at the laboratory. Final transmissions of data are also critical to sponsors who are often working on their own submissions to the FDA for approval of drug compounds. We believe that our rapid turnaround time on testing and our project milestones are a key differentiator in the Pharma Services segment.

NEOGENOMICS, INC.

ITEM 1. BUSINESS (CONTINUED)

World-class Medical and Scientific Team

Our team of medical professionals and Ph.Ds. are specialists in the field of genetics, oncology and pathology. As of December 31, 2017, we employed, or contracted with approximately 30 full-time M.D.s and Ph.Ds. We have many nationally world renowned pathologists on staff, which is a key differentiator from many smaller laboratories. Our clinical customers look to our staff and their expertise and they often call our medical team on challenging cases. For our Pharma Services segment, many sponsors work with our medical team on their study design and on the interpretation of results from the studies. Again, our medical team is a key differentiator as we have a depth of medical expertise that many other laboratories cannot offer to Pharmaceutical companies.

Extensive Tech-Only Service Offerings

We believe that NeoGenomics currently has the most extensive menu of tech-only FISH services in the country as well as extensive and advanced tech-only flow cytometry and IHC testing services. These types of testing services allow the professional interpretation component of a test to be performed and billed separately by our physician clients. Our FISH, flow cytometry and other tech-only service offerings allow properly trained and credentialed community-based pathologists to extend their own practices by performing professional interpretations services, which allows them to better service the needs of their local clientele without the need to invest in the lab equipment and personnel required to perform the technical component of genetic and molecular testing.

Our tech-only services are designed to give pathologists the option to choose, on a case by case basis, whether they want to order just the technical information and images relating to a specific test so they can perform the professional interpretation, or order global services and receive a comprehensive test report which includes a NeoGenomics pathologist's interpretation of the test results. Our clients appreciate the flexibility to access NeoGenomics' medical staff for difficult or complex cases or when they are otherwise unavailable to perform professional interpretations. We believe this innovative approach to serving the needs of pathology clients' results in longer term, more committed client relationships that are, in effect, strategic partnerships. Our extensive tech-only service offerings have differentiated us and allowed us to compete more effectively.

Global Service Offerings

We offer a comprehensive suite of technical and interpretation services to meet the needs of those clients who are not credentialed and trained in interpreting genetic tests and who require pathology specialists to interpret the testing results for them. In our global service offerings, our lab performs the technical component of the tests and our M.D.s and Ph.Ds. provide the service of interpreting the results of those tests. Our professional staff is also available for post-test consultative services. Clients using our global service offering rely on the expertise of our medical team to give them the answers they need in a timely manner to help inform their diagnoses and treatment decisions. Many of our tech-only clients also rely on our medical team for difficult or challenging cases by ordering our global testing services on a case-by-case basis. Our medical team can serve as a backup to support our clients who need help to satisfy the continued and demanding requirements of their practice. Our reporting capabilities allow for all relevant case data from our global services to be captured in one summary report. When providing global services,

NeoGenomics bills for both the technical and professional component of the test, which results in a higher reimbursement level.

Client Education Programs

We believe we have one of the most extensive client education programs in the genetic and molecular testing industry. We train pathologists how to use and interpret genetic testing services so that they can better interpret technical data and render their diagnosis.

Our educational programs include an extensive library of on-demand training modules, online courses, and custom tailored on-site training programs that are designed to prepare clients to utilize our tech-only services. We offer

training and information on new cancer tests and the latest developments in the field of molecular genetic testing. Each year, we also regularly sponsor seminars and webinars on emerging topics of interest in our field. Our medical staff is involved in many aspects of our training programs.

Superior Testing Technologies and Instrumentation

We use some of the most advanced testing technologies and instrumentation in the laboratory industry. The use of next generation sequencing in our molecular testing allows us to detect multiple mutations and our proprietary techniques allow us to achieve high sensitivity in our next generation sequencing testing. In addition, we use high sensitivity Sanger sequencing, RNA and DNA quantification, SNP/Cytogenetic arrays, Fragment Length analysis, and other molecular testing technologies. Our automated FISH and Cytogenetics tools allow us to deliver the highest quality testing to our clients and our flow cytometry laboratory uses 10-color flow cytometry analysis technology on a technical-only basis. NeoGenomics is continually testing new laboratory equipment in order to remain at the forefront of new developments in the testing field.

Laboratory Information System

We believe we have a state-of-the-art LIS that interconnects our locations and provides flexible reporting solutions to clients. This system allows us to standardize testing and deliver uniform test results and images throughout our network, regardless of the location that any specific portion of a test is performed within our network. This allows us to move specimens and image analysis work between locations to better balance our workload. Our LIS also allows us to offer highly specialized and customizable reporting solutions to our tech-only clients. For instance, our tech-only FISH and flow cytometry applications allow our community-based pathologist clients to tailor individual reports to their specifications and incorporate only the images they select and then issue and sign-out such reports using our system. Our customized reporting solution also allows our clients to incorporate test results performed on ancillary tests not performed at NeoGenomics into summary report templates. This FlexREPORT feature has been well-received by clients.

National Direct Sales Force and Marketing

Our direct sales force has been trained extensively in cancer genetic testing and consultative selling skills to service the needs of clients. Our sales team for the clinical cancer testing services is organized into five regions (Northeast, Southeast, North Central, South Central and West), and we have a separate sales team for our Pharma Services division. These sales representatives utilize our custom Customer Relationship Management System (“CRM”) to manage their territories, and we have integrated all of the important customer care functionality within our LIS into the CRM so that our sales representatives can stay informed of emerging issues and opportunities within their regions. Our in-house customer care team is aligned with our field sales team to serve the needs of our clients by utilizing the same LIS and CRM. Our field teams can see in real-time when a client calls the laboratory, the reason for the call, the resolution, and if face-to-face interaction is needed for follow-up.

We continue to produce higher testing volumes and revenue due to our ongoing investment in sales and marketing. We have expanded the size of our sales team and are investing more in trade shows and in our overall marketing budget. We plan to continue to develop and execute strategic marketing plans throughout 2018.

Geographic Locations

Many high complexity laboratories within the cancer testing industry have operated a core facility on either the West Coast or the East Coast of the United States to service the needs of their customers around the country. We believe our clients and prospects desire to do business with a laboratory with national breadth and a local presence, and have developed our laboratory facility strategy accordingly. We have seven facilities, including three large laboratory locations in Fort Myers, Florida, Aliso Viejo, California, and Houston Texas. We also have four smaller laboratory locations in Fresno, California, Nashville, Tennessee, Tampa, Florida and Rolle, Switzerland. Our objective is to "operate one lab with multiple locations" in order to deliver standardized, high quality, test results. In November 2017, we opened a laboratory in Rolle, Switzerland where we are offering Pharma Services to international clients. In addition, due to growth in the Pharma Services segment, we are constructing a new, expanded laboratory in

NEOGENOMICS, INC.

ITEM 1. BUSINESS (CONTINUED)

Houston, Texas, which is a Pharma-first facility. In 2018, we are also opening a small laboratory facility in Atlanta, Georgia to offer rapid turnaround time testing to clients in that market. We intend to continue our growth and open new laboratories and/or expand our current facilities as market situations dictate and business opportunities arise.

Seasonality

The majority of our clinical testing volume is dependent on patients being treated by hematology/oncology professionals and other healthcare providers. The volume of our testing services generally declines modestly during the summer vacation season, year-end holiday periods and other major holidays, particularly when those holidays fall during the middle of the week. In addition, the volume of our testing tends to decline due to extreme adverse weather conditions, such as excessively hot or cold spells, heavy snow, hurricanes or tornados in certain regions, consequently reducing revenues and cash flows in any affected period. Therefore, comparison of the results of successive periods may not accurately reflect trends for future periods.

In our Pharma Services business, we enter into both short term and long term contracts, ranging from one month to several years. While the volume of this testing is not as directly affected by seasonality as described above, the testing volume does vary based on the terms of the contract. Many of our long term contracts contain specific performance obligations whereas the testing is performed on a specific schedule. This results in revenue that is not consistent among periods. In addition, this results in backlog that can be significant.

In the third quarter of 2017, our Houston, Texas laboratory was impacted by Hurricane Harvey and the resulting wide spread flooding in the area. While our facility was not damaged, many of our customers were unable to open for several days which impacted our business. A few weeks later our Fort Myers, Florida laboratory was impacted by Hurricane Irma. Our laboratory was not damaged and while power did go out in the area our generator kept power to our lab. Extensive power outages in the southern half of Florida did impact many of our customers who were unable to open for days after the storm had passed. The storms had a significant impact on our third quarter revenue.

Competition

For our Clinical Services segment, the genetic and molecular testing niche of the laboratory testing industry is highly competitive and, given the opportunities in this industry, we expect it to become even more competitive. Competitive factors in genetic and molecular testing generally include the reputation of the laboratory, range of services offered, pricing, convenience of sample collection and pick-up, quality of analysis and reporting, medical staff, timeliness of delivery of completed reports (i.e. turnaround times) and post-reporting follow-up for clients.

Our competitors for our Clinical Services segment in the United States are numerous and include major national medical testing laboratories, hospital laboratories and in-house physician laboratories. Our principal competitors are Quest Diagnostics and Laboratory Corporation of America. Some of our competitors have greater financial resources and production capabilities than us. These companies may succeed in developing service offerings that are more effective than any that we have or may develop, and may also prove to be more successful than we are in marketing such services. In addition, technological advances or different approaches developed by one or more of our competitors may render our service offerings obsolete, less effective or uneconomical.

We intend to continue our efforts to gain market share by offering industry-leading turnaround times, a broad service menu, high-quality test reports, new tests including proprietary ones, enhanced post-test consultation services, and the personal attention from our direct sales force. In addition, we believe our flexible reporting solutions, which enable clients to report out customized results in a secure, real-time environment, will allow us to continue to gain market share.

Our Pharma Services business competes against many other clinical research organizations and central reference laboratories. Many of these competitors are much larger and have a greater international presence than we do. Over the past year, we expanded our Pharma Services business into Europe at the request of our clients and believe that our state of the art testing menu and our high level of service along with our international expansion will allow us to continue to gain market share in this segment.

NEOGENOMICS, INC.

ITEM 1. BUSINESS (CONTINUED)

Our Pharma Services segment competitors are numerous Contract Resource Organizations or “CRO’s”. These include larger multi-national firms such as IQVIA, Covance, Parexcel and ICON. These competitors are larger than NeoGenomics and have global operations including operations in Asia, where we do not yet have service capabilities. These laboratories may be more effective than us in gaining business for global clinical trials. Many clinical reference laboratories have also entered the space in support of clinical trials and the related laboratory testing. These reference laboratories can often compete with lower pricing for smaller more limited studies. We believe our service focus and our leading Molecular and Immunohistochemistry platforms, as well as our exclusive MultiOmyx platform will continue to lead to rapid growth in this segment.

Suppliers

The Company orders its laboratory and research supplies from large national laboratory supply companies. We do not believe a short term disruption from any one of these suppliers would have a material effect on our business.

Dependence on Major Clients

We market our services to pathologists, oncologists, urologists, other clinicians, hospitals, pharmaceutical firms and other clinical laboratories throughout the United States and Europe. The Company’s client base consists of a large number of geographically dispersed clients diversified across various customer types. For the years ended December 31, 2017, 2016 and 2015, no single client accounted for more than 5% of revenue.

Payer Mix

The following table reflects our estimate of the breakdown of net clinical revenue by type of payer for the fiscal years ended December 31, 2017, 2016 and 2015:

	2017		2016		2015	
Medicare and other government	15	%	16	%	21	%
Commercial insurance	18	%	25	%	21	%
Client direct billing	64	%	56	%	55	%
Patient, other and year-end accruals	3	%	3	%	3	%
Total	100	%	100	%	100	%

Our proportion of client direct billing has increased over the years shown above, as more payers, including Medicare, private commercial insurances and Medicare Advantage plans, are practicing “consolidated payment” or “bundled payment” models where they pay the hospitals a lump sum, which is intended to include laboratory testing. This reflects an increase in the amount of risk sharing that CMS and other private payers are encouraging providers such as hospital systems to undertake. We anticipate a gradual increase in the percentage of client direct billing in the coming years.

Trademarks

The “NeoGenomics” and “Clarient” names and logos have been trademarked with the United States Patent and Trademark Office. We have also trademarked or have applications pending for the brand names NeoFISH, NeoFLOW, NeoSITE, NeoArray, NeoTYPE, NeoSCORE, NeoLAB and NeoLINK. We have also trademarked the marketing slogans, “When time matters and results count” and “Time matters, results count.”

Insurance

We maintain professional liability and numerous other insurance policies. We believe that our present insurance is sufficient to cover currently estimated exposures, but we cannot assure that we will not incur liabilities in excess of the policy coverage limits. In addition, although we believe that we will be able to continue to obtain adequate insurance coverage, we cannot assure that we will be able to do so at acceptable cost.

NEOGENOMICS, INC.

ITEM 1. BUSINESS (CONTINUED)

Available Information

Our internet website address is www.neogenomics.com. Our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports filed or furnished pursuant to section 13(a) or 15(d) of the Exchange Act are available free of charge through our website as soon as reasonably practicable after we electronically file with or furnish them to the SEC, and are available in print to any stockholder who requests a copy. Information on our website shall not be deemed incorporated into, or to be part of, this Annual Report on Form 10-K.

Additionally, the SEC maintains a website that contains reports, proxy statements, information statements and other information regarding issuers, including us, that file electronically with the SEC at www.sec.gov.

Number of Employees

As of December 31, 2017, we had approximately 1,000 full-time equivalent employees and contracted pathologists. The Company also had approximately 30 temporary contract personnel at December 31, 2017. Our employees are not represented by any union and we believe our employee relations are good.

Government Regulation

The laboratory business is subject to extensive governmental regulation at the federal, state and local levels. Our laboratories are required to be licensed by the states, certified by the federal government to participate in the Medicare and Medicaid programs, and are subject to extensive requirements as a condition of participation in various governmental health benefits programs. The failure to comply with any of the applicable federal and state laws, regulations, and reimbursement guidelines could have a material adverse effect on the Company's business. The applicable laws and regulations, and the interpretations of them, change frequently and there can be no assurance that the Company will not be subject to audit, inquiry, or investigation with respect to some aspect of its operations. Some of the federal and state laws and regulations are described below under "Clinical Laboratory Operations," "Anti-Fraud and Abuse Laws," "The False Claims Act," "Confidentiality of Health Information" and "Food and Drug Administration".

Clinical Laboratory Operations

Licensure and Accreditation

The Company operates clinical laboratories in Florida, Tennessee, Texas and California. The laboratories are licensed as required by the states in which they are located. In addition, the laboratories in Fort Myers, Florida, Aliso Viejo, California, and Nashville, Tennessee are licensed by the State of New York as they accept clinical specimens obtained in New York. All of our laboratories are certified in accordance with the Clinical Laboratory Improvement Amendments, as amended ("CLIA"). Under CLIA, the U.S. Department of Health and Human Services ("HHS") establishes quality standards for each category of testing performed by the laboratory. The categories of testing include waived, moderate complexity and high complexity. NeoGenomics' laboratories are categorized as high complexity. Four of the seven site locations for NeoGenomics' laboratories are also accredited by the College of American Pathologists ("CAP") and actively participate in CAP's proficiency testing programs for all tests offered by the

Company. Our Tampa, Florida and Fresno, California facilities are read-only laboratories and, therefore, wouldn't qualify for CAP accreditation. Our Houston, Texas location mainly supports Pharma Services and was recently approved for its CAP accreditation. Proficiency testing programs require the participating laboratories to test specimens that they receive from the testing entity and return the results. The testing entity, conducting an approved program, analyzes the results returned and provides to the Company a quality control report assessing the results. An important component of a quality assurance program is to establish whether the laboratory's test results are accurate and valid.

NEOGENOMICS, INC.

ITEM 1. BUSINESS (CONTINUED)

The federal and state certification and licensure programs establish standards for the operation of clinical laboratories, including, but not limited to, qualifications of personnel and quality control. Compliance with such standards is verified by periodic inspections by inspectors employed by federal and state regulatory agencies and accrediting organizations. The Company has a Quality Assurance Committee, which is comprised of representatives of all departments of the Company, conducts routine internal surveys and requires corrective action reports in response to the findings.

Quality of Care

Our mission is to improve patient care through quality cancer genetic diagnostic services. By delivering exceptional service and innovative solutions, we aspire to become the world's leading cancer and information company. The quality of care provided to clients and their patients is of paramount importance to us. We maintain quality control processes, including standard operating procedures, controls, performance measurement and reporting mechanisms. Our employees are committed to providing accurate, reliable and consistent services at all times. Any concerns regarding the quality of testing or services provided by the Company are immediately communicated to our Medical Team, Company management and, if necessary, the Director for Quality Systems, the Compliance Department or Human Resources Department. We also continually revise and improve our tests and work with laboratory equipment vendors to ensure that our laboratory has the highest possible quality.

Compliance Program

The health care industry is highly regulated and scrutinized with respect to fraud, abusive billing practices and improper financial relationships between health care companies and their referral sources. The Office of the Inspector General of HHS (the "OIG") has published compliance guidance, including the Compliance Program Guidance for Clinical Laboratories in August of 1998, and advisory opinions. The Company has implemented a robust Compliance Program, which is overseen by our Board of Directors. Its objective is to ensure compliance with the myriad federal and state laws, regulations and governmental guidance applicable to our business. Our program consists of training/education of employees and monitoring and auditing Company practices. The Board of Directors has formed a Compliance Committee of the Board, which meets regularly to discuss all compliance-related issues that may affect the Company. The Company reviews its policies and procedures as new regulations and interpretations come to light to comply with applicable regulations. The Chief Compliance Officer reports directly to the Compliance Committee.

Hotline

As part of its Compliance Program, the Company provides a hotline for employees who wish to anonymously or confidentially report suspected violations of our codes of conduct, policies/procedures, or laws and regulations. Employees are strongly encouraged to report any suspected violation if they do not feel the problem can be appropriately addressed through the normal chain of command. The hotline does not replace other resources available to our employees, including supervisors, managers and human resources staff, but is an alternative channel available 24 hours a day, 365 days a year. The hotline forwards all reports to the Compliance Officer who is responsible for investigating, reporting to the Compliance Committee, and documenting the disposition of each report. The hotline forwards any calls pertaining to the financial statements or financial issues to the Chairman of the Audit Committee. The Company does not allow any retaliation against an employee who reports a compliance related issue in good

faith.

Laboratory Developed Tests (“LDTs”):

The federal Food and Drug Administration (“FDA”) has regulatory responsibility over, among other areas, instruments, test kits reagents and other medical devices used by clinical laboratories to perform diagnostic testing. High complexity and CLIA-certified laboratories, such as ours, frequently develop internal testing procedures to provide diagnostic results to customers. These tests are referred to as laboratory developed tests (“LDTs”). LDTs are subject to CMS oversight through its enforcement of CLIA. The FDA has also claimed regulatory authority over all LDTs, but indicates that it has exercised enforcement discretion with regard to most LDTs offered by high

complexity CLIA-certified laboratories, and has not subjected these tests to FDA rules and regulations governing medical devices. However, the FDA has stated that it has been considering changes in the way it believes that laboratories ought to be allowed to offer these LDTs, and since 2010 publicly announced that it would be exercising regulatory authority over LDTs, using a risk-based approach that will direct more resources to tests with the highest risk of injury. In October 2014, the FDA published a draft guidance setting forth its proposed framework and timetable for regulating LTDs. The FDA received numerous comments both in support of and opposed to the draft guidance. In November 2016, FDA announced that it would not be finalizing the draft guidance. On January 13, 2017, FDA published a non-binding Discussion Paper to "advance the public discussion by providing a possible approach to spur further dialogue." The Discussion Paper sets forth a possible LDT regulatory approach where LDTs currently on the market would be exempt from FDA regulation except for adverse event and malfunction reporting, and regulation of new and modified LDTs would be phased in over four years, based on risk. It remains uncertain whether FDA's proposed approach will be adopted by the FDA or Congress. It is also uncertain what position the new administration will adopt with respect to LDTs. It is possible that the FDA could adopt a new policy, or Congress could enact new legislation, that may result in increased regulatory burdens for us to register and continue to offer our tests or to develop and introduce new tests, or modify existing tests and may increase our costs. We cannot be certain as to which of our tests would require FDA review and approval, and if approval was to be required, that our tests could obtain FDA approval.

The federal laws governing Medicare, Medicaid and other federal health benefits, as well as other state and federal laws, regulate certain aspects of the relationships between health care providers, including clinical laboratories, and their referral sources, including physicians, hospitals, other laboratories and other entities. We are subject to the federal Anti-Kickback Statute ("federal AKS"), as well as similar state statutes and regulations, which prohibit the offer, payment, solicitation or receipt of any form of remuneration in return for referring, ordering, leasing, purchasing or arranging for or recommending the ordering, purchasing or leasing of items or services payable by Medicare, Medicaid or any other federally funded healthcare program. The federal AKS defines remuneration to include anything of value, in cash or in kind, and thus can implicate financial relationships including payments not commensurate with fair market value, such as in the form of space, equipment leases, professional or technical services or anything else of value.

The federal AKS is an "intent based" statute, meaning that a violation occurs when one or both parties intend the remuneration to be in exchange for or to induce referrals. Violations of the federal AKS may result in substantial civil or criminal penalties, including criminal fines of up to $25,000, imprisonment of up to five years, civil penalties under the federal CMP Law of up to $50,000 for each violation, plus three times the remuneration involved, civil penalties under the federal False Claims Act of up to $11,000 for each claim submitted, plus three times the amounts paid for such claims and exclusion from participation in the Medicare and Medicaid programs.

Because of the broad proscriptions of the federal AKS, subsequent federal law required the HHS to publish regulations to guide the health care community in structuring relationships that would not violate the law. The OIG published regulations outlining certain categories of relationships between health care providers and persons or entities that may have a referral relationship that would be deemed not to violate the federal AKS. These regulations are known as the Safe Harbor Regulations (the "Safe Harbor Regulations") because persons who enter into transactions that comply with all of the criteria for an applicable safe harbor will not violate the AKS. The Safe Harbor Regulations are narrowly drafted to avoid inadvertently immunizing prohibited conduct. A relationship or transaction

that does not meet all of the criteria of an applicable Safe Harbor Regulation is not deemed to be illegal per se, rather it may be subject to additional scrutiny. The Company endeavors to comply with the Safe Harbor Regulations, but there can be no assurance that the Company would not be subject to investigation and, if investigated, that relationships could be found not to comply with the Safe Harbor Regulations.

Further, most states have adopted similar anti-kickback laws prohibiting the offer, payment, solicitation or receipt of remuneration in exchange for referrals, and typically impose criminal and civil penalties as well as loss of licenses. Some of these state laws apply to items and services paid for by private payers as well as to government payers. In addition, many states have adopted laws prohibiting the splitting or sharing of fees between physicians and non physicians, as well as between treating physicians and referral sources. We believe our arrangements with physicians comply with the federal AKS, and state anti-kickback and fee splitting laws of the states in which we operate, however, if government regulatory authorities were to disagree, we could be subject to civil and criminal

penalties, and be required to restructure or terminate our contractual and other arrangements with physicians. This could result in a loss of revenue and have a material adverse effect on our business.

Medicare Payment Guidelines

We have various billing arrangements with our clients and with third party payers, including the Medicare program. When the Company bills the client for all, or a portion of, a lab test performed, these client billing arrangements are priced competitively at fair market value. These client billing arrangements may implicate the prohibition of the Medicare program against charging the Medicare or Medicaid programs fees substantially in excess of the Company's usual and customary charges. These billing arrangements may also implicate the federal Stark Law and the federal and state anti-kickback statutes.

Federal law authorizes the Secretary of HHS to suspend or exclude providers from participation in the Medicare and Medicaid programs if providers charge Medicare or state Medicaid programs fees "substantially in excess" of their "usual charges." The OIG has stated in commentary to various final and proposed regulations its position that this statute has limited applicability to the current Medicare reimbursement system, though the OIG has also commented "we note that ancillary services, such as laboratory tests and drugs, would remain subject to these regulations, even when furnished by physicians." [F.R., Vol. 68, No. 178, September 15, 2003 at 53940]. As such, application of this prohibition to the Company's business is not clear, but the government could scrutinize the Company's pricing and billing arrangements and determine to apply this law.

The Centers for Medicare and Medicaid Services promulgated, in 2009, a revision to the regulation that prohibits the mark up of purchased diagnostic services [42 C.F.R. §414.50] (the "Anti-Markup Rule"). The Anti-Markup Rule prohibits a physician or other supplier from marking up the price paid for the technical or professional component of a diagnostic test that was ordered by the billing physician or supplier and which was performed by a physician who does not share a practice with the billing physician or supplier. The billing physician is prohibited from billing the Medicare program an amount greater than the lesser of: (i) the performing supplier's net charge to the billing physician; (ii) the billing physician's actual charge; or (iii) the fee schedule amount for the test that would be allowed if the performing supplier billed directly.

In light of the various federal regulations and guidance from the OIG, the Company seeks to price its products competitively while endeavoring to meet applicable statutes and regulations.

Physician Self-Referral Laws

The federal law referred to as the "Stark Law", named after U.S. Representative Fortney "Pete" Stark, prohibits physicians who have a financial relationship with an entity from referring Medicare and Medicaid patients to that entity for the provision of designated health services unless the transaction meets an exception to the law. A "financial relationship" includes both an ownership interest and/or a compensation arrangement with a physician, both direct and indirect, and DHS includes, but is not limited to, laboratory services.

The Stark Law prohibits an entity that receives a prohibited DHS referral from seeking payment from Medicare and Medicaid for any DHS services performed as a result of such a referral, unless an arrangement is carefully structure to

satisfy every requirement of a regulatory exception. The Stark Law is a strict liability statute, and thus any technical violation requires repayment of all "tainted" referrals, regardless of the intent. Penalties for violating the Stark Law may include the denial of payment to an entity for the impermissible provision of DHS, the requirement to refund any amounts collected in violation of the Stark Law, and civil monetary penalties of up to $15,000 for each violation and $100,000 for each circumvention arrangement or scheme. Other implications of a Stark Law violation may include criminal penalties, exclusion from Medicare and Medicaid programs, and potential False Claims Act liability, including via "qui tam" action. The Company endeavors to structure its financial relationships in compliance with the Stark Law and with similar state physician self-referral laws.

Further, many states have promulgated self referral laws and regulations similar to the federal Stark Law, but these vary significantly based on the state. For example, the Florida Patient Self-Referral Act of 1992, as amended, (the "Florida Self-Referral Act") is similar to the Stark law, but is narrower in some respects and broader in others. In

addition to services reimbursed by Medicaid or government payers, often these state laws and regulations can encompass services reimbursed by private payers as well. Penalties for violating state self-referral laws and regulations vary based on the state, but often include civil and criminal penalties, exclusion from Medicaid, and loss of licenses. Our financial arrangements with physicians are governed by the federal Stark Law and similar state self-referral laws, and we rely on certain exceptions to the Stark Law with respect to such relationships. While we believe that our financial relationships with physicians and referral practices are in compliance with applicable laws and regulations, we cannot guarantee that government authorities would agree. If we are found by the government to be in violation of the Stark Law or a similar state self-referral law, we could be subject to significant penalties, including fines as specified above, exclusion from participation in government and private payer programs and requirements to refund amounts previously received from government.

The False Claims Act

The federal False Claims Act prohibits any person or entity from knowingly presenting, or causing to be presented, to the U.S. government, or to a Medicare program contractor, a false or fraudulent claim for payment, or knowingly making or using a false record or statement to have a false claim paid by the government, or conspiring to defraud the U.S. government, or knowingly making or using a false statement to conceal an obligation to pay the government, or improperly retaining overpayments from, the government. A violation of the federal False Claims Act is punishable by a civil penalty of $5,500 to $11,000 for each separate false claim plus three times the amount of damages sustained by the government. Further, False Claims Act liability may lead to exclusion from participation in Medicare, Medicaid and other federal healthcare programs. The False Claims Act's "whistleblower" or "qui tam" provisions are being used with more frequency to challenge the reimbursement practices of providers and suppliers. Those provisions allow a private individual to bring an action on behalf of the government alleging that the defendant has submitted false claims for payment to the federal government. The government must decide whether to intervene in the lawsuit and whether to prosecute the case. If it declines to do so, the individual may pursue the case alone, although the government must be kept apprised of the progress of the lawsuit. Whether or not the federal government intervenes in the case, it will receive the majority of any recovery. The successful qui tam relator who brought the case is entitled to a portion of the proceeds and its attorneys' fees and costs. As most qui tam cases are filed by current or former employees, an effective compliance program plays a crucial role in reducing the Company's exposure to liability. It is also a criminal offense, under Title 18 U.S. Code, Section 287, for a person or entity to make a claim against the United States or any department or agency, knowing the claim to be false, fictitious or fraudulent. The penalty is a fine, and imprisonment of up to five years. The federal False Claims Act has been an effective enforcement tool for the federal government. Many states have enacted similar false claims acts as well.

The Company seeks to structure its arrangements with physicians and other clients to be in compliance with the Anti-Kickback Statute, Stark Law, state laws, and the federal False Claims Act and to stay abreast of current developments and changes in the law and regulations. However, these laws and regulations are complex and subject to interpretation. Consequently, we are unable to ascertain with certainty that any of our transactions will not be subject to scrutiny and, if scrutinized, will not result in sanctions or penalties. The Company has taken, and will continue to take, actions to endeavor to ensure compliance with the myriad federal and state laws that govern our business.

Confidentiality and Security of Personal Health Information

The Health Insurance Portability and Accountability Act of 1996, as amended ("HIPAA"), contains provisions that protect individually identifiable health information from unauthorized use or disclosure by covered entities and their business associates. The Office for Civil Rights of HHS, the agency responsible for enforcing HIPAA, has published regulations to address the privacy (the "Privacy Rule") and security (the "Security Rule") of protected health information ("PHI"). The Company is a covered entity under HIPAA and has adopted policies and procedures to comply with the Privacy Rule and the Security Rule and HIPAA statute. The health care facilities and providers that refer specimens to the Company are also bound by HIPAA. HIPAA also requires that all providers who transmit claims for health care goods or services electronically utilize standard transaction and data sets and to standardize national provider identification codes. The Company has taken necessary steps to comply with HIPAA regulations,

NEOGENOMICS, INC.

ITEM 1. BUSINESS (CONTINUED)

utilizes standard transaction data sets, and has obtained and implemented national provider identifiers, or NPIs, as the standard unique health identifier in filing and processing health care claims and other transactions.

The American Recovery and Reinvestment Act ("ARRA") recently enacted the HITECH Act which extends the scope of HIPAA to permit enforcement against business associates for a violation, establishes new requirements to notify the Office for Civil Rights of HHS of a breach of HIPAA, and allows the Attorneys General of the states to bring actions to enforce violations of HIPAA. Rules implementing various aspects of HIPAA are continuing to be promulgated. With respect to these rules, commencing July 1, 2012, CMS required all HIPAA-covered entities such as the Company to conduct electronic claim submissions and related electronic transactions under a new HIPAA transaction standard called Version 5010.

In addition to the HIPAA Privacy Rule and Security Rule described above, the Company is subject to state laws regarding the handling and disclosure of patient records and patient health information. These laws vary widely. Penalties for violation include sanctions against a laboratory's licensure as well as civil or criminal penalties. Additionally, private individuals may have a right of action against the Company for a violation of a state's privacy laws. We believe we are in material compliance with current state laws regarding the confidentiality of health information and will continue to monitor and comply with new or changing state laws.

The Fair and Accurate Credit Transactions Act of 2003, enacted on Dec. 4, 2003, directed the Federal Trade Commission to implement regulations to protect consumers against identity theft. The Federal Trade Commission issued what are referred to as the "Red Flag Rules", but the effective date for enforcement has been delayed several times. The Red Flag Rules are now subject to enforcement as of January 1, 2012. The Red Flag Program Clarification Act of 2010 ("RFPCA") gave some relief to health care providers by changing the definition of "creditor", thereby narrowing the application to health care providers who do not otherwise obtain or use consumer reports or furnish information to consumer reporting agencies in connection with a credit transaction. Health care providers who act as a "creditor" to any of its patients with respect to a "covered account" are required to implement an identity theft protection program to safeguard patient information. A creditor includes any entity that regularly in the course of business obtains or uses consumer reports in connection with credit transactions, furnishes information to a consumer reporting agency in connection with a credit transaction, or advances funds to or on behalf of a person based on the person's obligation to repay the funds or repayable from specific property pledged by or on behalf of the person. But, a creditor, as defined in the RFPCA, that advances funds on behalf of a person for expenses incidental to a services provided by the creditor to that person is not subject to the Red Flag Rules. The Company has developed a written program designed to identify and detect the relevant warning signs – or "red flags" – of identity theft and establish appropriate responses to prevent and mitigate identity theft in order to comply with the Red Flag Rules. We are also developing a plan to update the program, and the program will be managed by senior management staff under the policy direction of our Board of Directors. The Company intends to take such steps as necessary to determine the extent to which the Red Flag Rules apply to it and to take such steps as necessary to comply.

NEOGENOMICS, INC.

ITEM 1. BUSINESS (CONTINUED)

Executive Officers of the Company

The following table sets forth certain information regarding members of the Board of Directors and our executive officers as of March 1, 2018:

Name	Age	Position
Board of Directors:		
Douglas M. VanOort	62	Chairman of the Board of Directors and Chief Executive Officer
Steven C. Jones	54	Executive Vice President, Chief Compliance Officer, Board Member
Kevin C. Johnson	63	Board Member
Raymond R. Hipp	75	Board Member
Bruce K. Crowther	66	Board Member
William J. Robison	82	Board Member
Lynn A. Tetrault	55	Board Member
Alison L. Hannah	57	Board Member
Stephen Kanovsky	55	Board Member
Other Executives:		
George A. Cardoza	56	Senior Vice President, Chief Financial Officer
Dr. Maher Albitar	62	Senior Vice President, Chief Medical Officer and Director of Research & Development
Dr. Steven Brodie	57	Vice President of Operations
Robert J. Shovlin	47	President, Clinical Services Division
Steven A. Ross	53	Vice President, Chief Information Officer
Jennifer M. Balliet	40	Vice President, Chief Culture Officer
Kathryn B. McKenzie	33	Principal Accounting Officer and Vice President of Finance

Members of the Company’s Board of Directors are elected at the annual meeting of stockholders and hold office until their successors are elected. The Company’s officers are appointed by the Board of Directors and serve until their resignation or removal by the Board and are subject to employment agreements, if any, approved and ratified by the Board. There are no family relationships between any of our officers or directors.

In addition, pursuant to the Investor Board Rights, Lockup and Standstill Agreement dated December 30, 2015, GE Medical Systems has the right to designate one individual for approval and we are required to appoint such designee, as a director to our Board of Directors. Kieran Murphy, President and Chief Executive Officer of GE Healthcare Life Sciences was appointed to the Board pursuant to such agreement. In 2017, Kieran Murphy was appointed President and Chief Executive Officer of GE Healthcare, a business unit of General Electric and resigned his role on the Board. Stephen Kanovsky was appointed to serve as a member of the Board effective immediately to fill the vacancy created by Mr. Murphy’s resignation.

Douglas M. VanOort, – Chairman of the Board of Directors and Chief Executive Officer

Mr. VanOort has served as the Chairman of the Board of Directors and Chief Executive Officer of NeoGenomics since October 28, 2009. For seven months prior to October 2009, he served as Chairman of the Board of Directors, Executive Chairman and Interim Chief Executive Officer. Prior to joining NeoGenomics, Mr. VanOort was a General Partner with a private equity firm, and a Founding Managing Partner of a venture capital firm. From 1982 through 1999, Mr. VanOort served in various positions at Corning Incorporated and at its spin-off company, Quest Diagnostics, Inc. During the period from 1995 through 1999, he served as the Senior Vice President Operations for Quest Diagnostics, Inc. which was then a $1.5 billion newly formed NYSE-traded Company. During the period of 1989 to 1995, he held senior executive positions at Corning Life Sciences, Inc., including Executive Vice President. Corning Life Sciences Inc. had revenues of approximately $2 billion and was spun-off in a public transaction to create both Quest Diagnostics and Covance, Inc. From 1982 to 1989, Mr. VanOort served in various executive positions at Corning Incorporated, including Director of Mergers & Acquisitions. Mr. VanOort currently serves as a member of the Board of Directors of several privately-held companies, and is a principal owner of a privately-held retail hardware store chain. Mr. VanOort is a graduate of Bentley University.

Steven C. Jones – Executive Vice President, Chief Compliance Officer, Board Member

Mr. Jones served as a director since October 2003, as Executive Vice President since November 4, 2016, and as Chief Compliance Officer since February 7, 2013. Mr. Jones served as Chief Financial Officer for the Company from October 2003 until November 30, 2009, and was Executive Vice President – Finance from November 30, 2009 to November 4, 2016. Mr. Jones is also the founder and Chairman of the Aspen Capital Group, a private equity investment firm, and has been President and Managing Director of Aspen Capital Advisors since January 2001. Prior to that Mr. Jones was a chief financial officer at various public and private companies and was a Vice President in the Investment Banking Group at Merrill Lynch & Co. Mr. Jones received his B.S. degree in Computer Engineering from the University of Michigan in 1985 and his MBA degree from the Wharton School of the University of Pennsylvania in 1991. He also serves as Chairman of the Board of T3 Communications, Inc. and he is a member of the Board of XG Sciences, Inc. and ERP Maestro, Inc.

Kevin C. Johnson – Board Member

Mr. Johnson has served as a director since 2010. Mr. Johnson was the Chief Executive Officer for United Allergy Services, a provider of allergy testing and immunotherapy services, from September 2014 through July 2015. From January 2003 until September 2014 Mr. Johnson was retired. From May 1996 until January 2003, Mr. Johnson was Chairman, Chief Executive Officer and President of DIANON Systems, Inc., a publicly-traded cancer diagnostic services company providing anatomic pathology and molecular genetic testing services to physicians nationwide. During that time, DIANON grew annual revenues from approximately $56 million in 1996 to approximately $200 million in 2002. DIANON was sold to Laboratory Corporation of America (NYSE: LH) in January of 2003. Prior to joining DIANON in 1996, Mr. Johnson was employed by Quest Diagnostics and Quest's predecessor, the Life Sciences Division of Corning, Incorporated, for 18 years, and held numerous management and executive level positions.

Raymond R. Hipp – Board Member

Mr. Hipp has served as a director since February 2011. Mr. Hipp is a retired senior executive that has been involved in consulting work over the last few years involving mergers and acquisitions as well as serving on the Board of Directors for several public companies. From July 1998 until his retirement in June 2002, Mr. Hipp served as Chairman, President and CEO of Alternative Resources Corporation, a provider of information technology outsourcing services. From August 1996 until May 1998, Mr. Hipp was the Chief Executive Officer of ITI Marketing Services, a provider of marketing services. Prior to that, Mr. Hipp held senior executive positions with several other firms. Mr. Hipp has a B.S. from Southeast Missouri State University. Mr. Hipp served on the Board of Directors and on the Audit Committee of Gardner Denver, Inc. (NYSE: GDI), an industrial manufacturing company, for over 14 years.

Bruce K. Crowther – Board Member

Mr. Crowther has served as a Director since October 2014. Mr. Crowther retired in 2013 as President and Chief Executive Officer of Northwest Community Healthcare where he served for 23 years. Northwest Community Healthcare is an award winning hospital offering a complete system of care. Mr. Crowther has a B.S. in Biology and

an M.B.A. from Virginia Commonwealth University. Mr. Crowther serves on the Board of Directors of Wintrust Financial Corporation, a public company and serves on the Board of Directors of Barrington Bank and Trust which is a Wintrust Financial Corporation owned Company. He was previously the Chairman and currently a Director of the Max McGraw Wildlife Foundation; a not for profit organization committed to conservation education and research.

William J. Robison – Board Member

Mr. Robison has served as a director since May 2007. Mr. Robison, who is retired, spent his entire 41 year career with Pfizer, Inc. At Pfizer, he rose through the ranks of the sales organization and became Senior Vice President of Pfizer Labs in 1986. In 1990, he became General Manager of Pratt Pharmaceuticals, a then new division of the U.S. Pharmaceuticals Group, and in 1992 he became the President of the Consumer Health Care Group. In 1996 he

became a member of Pfizer's Corporate Management Committee and was promoted to the position of Executive Vice President and head of Worldwide Corporate Employee Resources. Mr. Robison retired from Pfizer in 2001. Mr. Robison was previously a board member of the University of Louisiana – Monroe, MWI Veterinary Supply Company, Inc., USO of Metropolitan New York, Inc., the Human Resources Roundtable Group, the Pharmaceutical Human Resource Council, the Personnel Round Table, and the Employee Relations Steering Committee for The Business Round Table. Mr. Robison was also a founding member of the Marine Corps Museum.

Lynn A. Tetrault – Board Member

Ms. Tetrault has served as a director since June 2015. Ms. Tetrault is founder and principal of Anahata Leadership, an advisory firm focused on supporting the leadership effectiveness and development of executive women. She worked from 1993 to 2014 with AstraZeneca, PLC most recently as Executive Vice President Human Resources and Corporate Affairs. Ms. Tetrault was responsible for all human resources strategy, talent management, executive compensation and related activities, internal and external communications, government affairs, corporate reputation and corporate social responsibility for the Company. Ms. Tetrault has an undergraduate degree from Princeton University and a J.D. from the University of Virginia Law School.

Alison L. Hannah – Board Member

Dr. Hannah has served as a director since June 2015. Dr. Hannah has over 25 years' experience in the development of investigational cancer chemotherapies. Since 2000, she has served as a consultant to the pharmaceutical industry, working with over 20 companies with a focus on molecularly targeted therapy. Prior to this, she worked as Senior Medical Director at SUGEN on various compounds, including Sutent approved in kidney cancer, and Quintiles, a global Contract Research Organization. Dr. Hannah specializes in clinical development strategy, and has filed over 30 Investigational New Drug applications for new molecular entities and 7 New Drug Applications. She participates in Data Monitoring Committees, Scientific Advisory Boards and Independent Review Committees for clinical trials. She has a bachelor's degree in biochemistry and immunology from Harvard University and her medical degree from the University of Saint Andrews. She is a member of ASCO, AACR, ASH, ESMO and a Fellow with the Royal Society of Medicine.

Stephen Kanovsky – Board Member

Mr. Kanovsky is General Counsel, Global Innovation of GE Healthcare, a business unit of General Electric that provides medical technologies and solutions to the global healthcare industry and supports customers in over 100 countries with a broad range of services and systems, from diagnostic imaging and healthcare IT through to molecular diagnostics and life sciences. Mr. Kanovsky has over 23 years of legal experience in the global life sciences and biotechnology industry. Mr. Kanovsky earned his bachelor's degree in 1984 from the University of Pennsylvania. He subsequently graduated from Temple University's School of Pharmacy with a master's degree in Pharmacology and Temple University's School of Law with a juris doctorate degree. Mr. Kanovsky also holds a master's degree in business administration from Saint Joseph's University's Haub School of Business.

George A. Cardoza – Senior Vice President, Chief Financial Officer

Mr. Cardoza has served as Chief Financial Officer since November 2009. Prior to that from March 2008 to November 2009, Mr. Cardoza served as the Chief Financial Officer of Protocol Global Solutions, Inc., a privately held international marketing company. Mr. Cardoza also served as the Controller of Protocol Global Solutions from March 2006 to March 2008. From April 1991 to March 2006, Mr. Cardoza was employed by Quest Diagnostics Inc., a diagnostic testing, information and services company, in a number of positions, including the position of Controller—Central Region from 2001 to March 2006. At Quest Mr. Cardoza was responsible for overseeing all the financial operations of the Central Region, which had revenue of over $1.2 billion in 2006. Prior to his time with Quest, he worked for Sony Music Entertainment Inc. and the Continental Grain Company in various financial roles. Mr. Cardoza received his B.S. from Syracuse University in finance and accounting and has received his M.B.A. from Michigan State University.

NEOGENOMICS, INC.

ITEM 1. BUSINESS (CONTINUED)

Maher Albitar, M.D. – Senior Vice President, Chief Medical Officer and Director of Research and Development

Dr. Albitar has served as Chief Medical Officer and Director of Research and Development since January 2012. From 2008 to 2011, Dr. Albitar served as the Medical Director for Hematopathology and Oncology, Nichols Institute of Quest Diagnostics, and Chief R&D Director for Hematopathology and Oncology for Quest Diagnostics, a diagnostic testing, information and services company. From 2003 to 2008, Dr. Albitar served as the Director of Hematopathology for the Nichols Institute of Quest Diagnostics. From 2005 to 2011, Dr. Albitar also served as a Board member of Associated Diagnostics Pathologists, Inc. From 1991 to 2003, Dr. Albitar held various faculty positions at The University of Texas MD Anderson Cancer Center. Dr. Albitar previously served as the Chief Medical Officer of Health Discovery Corporation ("HDC") and a member of the Board of Directors of HDC. Dr. Albitar has also served as a consultant to multiple companies. Dr. Albitar received his medical degree in 1979 from Damascus Medical School in Damascus, Syria. Dr. Albitar has co-authored approximately 300 peer reviewed articles, chapters and reviews.

Steven G. Brodie, Ph.D. – President, Pharma Services Division

Dr. Brodie has served as the President of our Pharma Services Division since September, 2016. Prior to this he had served as Chief Scientific Officer of NeoGenomics since April 2015. Dr. Brodie is also the Laboratory Director for our Fort Myers, FL lab facility, a role he has held since 2014. He also has served as our Director of Molecular Genetics and Cytogenetics since 2011. Prior to joining NeoGenomics, Dr. Brodie served as a Senior Director of Cytogenetics, Assistant Director of Molecular Genetics, and Scientific Director of Maternal Serum Screening at Quest Diagnostics (Specialty Laboratories) in Valencia Ca. In addition to his clinical responsibilities, he trained Pathology residents in genetic testing for Loma Linda University Medical Center as the Affiliate Rotation Director and the University of Southern California, Keck SOM as a Clinical Assistant Professor of Pathology. Prior to joining Quest Diagnostics, he held a variety of research and clinical positions at the National Institutes of Health, University of New Mexico School of Medicine, and the University of California Los Angeles David Geffen School Of Medicine. Dr. Brodie was trained in Genetics at the University of California Los Angeles/Cedar-Sinai Medical Center medical genetics training program. He received a Ph.D. in Biomedical Sciences from the University of New Mexico School of Medicine and Clinical Molecular Genetics and Cytogenetics training at the University of California Los Angeles. Dr. Brodie is Board Certified by the American Board of Medical Genetics and Genomics and holds Directors Licenses in California, Florida, Tennessee, and New York.

Robert J. Shovlin – President, Clinical Services Division

Mr. Shovlin has served as the President of our Clinical Services Division since September, 2016. Prior to this, he had served as our Chief Growth Officer since the acquisition of Clarient Inc. ("Clarient") in 2015. From his hire date in October 2014 until the Clarient acquisition, Mr. Shovlin served as the Chief Operating Officer of NeoGenomics. From 2012 until October 2014, Mr. Shovlin served as Chief Development officer for Bostwick Laboratories, a provider of anatomic pathology testing services targeting urologists and other clinicians, where he was responsible for Sales, Marketing, Managed Care, Business Development, and Clinical Trials. From 2005 until 2011, he served in progressively more responsible positions, including President and Chief Executive Officer, for Aureon Biosciences, Inc., a venture-backed diagnostics company focused on developing novel and proprietary prostate cancer tests. Mr. Shovlin also served as Executive Director for Anatomic Pathology and Director of Managed Care for Quest

Diagnostics from 2003 until 2005, and held sales leadership positions at Dianon Systems from 1997 until 2003. Mr. Shovlin served as a Captain, Infantry Officer in the United States Marine Corps from 1992 until 1997 where he served as a Platoon and Company Commander with 1st Battalion 4th Marines and as an Instructor and Staff Platoon Commander at the Basic School. He holds a Bachelor of Science Degree from Pennsylvania State University, and a Masters of Business Administration from Rutgers University.

Steven A. Ross – Vice President, Chief Information Officer

Mr. Ross has served as Chief Information Officer since April 2013. Prior to joining the Company, Mr. Ross served as Vice President Technology at Chico's FAS, Inc. during the period from 2003 to 2013 where he participated in the direction of all information technology resource planning, budgeting, technology associate development coaching and operation initiatives for the $2.5 billion dollar global consumer products company. Prior to that Mr. Ross

worked for Zinn Corporation as a Project Director, assisting Target Inc. Mr. Ross has his Bachelor of Science from New Mexico State University.

Jennifer M. Balliet – Vice President, Chief Culture Officer

Ms. Balliet has served as our Chief Culture Officer since September, 2016. Prior to that, she had served as our Vice President of Human Resources since April 2015. Ms. Balliet joined NeoGenomics in 2008 and has steadily increased her responsibilities and was previously serving as Director of Human Resources. During her time with NeoGenomics, she managed the Human Resources process as the Company grew from 100 employees to approximately 1,000 employees. As Vice President of Human Resources, Ms. Balliet has responsibility for all areas of our Human Resources including recruiting, training, development, compensation, incentive plans and organizational development. Ms. Balliet received her B.S. degree in Psychology and M.S. degree in Business Management from the University of Florida.

Kathryn B. McKenzie – Principal Accounting Officer and Vice President of Finance

Ms. McKenzie has served as our Principal Accounting Officer and Vice President of Finance since October 2017. Prior to joining the Company, Ms. McKenzie served at Chico’s FAS, Inc. in various roles including Assistant Controller and Director of Financial Reporting and Treasury. Ms. McKenzie also previously served as Audit Manager for Ernst and Young. Ms. McKenzie is a Certified Public Accountant and holds a Master’s of Science in Accountancy from the University of North Carolina Wilmington.

NEOGENOMICS, INC

ITEM 1A. RISK FACTORS

We are subject to various risks that may materially harm our business, financial condition and results of operations. They are not, however, the only risks we face. Additional risks and uncertainties not presently known to us or that we currently believe not to be material may also adversely affect our business, financial condition or results of operations. An investor should carefully consider the risks and uncertainties described below and the other information in this filing before deciding to purchase our common stock. If any of these risks or uncertainties actually occurs, our business, financial condition or operating results could be materially harmed. In that case, the trading price of our common stock could decline or we may be forced to cease operations.

Risks Relating to Our Business

Our business is subject to rapid scientific change, which could have a material adverse effect on our business, results of operations and financial condition.

The market for genetic and molecular testing services is characterized by rapid scientific developments, evolving industry standards and customer demands, and frequent new product introductions and enhancements. For example, new tests developed by our competitors may prove superior and replace our existing tests. Our future success will depend in significant part on our ability to continually improve our offerings in response to both evolving demands of the marketplace and competitive service offerings, and we may be unsuccessful in doing so which could have a material adverse effect on our business, results of operations and financial condition. Certain technological changes such as advances in point-of-care testing, could reduce the need for the laboratory tests we provide.

The market for our services is highly competitive, which could have a material adverse effect on our business, results of operations and financial condition.

The market for genetic and molecular testing services is highly competitive and we expect competition to continue to increase. We compete with other commercial clinical laboratories in addition to the in-house laboratories of many major hospitals and physician practices. Many of our existing competitors have significantly greater financial, human, technical and marketing resources than we do. Some physician groups and hospitals have decided to internalize testing rather than use an outsourced laboratory such as our Company. Our competitors may develop products and services that are superior to ours or that achieve greater market acceptance than our offerings. We may not be able to compete successfully against current and future sources of competition and in such cases, this may have a material adverse effect on our business, results of operations and financial condition.

Proposed government regulation of LDTs may result in delays to launching certain laboratory tests and increase our costs to implement new tests.

We frequently develop testing procedures to provide diagnostic results to clients that cannot currently be provided using test kits approved or cleared by the FDA. The FDA has been considering changes to the way that it regulates these LDTs. Currently all LDTs are conducted and offered in accordance with the CLIA, and individual state licensing procedures. The FDA has published a draft guidance document that would require FDA clearance or approval of a subset of LDTs, as well as a modified approach for some lower risk LDTs that may require FDA oversight short of the full premarket approval or clearance process. Congress may enact legislation to provide a regulatory framework for the FDA's role with regard to LDTs. As a result, there is a risk that the FDA's proposed regulatory process could delay the offering of certain tests and result in additional validation costs and fees. There is also an associated risk for us that some tests currently offered might become subject to FDA premarket approval or clearance. This FDA approval or

clearance process may be time-consuming and costly, with no guarantee of ultimate approval or clearance.

On July 31, 2014 the FDA issued a notification to Congress of the "Anticipated Details of the Draft Guidance for Industry, Food and Drug Administration Staff, and Clinical Laboratories: Framework for Regulatory Oversight of Laboratory Developed Tests," or the Draft LDT Guidance. As described in this notification, the FDA planned to provide draft guidance to clinical laboratories that develop their own LDTs regarding how the FDA intends to regulate such laboratories under the Federal Food, Drug, and Cosmetic Act. On October 3, 2014 the FDA issued the draft guidance to clinical laboratories. The regulatory framework will use a risk-based approach to enforce the FDA's premarket review requirements, and for high-risk tests, the framework may require laboratories to use FDA-

approved tests, if available, rather than LDTs. If implemented, the framework outlined in the Draft LDT Guidance may also require us to obtain premarket clearance or approval for certain of our LDTs. Implementation of this framework would include a lengthy phase-in period ranging from two to nine years depending on the risk assessment rating of each particular test. The FDA provided an opportunity for public comment through February 2015 and received numerous public comments in response to the Draft LDT Guidance. In January 2017 the FDA announced that it would not issue a final guidance on the oversight of LDTs at the request of various stakeholders to allow for further public discussion on an appropriate oversight approach, and to give congressional authorizing committees the opportunity to develop a legislative solution. At the same time, Congress, the FDA, and various industry stakeholders have worked to provide recommendations for comprehensive reform of LDAs. Recently, Congress has submitted a legislative discussion draft, the Diagnostic Accuracy and Innovation Act ("DAIA") to the FDA and requested technical assistance on the draft. However, it remains unknown whether the regulatory framework ultimately implemented by the FDA will differ substantially from the framework described in the Draft LDT Guidance or in the DAIA. This FDA regulation may result in increased regulatory burdens for us to register and continue to offer our tests or to develop and introduce new tests and may increase our costs. We do not yet know which of our tests would be classified as high-risk and would require a full FDA approval. If such approval was required, we cannot be certain that our tests would obtain FDA approval or clearance.

In the event that, in the future, the FDA and/or congressional authorizing committees begin to regulate our tests, it could require a significant volume of applications with the FDA and/or document responses to congressional authorizing committees which would be burdensome and the FDA and/or congressional authorizing committees could take a long time to review such applications and/or document responses if every lab in the country files a large volume of applications and/or document responses for each of their LDTs.

In November of 2017, CMS initiated a national coverage analysis for the use of Next Generation Sequencing "NGS" diagnostic tests for patients with advanced cancer. The proposed decision memo was released and open to a public comment period. Through this national coverage analysis, CMS is considering making changes to reimbursement for NGS testing which once finalized could directly affect our revenue for this test type.

Healthcare reform programs may impact our business and the pricing we receive for our services.

In March of 2010, health care reform legislation known as the "Patient Protection and Affordable Care Act," also known as the ACA, was passed into law. The ACA also makes changes that are expected to significantly impact the pharmaceutical and medical device industries and clinical laboratories. For example, effective December 31, 2017, each medical device manufacturer must pay sales tax in an amount equal to 2.3% of the price for which such manufacturer sells its medical devices that are listed with the FDA. Although the FDA issued Draft LDT Guidance that, if finalized, would regulate certain clinical laboratory tests that are developed and validated by a laboratory for its own use, or LDTs, as medical devices, none of our LDTs such as our prostate cancer test are currently listed with the

FDA. We cannot assure you that the tax will not apply to services such as ours in the future.

The ACA contains several provisions that seek to limit Medicare spending in the future. One key provision in the ACA is the establishment of "Accountable Care Organizations," or ACOs, under which hospitals and physicians are able to share savings that result from cost control efforts. We cannot predict how the continued establishment and implementation of these new business models will impact our business. There is the possibility that these organizations will seek to lower reimbursement for the services we provide and some may potentially restrict access to our services. We may not be able to gain access into certain ACOs. These changes could have an adverse and material impact on our operations. In furtherance of health care reform and the reduction in health care expenditures, the ACA contains numerous provisions to be implemented through 2018. There can be no assurance at this time that the implementation of these provisions will not have a material adverse effect on our business.

The ACA provided for states to create health insurance "Marketplaces" where individuals can compare and enroll in Qualified Health Plans, or QHPs. Individuals with an income less than 400% of the federal poverty level that purchase insurance on a Marketplace may be eligible for federal subsidies to cover a portion of their health insurance premium costs and cost sharing of co insurance or co pay obligations. Our patients may be enrolled in QHPs, and we may begin to submit bills to QHPs for services we provide. The presence of federal funds in QHPs in

the form of subsidies and cost-sharing may subject providers to heightened government attention and enforcement, which could significantly increase the cost of compliance and could materially impact our operations. For example, it is not clear whether the availability of these federal subsidies classifies a QHP as a federal healthcare program, particularly for purposes of federal fraud and abuse laws. In letters published on October 30, 2013 and February 6, 2014, the former Secretary of the Department of Health & Human Services, or DHHS, Kathleen Sebelius, indicated that DHHS does not consider QHPs to be federal healthcare programs. However, a judge may not agree with this statement by Secretary Sebelius, and other government regulators, including, but not limited to the current of future Secretary of the DHHS, may take a different position. For example, subsequent letters from U.S. Senator Charles Grassley to Secretary Sebelius and Attorney General Eric Holder on November 7, 2013 and February 12, 2014 indicate that this issue remains an outstanding question. If QHPs are classified as federal healthcare programs, it could significantly increase our costs of compliance.

In January 2017, Congress voted to adopt a budget resolution for fiscal year 2017, or the Budget Resolution, that authorizes the implementation of legislation that would repeal portions of the ACA. Further, in January 2017, President Trump signed an Executive Order directing federal agencies with authorities and responsibilities under the ACA to waive, defer, grant exemptions from, or delay the implementation of any provision of the ACA that would impose a fiscal or regulatory burden on states, individuals, healthcare providers, health insurers, or manufacturers of pharmaceuticals or medical devices. In December of 2017, President Trump signed into law Public Law No. 115-97, which made changes to the tax code and included, among other things, a repeal of the ACA's penalties for the individual mandate, a provision that required individuals to buy health insurance or pay a fine. Congress also could consider subsequent legislation to replace elements of the ACA that are repealed. Additionally, the ACA continues to be challenged in a variety of lawsuits. Because of the continued uncertainty about the implementation of the ACA, there can be no assurance at this time that the implementation (or repeal) of these provisions will not have a material adverse effect on our business.

Steps taken by government payers, such as Medicare and Medicaid to control the utilization and reimbursement of healthcare services, including esoteric testing may diminish our net revenue.

We face efforts by government payers to reduce utilization as well as reimbursement for laboratory testing services. Changes in governmental reimbursement may result from statutory and regulatory changes, prospective and/or retroactive rate adjustments, administrative rulings and other policy changes.

From time to time, legislative freezes and updates affect some of our tests that are reimbursed by the Medicare program under the Medicare Physician Fee Schedule, or MPFS, or Clinical Laboratory Fee Schedule, or CLFS. The MPFS is updated on an annual basis. In the past, the MPFS was updated using a prescribed statutory formula; when application of the statutory formula resulted in lower payments, Congress has passed interim legislation to prevent the reductions. The Medicare Access and CHIP Reauthorization Act of 2015, or MACRA, repealed the previous statutory

update formula and specified the update adjustment factors for calendar years 2015 and beyond. If the updated conversion factor results in negative reimbursement in future years, the resulting decrease in payment may adversely affect our revenue, business, operating results, financial condition and prospects.

In addition, recent laws have made changes to Medicare reimbursement for our tests that are reimbursed under the CLFS, many of which have already gone into effect. In June 2016, CMS published the Clinical Laboratory Fee CLFS final rule entitled “Medicare Program: Medicare Clinical Diagnostic Laboratory Tests Payment System” (CMS-1621-F). The final rule provides regulations to implement the provisions of the Protecting Access to Medicare Act of 2014, or PAMA, which was signed to law in April 2014. Under the final rule, laboratories, including physician office laboratories, are required to report private payer rate and volume data if they:

•Have more than $12,500 in Medicare revenues from laboratory services on the CLFS and

•They receive more than 50 percent of their Medicare revenues from laboratory and physician services during a data collection period.

Tests that meet the criteria for being considered new advanced tests will be paid at actual list charge during an initial period of three calendar quarters. Once the initial period is over, payment for new, advanced tests would be based on

the weighted median private payer rate reported by the single laboratory that performs the new ADLT. Advanced tests are tests furnished by only one laboratory that include a unique algorithm and, at a minimum, are an analysis of RNA, DNA or proteins or are cleared or approved by the FDA.

Applicable laboratories must report data that includes the payment rate (reflecting all discounts, rebates, coupons and other price concessions) and the volume of each test that was paid by each private payer (including health insurance issuers, group health plans, Medicare Advantage plans and Medicaid managed care organizations). The definition of "applicable" lab may exclude certain types of laboratories that generally received more favorable pricing than other laboratories, and thus the make-up of laboratories reporting pricing data to CMS under the proposed rule may result in lower overall pricing data. Beginning in 2017, the Medicare payment rate for each clinical diagnostic lab test is equal to the weighted median amount for the test from the most recent data collection period. For example, laboratories were required to collect private payer data from January 1, 2016 through June 30, 2016 and report it to CMS by March 31, 2017. The new Medicare CLFS rates (based on weighted median private payer rates) was released in November 2017 and were effective on January 1, 2018. Also for the years 2017 through 2019, the amount of reduction in the Medicare rate (if any) shall not exceed 10 percent from the prior year's rate and for the years 2020 through 2022, any reduction shall not exceed 15 percent from the prior year's rate. It is too early to predict the impact on reimbursement for our tests reimbursed under the CLFS, though we believe the government's goal is to reduce Medicare program payments for CLFS tests. Specifically, CMS states that it anticipates the effect of the proposed rule on the Medicare program to save $360 million in program payments for CLFS tests furnished in FY 2017, and to save $5.14 billion over 10 years. CMS has also proposed that a laboratory's failure to comply with reporting obligations, or a laboratory that makes a misrepresentation or omission in reporting required information, would be a violation of the Civil Monetary Penalties Law.

Also under PAMA, CMS is required to adopt temporary billing codes to identify new tests and new advanced diagnostic laboratory tests that have been cleared or approved by the FDA. For an existing test that is cleared or approved by the FDA and for which Medicare payment is made, CMS is required to assign a unique billing code if one has not already been assigned by the agency. Further, PAMA provides special payment status to "advanced diagnostic laboratory tests," or ADLTs, to allow such ADLTs to be paid using their actual list charge amount during a certain time frame. We cannot determine at this time the full impact of the new law on our business, financial condition and results of operations.

CMS also adopts regulations and policies, from time to time, revising, limiting or excluding coverage or reimbursement for certain of the tests that we perform. Likewise, many state governments are under budget pressures and are also considering reductions to their Medicaid fees. Further, Medicare, Medicaid and other third party payers audit for overutilization of billed services. Even though all tests performed by us are ordered by our clients, who are responsible for establishing the medical necessity for the tests ordered, we may be subject to recoupment of payments, as the recipient of the payments for such tests, in the event that a third party payer such as CMS determines that the tests failed to meet all applicable criteria for payment. When third party payers like CMS revise their coverage regulations or policies, our costs generally increase due to the complexity of complying with additional administrative requirements. Furthermore, Medicaid reimbursement and regulations vary by state. Accordingly, we are subject to varying administrative and billing regulations, which also increase the complexity of servicing such programs and our administrative costs. Finally, state budget pressures have encouraged states to consider several courses that may impact our business, such as delaying payments, restricting coverage eligibility, service coverage restrictions and

imposing taxes on our services.

In certain jurisdictions including Arkansas, Arizona, California, Hawaii, Indiana, Idaho, Iowa, Kansas, Kentucky, Michigan, Missouri, Montana, Nebraska, Nevada, North Carolina, North Dakota, Ohio, Oregon, South Carolina, South Dakota, Utah, Virginia, Washington, West Virginia and Wyoming, Medicare administrative contractors CGS Administrators, Noridian Healthcare Solutions and Palmetto GBA, administer the Molecular Diagnostic Services Program, or MolDX, and establish coverage and reimbursement for certain molecular diagnostic tests, including many of our tests. To obtain Medicare coverage for a molecular diagnostic test (FDA approved or LDT), laboratories must apply for and obtain a unique test identifier or what is known as a “Z” code. For newly developed tests or for established tests that have not been validated for clinical and analytical validity and clinical utility, laboratories must submit a detailed dossier of clinical data to substantiate that the test meets Medicare’s requirements for coverage. We have received favorable coverage for many of our molecular tests, however we have

also received non-coverage determinations for many newer tests. The field of molecular diagnostics is evolving very rapidly, and clinical studies on many new tests are still underway. We cannot be assured that some of our molecular tests will ever be covered services by Medicare, nor can we determine when the medical literature will meet the standard for coverage that Medicare administrative contractors have set.

In recent years, Medicare has encouraged beneficiaries to participate in managed care programs, known as “Medicare Advantage” programs, and has encouraged beneficiaries from the traditional fee-for- service Medicare program to switch to Medicare Advantage programs. This has resulted in rapid growth of health insurance and managed care plans offering Medicare Advantage programs and growth in Medicare beneficiary enrollment in these programs. Also in recent years, many states have increasingly mandated that Medicaid beneficiaries enroll in managed care arrangements. If these efforts continue to be successful, we may experience a further shift of traditional Medicare and Medicaid fee-for-service beneficiaries to managed care programs. As a result, we would be required to contract with those private managed care programs in order to be reimbursed for services provided to their Medicare and Medicaid members. There can be no assurance that we will be successful in entering into agreements with these managed care programs at rates of payment similar to those we realize from our non-managed care lines of business.

On January 1, 2018 CMS made changes to what is known as the “14-day rule” regarding Molecular testing. Prior to 2018, CMS’ 14-day rule prevented reference and independent laboratories such as ours from billing Medicare directly for molecular pathology tests ordered less than 14days following an outpatients discharge from the hospital. Instead, we would seek reimbursement from the hospital and the hospital would bill Medicare. Certain Molecular tests that previously were not allowed to be billed to Medicare, are now once again allowed to be billed by laboratories directly to the Medicare program. In 2017, these tests related to patients that had testing within 14 days of a hospital stay were charged directly to the referring hospital. Since our client-bill pricing is typically higher for Molecular testing than the Medicare fee schedule, we anticipate a reduction in revenue from this policy change. Under the MolDX program there are many policies that limit reimbursement on certain tests based on diagnosis codes, and for certain tests there is no reimbursement regardless of the patient’s condition.

We expect the initiatives described above to continue and, if they do, to reduce reimbursements for clinical laboratory services, to impose more stringent cost controls on clinical laboratory services and to reduce utilization of clinical laboratory services. These efforts, including changes in law or regulations that may occur in the future, may each individually or collectively have a material adverse impact on our business, results of operations, financial condition and prospects.

Changes in regulations, payer policies or contracting arrangements with payers or changes in other laws, regulations or policies may adversely affect coverage or reimbursement for our specialized diagnostic services, which may decrease our revenues and adversely affect our results of operations and financial condition.

Governmental payers, as well as private insurers and private payers, have implemented and will continue to implement measures to control the cost, utilization and delivery of healthcare services, including clinical laboratory and pathology services. Congress and federal agencies, such as CMS, have, from time to time, implemented changes to laws and regulations governing healthcare service providers, including specialized diagnostic service providers. These changes have adversely affected and may in the future adversely affect coverage for our services. We also believe that healthcare professionals may not use our services if third-party payers do not provide adequate coverage

and reimbursement for them. These changes in federal, state, local and third-party payer regulations or policies may decrease our revenues and adversely affect our results of operations and financial condition. We will continue to be a non-contracting provider until such time as we enter into contracts with third-party payers with whom we are not currently contracted. Because a portion of our revenues is from third-party payers with whom we are not currently contracted, it is likely that we will be required to make positive or negative adjustments to accounting estimates with respect to contractual allowances in the future, which may adversely affect our results of operations, our credibility with financial analysts and investors, and our stock price.

Clinical trials and research services create a risk of liability.

Errors or omissions could occur during a clinical trial that may result in harm to study volunteers, or if unnoticed and regulatory approval received, to consumers of the drug, or that undermine the usefulness of the clinical trial or data from the clinical trial and may delay the entry of a drug to the market.

Our contracts include provisions entitling us to be indemnified or entitling us to a limitation of liability. These provisions do not uniformly protect us against liability arising from certain of our own actions, such as gross negligence or misconduct. We could be materially and adversely affected if we were required to pay damages or bear the costs of defending any claim which is not covered by a contractual indemnification provision or in the event that a party who must indemnify us does not fulfill its indemnification obligations or which is beyond the level of our insurance coverage. There can be no assurance that we will be able to maintain such insurance coverage on terms acceptable to us.

We may not be able to implement our business strategy, which could impair our ability to continue operations.

Implementation of our business strategies will depend in large part on our ability to (i) attract and maintain a significant number of clients; (ii) effectively provide acceptable products and services to our clients; (iii) develop and license new products and technologies; (iv) obtain adequate financing on favorable terms to fund our business strategies; (v) maintain appropriate internal procedures, policies, and systems; (vi) hire, train, and retain skilled employees and management; (vii) continue to operate despite increasing competition in the medical laboratory industry; (viii) be paid reasonable fees by government payer’s that will adequately cover our costs; (ix) establish, develop and maintain our name recognition; and (x) establish and maintain beneficial relationships with third-party insurance providers and other third-party payers. Our inability to obtain or maintain any or all these factors could impair our ability to implement our business strategies successfully, which could have material adverse effects on our results of operations and financial condition.

We may be unsuccessful in managing our growth which could prevent us from operating profitably.

Our growth has placed, and is expected to continue to place, a significant strain on our managerial, operational and financial resources. To manage our expanded business and our potential growth, we must continue to implement and improve our operational, financial and billing systems and to expand, train and manage our employee base. We may not be able to effectively manage the expansion of our operations and our systems, procedures or controls may not be adequate to support our operations. Our management may not be able to achieve the rapid execution necessary to fully exploit the market opportunity for our products and services. Any inability to manage growth could have a material adverse effect on our business, results of operations, potential profitability and financial condition.

We have a substantial amount of indebtedness. This level of indebtedness could adversely affect our flexibility in operating our business and our ability to react to changes in the economy or our industry.

In December 2016, we entered into a senior secured revolving credit facility, providing for up to $150 million of borrowings, comprised of a $75 million senior secured term loan facility and a $75 million revolving loan. At December 31, 2017, we had $96.7 million of indebtedness outstanding, and approximately $16.7 million of available borrowing capacity under our senior secured revolving credit facility. The revolving credit facility allows for additional borrowings as long as the debt to Adjusted EBITDA ratio remains below 3.75 for 2017, 3.50 for 2018, and as specified in the respective agreements for future years. The full amount of borrowings under the term loan facility and $22.9 million of borrowings under the revolving credit facility were used to retire the then existing term loan and redeem $55 million in shares of our convertible and redeemable ("Series A Preferred Stock") received by an affiliate of General Electric (GE Medical) in connection with our acquisition of Clarient ("the Acquisition"). Our substantial indebtedness could have significant consequences for our business and financial condition. For example:

- We could be required to dedicate a greater percentage of our cash flows to payments on our debt, thereby reducing the availability of cash flow to fund capital expenditures, pursue other acquisitions or

NEOGENOMICS, INC.

ITEM 1A. RISK FACTORS (CONTINUED)

investments in new technologies, make stock repurchases and fund other general corporate purposes. If we fail to meet our payment obligations or otherwise fail to comply with the covenants in our debt, including failure as a result of events beyond our control, it could result in an event of default on our debt. Upon an event of default, the lenders of that debt could elect to cause all amounts outstanding with respect to that debt to become immediately due and payable and we would be unable to access our revolving credit facility. Our debt imposes operating and financial covenants and restrictions on us, and compliance with such covenants and restrictions may adversely affect our ability to adequately finance our operations or capital needs, pursue attractive business opportunities that may arise, redeem or repurchase capital stock, pay dividends, sell assets, and make capital expenditures.

- We may experience increased vulnerability to general adverse economic conditions, including increases in interest rates for those borrowings that bear interest at variable rates or if such indebtedness is refinanced at a time when interest are higher.
- We may experience limited flexibility in planning for, or reacting to, changes in or challenges relating to our businesses and industry, creating competitive disadvantages compared to other competitors with lower debt levels and borrowing costs.

We cannot assure you that cash flows, combined with additional borrowings under the revolving credit facility or any future credit facility, will be available in an amount sufficient to enable us to repay our indebtedness, or to fund other liquidity needs.

In addition, we may incur substantial additional indebtedness in the future, which could cause the related risks to intensify. We may need to refinance all or a portion of our indebtedness on or before their respective maturities. We cannot assure you that we will be able to refinance any of our indebtedness on commercially reasonable terms or at all. If we are unable to refinance our debt, we may default under the terms of our indebtedness, which could lead to an acceleration of the debt. We do not expect that we could repay all of our outstanding indebtedness if the repayment of such indebtedness was accelerated.

In addition, for so long as any shares of our Series A Preferred Stock remain outstanding, in the event that we issue any other shares of capital stock or any unsecured debt securities for cash, we are required to apply at least 50% of the net cash proceeds to redeem shares of Series A Preferred Stock at the then-effective liquidation preference, which is $7.50 per share as of the date of this report, less any applicable redemption discounts. As a result, our ability to repay our outstanding indebtedness will be constrained by the fact that we will only receive half of the net cash proceeds from certain capital raising activities for as long as any shares of our Series A Preferred Stock remains outstanding.

If we are unable to successfully integrate any future business we may acquire, with our legacy business, the anticipated benefits of such transaction may not be realized.

Acquisitions, involve the combination of two companies that formerly operated as independent companies. Acquisitions require us to devote significant management attention and resources to integrating the acquired company’s business practices and operations with our own. Potential difficulties we may encounter as part of the integration process, all of which could materially and adversely affect our business, financial condition, results of operations, and cash flows, include the following:

- the potential inability to successfully combine the acquired company’s business with our legacy business in a manner that permits us to achieve the cost synergies expected to be achieved when expected, or at all, and other benefits

anticipated to result from such transaction;

- challenges optimizing the customer information and technology of the two companies, including the goal of consolidating to one laboratory information system and one billing system;
- challenges effectuating any diversification strategy, including challenges achieving revenue growth from sales of each company's products and services to the customers of the other company;
- difficulties offering products and services across our expanded portfolio;

NEOGENOMICS, INC.

ITEM 1A. RISK FACTORS (CONTINUED)

- the need to revisit assumptions about reserves, revenues, capital expenditures, and operating costs, including expected synergies;
- challenges faced by a potential diversion of the attention of our management as a result of the integration, which in turn could adversely affect our ability to maintain relationships with customers, employees and other constituencies or our ability to achieve the anticipated benefits of such transaction;
- the potential loss of key employees, customers, managed care contracts or strategic partners, or the ability to attract or retain key management and other key personnel, which could have an adverse effect on our ability to integrate and operate the acquired business;
- complexities associated with managing the combined businesses, including difficulty addressing possible differences in corporate cultures and management philosophies and the challenge of integrating complex systems, technology, networks and other assets of each of the companies in a seamless manner that minimizes any adverse impact on customers, suppliers, employees and other constituencies;
- costs and challenges related to the integration of the acquired company’s internal controls over financial reporting with ours; and
- potential unknown liabilities and unforeseen increased expenses.

We cannot be assured that all of the goals and anticipated benefits of an acquisition, will be achievable, particularly as the achievement of the benefits are in many important respects subject to factors that we do not control. These factors would include such things as the reactions of third parties with whom we enter into contracts and to business and the reactions of investors and analysts.

If we cannot integrate our business and any future business we may acquire, successfully, we may fail to realize the expected benefits of such transaction, including the anticipated cost synergies. We could also encounter additional transaction and integration costs or be subject to other factors that affect preliminary estimates.

Other manufacturers may discontinue or recall testing products used in our business.

We rely heavily on reagents, test kits and instruments manufactured by third parties in our testing services. From time to time, manufacturers discontinue or recall the reagents, test kits or instruments used by us to perform laboratory testing. Such discontinuations or recalls could adversely affect our costs, testing volume, costs and revenues.

Failure to develop, or acquire licenses for, new or improved testing technologies could materially and adversely affect our revenues.

Our industry is subject to changing technology and new product introductions. Other companies or individuals, including our competitors, may obtain patents or other property rights that would prevent, limit or interfere with our ability to develop, perform or sell our solutions or operate our business or increase our costs. In addition, they could introduce new tests, technologies or services thath U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates. Operating results for the three months ended March 31, 2014 are not necessarily indicative of the results for the year ending December 31, 2014. The unaudited consolidated financial statements should be read in conjunction with the Company’s Annual Report on Form 10-K for the year ended December 31, 2013 (the "2013 Annual Report").

2. Student Loans Receivable and Allowance for Loan Losses

Student loans receivable consisted of the following:

	As of March 31, 2014	As of December 31, 2013
Federally insured loans		
Stafford and other	$6,606,814	6,686,626
Consolidation	19,138,841	19,363,577
Total	25,745,655	26,050,203
Non-federally insured loans	68,540	71,103
	25,814,195	26,121,306
Loan discount, net of unamortized loan premiums and deferred origination costs (a)	(152,424)	(158,595)
Allowance for loan losses – federally insured loans	(42,909)	(43,440)
Allowance for loan losses – non-federally insured loans	(11,719)	(11,682)
	$25,607,143	25,907,589

(a) For loans purchased where there is evidence of credit deterioration since the origination of the loan, the Company records a credit discount, separate from the allowance for loan losses, which is non-accretable to interest income. Remaining discounts and premiums for purchased loans are recognized in interest income over the remaining estimated lives of the loans. The Company continues to evaluate credit losses associated with purchased loans based on current information and changes in expectations to determine the need for any additional allowance for loan losses. At March 31, 2014 and December 31, 2013, "loan discount, net of unamortized loan premiums and deferred origination costs" included $20.0 million and $20.2 million, respectively, of non-accretable discount associated with purchased loans.

Activity in the Allowance for Loan Losses

The provision for loan losses represents the periodic expense of maintaining an allowance appropriate to absorb losses, net of recoveries, inherent in the portfolio of student loans. Activity in the allowance for loan losses is shown below.

	Three months ended March 31,	
	2014	2013
Balance at beginning of period	$55,122	51,902
Provision for loan losses:		
Federally insured loans	3,000	6,000
Non-federally insured loans	(500)	(1,000)
Total provision for loan losses	2,500	5,000
Charge-offs:		
Federally insured loans	(3,631)	(5,990)
Non-federally insured loans	(421)	(772)
Total charge-offs	(4,052)	(6,762)
Recoveries - non-federally insured loans	371	368
Purchase (sale) of federally insured loans, net	100	(2,218)
Transfer from repurchase obligation related to non-federally insured loans repurchased, net	587	1,119
Balance at end of period	$54,628	49,409
Allocation of the allowance for loan losses:		
Federally insured loans	$42,909	37,913
Non-federally insured loans	11,719	11,496
Total allowance for loan losses	$54,628	49,409

Repurchase Obligations

As of March 31, 2014, the Company had participated a cumulative amount of $119.6 million (par value) of 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 in the Company’s consolidated balance sheets. Per the terms of the servicing agreements, the Company’s servicing operations are obligated to repurchase loans subject to the participation interests in the event such loans become 60 or 90 days delinquent.

In addition, in 2011, the Company sold a portfolio of non-federally insured loans for proceeds of $91.3 million (100% of par value). The Company retained credit risk related to this portfolio and will pay cash to purchase back any loans which become 60 days delinquent. As of March 31, 2014, the balance of this portfolio was $61.1 million (par value).

The Company’s estimate related to its obligation to repurchase these loans is included in “other liabilities” in the Company’s consolidated balance sheets. The activity related to this accrual is detailed below.

	Three months ended March 31,	
	2014	2013
Beginning balance	$16,143	16,130
Loans repurchased	(730)	(1,119)
Ending balance	$15,413	15,011

Student Loan Status and Delinquencies

Delinquencies have the potential to adversely impact the Company’s earnings through increased servicing and collection costs and account charge-offs. The percent of non-federally insured loans that were delinquent 31 days or greater as of March 31, 2014, December 31, 2013, and March 31, 2013 was 12.8 percent, 12.7 percent, and 20.5 percent, respectively. The table below shows the Company’s federally insured student loan delinquency amounts.

Rehabilitation Loans and Delinquent Loans Funded in FFELP Warehouse Facilities

Rehabilitation loans are student loans that have previously defaulted, but for which the borrower has made a specified number of on-time payments. Although rehabilitation loans benefit from the same guarantees as other federally insured student loans, rehabilitation loans have generally experienced re-default rates that are higher than default rates for federally insured student loans that have not previously defaulted. The Company has purchased a significant amount of rehabilitation loans. Upon purchase, these loans are recorded at fair value, which generally approximates the federal guarantee rate under the Federal Family Education Loan Program (the "FFEL Program" or "FFELP"). As such, there is minimal credit risk related to rehabilitation loans purchased; therefore, these loans are presented separately in the following delinquency tables.

In addition, the Company has purchased delinquent federally insured loans that are funded in the Company's FFELP warehouse facilities. Upon purchase, these loans are recorded at fair value, which generally approximates the federal guarantee rate. As such, there is minimal credit risk related to these loans. Loans delinquent 121 days or greater and funded in the Company's FFELP warehouse facilities are included with rehabilitation loans purchased in the following delinquency tables.

	As of March 31, 2014			As of December 31, 2013			As of March 31, 2013		
Federally insured loans, excluding rehabilitation loans:									
Loans in-school/grace/deferment	$2,617,628			$2,618,390			$2,933,416		
Loans in forbearance	2,797,432			2,954,495			2,890,574		
Loans in repayment status:									
Loans current	15,293,299	87.2	%	15,251,869	86.1	%	14,501,802	87.8	%
Loans delinquent 31-60 days	669,238	3.8		768,600	4.3		621,296	3.8	
Loans delinquent 61-90 days	407,779	2.3		426,089	2.5		409,209	2.5	
Loans delinquent 91-120 days	252,413	1.4		281,991	1.6		241,113	1.5	
Loans delinquent 121-270 days	640,214	3.7		712,204	4.0		512,875	3.1	
Loans delinquent 271 days or greater	272,159	1.6		269,066	1.5		211,461	1.3	
Total loans in repayment	17,535,102	100.0	%	17,709,819	100.0	%	16,497,756	100.0	%
Total federally insured loans, excluding rehabilitation loans	$22,950,162			$23,282,704			$22,321,746		
Rehabilitation loans:									
Loans in-school/grace/deferment	$261,754			$254,115			$213,101		
Loans in forbearance	416,206			415,530			394,733		
Loans in repayment status:									
Loans current	1,205,261	56.9	%	1,086,053	51.8	%	877,800	42.4	%
Loans delinquent 31-60 days	163,143	7.7		198,718	9.5		138,249	6.7	
Loans delinquent 61-90 days	114,920	5.4		124,244	5.9		109,129	5.3	
Loans delinquent 91-120 days	91,730	4.3		108,800	5.2		121,468	5.9	

Loans delinquent 121-270 days	344,434	16.3		405,732	19.3		573,054	27.7	
Loans delinquent 271 days or greater	198,045	9.4		174,307	8.3		249,011	12.0	
Total loans in repayment	2,117,533	100.0	%	2,097,854	100.0	%	2,068,711	100.0	%
Total rehabilitation loans	2,795,493			2,767,499			2,676,545		
Total federally insured loans	$25,745,655			$26,050,203			$24,998,291		

3. Bonds and Notes Payable

The following tables summarize the Company's outstanding debt obligations by type of instrument:

	As of March 31, 2014		
	Carrying amount	Interest rate range	Final maturity
Variable-rate bonds and notes issued in asset-backed securitizations:			
Bonds and notes based on indices	$23,780,072	0.24% - 6.90%	5/25/18 - 8/26/52
Bonds and notes based on auction or remarketing	1,132,900	0.07% - 2.18%	5/1/28 - 11/26/46
Total variable-rate bonds and notes	24,912,972		
FFELP warehouse facilities	772,435	0.16% - 0.24%	1/17/16 - 9/30/16
Unsecured line of credit	—	—	3/28/18
Unsecured debt - Junior Subordinated Hybrid Securities	96,457	3.61%	9/15/61
Other borrowings	61,374	1.65% - 5.10%	8/11/14 - 11/11/15
	25,843,238		
Discount on bonds and notes payable	(253,951)		
Total	$25,589,287		

	As of December 31, 2013		
	Carrying amount	Interest rate range	Final maturity
Variable-rate bonds and notes issued in asset-backed securitizations:			
Bonds and notes based on indices	$23,479,893	0.25% - 6.90%	5/25/18 - 8/26/52
Bonds and notes based on auction or remarketing	1,134,250	0.07% - 2.17%	5/1/28 - 11/26/46
Total variable-rate bonds and notes	24,614,143		
FFELP warehouse facilities	1,396,344	0.17% - 0.25%	1/17/16 - 6/12/16
Unsecured line of credit	45,000	1.67%	3/28/18
Unsecured debt - Junior Subordinated Hybrid Securities	96,457	3.62%	9/15/61
Other borrowings	61,401	1.67% - 5.10%	4/11/14 - 11/11/15
	26,213,345		
Discount on bonds and notes payable	(258,056)		
Total	$25,955,289		

FFELP Warehouse Facilities

The Company funds a portion of its FFELP loan acquisitions using its FFELP warehouse facilities. Student loan warehousing allows the Company to buy and manage student loans prior to transferring them into more permanent financing arrangements.

As of March 31, 2014, the Company had three FFELP warehouse facilities as summarized below.

	NHELP-III	NFSLW-I (a)	NHELP-II	Total
Maximum financing amount	$750,000	500,000	500,000	1,750,000
Amount outstanding	377,995	276,915	117,525	772,435
Amount available	$372,005	223,085	382,475	977,565
Expiration of liquidity provisions	February 5, 2015	June 12, 2014	September 30, 2014	
Final maturity date	January 17, 2016	June 12, 2016	September 30, 2016	
Maximum advance rates	92.2 - 95.0%	92.0 - 98.0%	84.5 - 94.5%	
Minimum advance rates	92.2 - 95.0%	84.0 - 90.0%	84.5 - 94.5%	
Advanced as equity support	$22,912	16,847	11,745	51,504

(a) On April 15, 2014, the Company amended the agreement for this warehouse facility to temporarily increase the maximum financing amount to $1.0 billion, change the expiration date for the liquidity provisions to June 11, 2015, and change the maturity date to June 11, 2017. The maximum financing amount is scheduled to decrease $100.0 million a month beginning in June 2014 until it returns to $500.0 million in size.

Asset-backed Securitizations

The following table summarizes the asset-backed securitization transactions completed during the three months ended March 31, 2014.

	2014-1	2014-2 Class A-1 notes	2014-2 Class A-2 notes	2014-2 Class A-3 notes	2014-2 total	Total
Date securities issued	2/6/14	3/12/14	3/12/14	3/12/14	3/12/14	
Total original principal amount	$458,500				509,000	$967,500
Class A senior notes:						
Total original principal amount	$445,000	191,000	222,000	84,000	497,000	942,000
Bond discount	—	—	—	(535)	(535)	(535)
Issue price	$445,000	191,000	222,000	83,465	496,465	941,465
Cost of funds (1-month LIBOR plus:)	0.57%	0.28%	0.60%	0.85%		
Final maturity date	9/25/41	6/25/21	3/25/30	7/27/37		
Class B subordinated notes:						
Total original principal amount	$13,500				12,000	25,500
Bond discount	(1,132)				(1,046)	(2,178)
Issue price	$12,368				10,954	23,322
Cost of funds (1-month LIBOR plus:)	1.50%				1.50%	
Final maturity date	10/25/47				6/25/41	

Unsecured Line of Credit

The Company has a $275.0 million unsecured line of credit that matures on March 28, 2018. As of March 31, 2014, no amounts were outstanding on the unsecured line of credit and $275.0 million was available for future use.

Debt Repurchases

The Company repurchased $1.4 million (face amount) and $13.0 million (face amount) of its own asset-backed debt securities during the three months ended March 31, 2014 and 2013, respectively, and recognized gains on such purchases of approximately $39,000 and $1.4 million, respectively.

4. Derivative Financial Instruments

The Company uses derivative financial instruments primarily to manage interest rate risk and foreign currency exchange risk. Derivative instruments used as part of the Company's risk management strategy are further described in note 6 of the notes to consolidated financial statements included in the 2013 Annual Report. A tabular presentation of such derivatives outstanding as of March 31, 2014 and December 31, 2013 is presented below.

Basis Swaps

The following table summarizes the Company’s basis swaps outstanding as of March 31, 2014 and December 31, 2013 in which the Company receives three-month LIBOR set discretely in advance and pays one-month LIBOR plus or minus a spread as defined in the agreements (the "1:3 Basis Swaps").

Maturity		Notional amount	
2021		$250,000	
2022		1,900,000	
2023		3,650,000	
2024		250,000	
2026		800,000	
2028		100,000	
2036		700,000	
2039	(a)	150,000	
2040	(b)	200,000	
		$8,000,000	(c)

(a) This derivative has a forward effective start date in 2015.
(b) This derivative has a forward effective start date in 2020.
(c) The weighted average rate paid by the Company on the 1:3 Basis Swaps as of March 31, 2014 and December 31, 2013 was one-month LIBOR plus 3.5 basis points.

Interest Rate Swaps – Floor Income Hedges

The following table summarizes the outstanding derivative instruments used by the Company to economically hedge loans earning fixed rate floor income as of March 31, 2014 and December 31, 2013.

Maturity	Notional amount	Weighted average fixed rate paid by the Company (a)	
2014	$1,750,000	0.71	%
2015	1,100,000	0.89	
2016	750,000	0.85	
2017	1,250,000	0.86	
	$4,850,000	0.81	%

(a) For all interest rate derivatives, the Company receives discrete three-month LIBOR.

12

Interest Rate Swaps – Unsecured Debt Hedges

The Company had the following derivatives outstanding as of March 31, 2014 and December 31, 2013 that are used to effectively convert the variable interest rate on a portion of the Junior Subordinated Hybrid Securities ("Hybrid Securities") to a fixed rate.

Maturity	Notional amount	Weighted average fixed rate paid by the Company (a)	
2036	$25,000	4.28	%

(a) For all interest rate derivatives, the Company receives discrete three-month LIBOR.

Foreign Currency Exchange Risk

In 2006, the Company issued €352.7 million of student loan asset-backed Euro Notes (the "Euro Notes") with an interest rate based on a spread to the EURIBOR index. As a result of the Euro Notes, the Company is exposed to market risk related to fluctuations in foreign currency exchange rates between the U.S. dollar and Euro. The principal and accrued interest on these notes are re-measured at each reporting period and recorded in the Company’s consolidated balance sheet in U.S. dollars based on the foreign currency exchange rate on that date.

The Company entered into a cross-currency interest rate swap in connection with the issuance of the Euro Notes. Under the terms of the cross-currency interest rate swap, the Company receives from the counterparty a spread to the EURIBOR index based on a notional amount of €352.7 million and pays a spread to the LIBOR index based on a notional amount of $450.0 million. In addition, under the terms of this agreement, all principal payments on the Euro Notes will effectively be paid at the exchange rate in effect between the U.S. dollar and Euro as of the issuance of the notes.

The following table shows the income statement impact as a result of the re-measurement of the Euro Notes and the change in the fair value of the related derivative instrument.

	Three months ended March 31,	
	2014	2013 (b)
Re-measurement of Euro Notes	$(952)	28,763
Change in fair value of cross-currency interest rate swaps	(39)	(34,844)
Total impact to consolidated statements of income - income (expense) (a)	$(991)	(6,081)

(a) The financial statement impact of the above items is included in "Derivative market value and foreign currency adjustments and derivative settlements, net" in the Company's consolidated statements of income.

(b) The 2013 operating results includes the re-measurement of €420.5 million of student loan asset-backed Euro notes and the change in fair value of a related cross-currency interest rate swap entered into in connection with the issuance of such notes. In November 2013, the notional amount outstanding on the notes was changed to U.S. dollars and the cross-currency interest swap was terminated.

The re-measurement of the Euro-denominated bonds generally correlates with the change in fair value of the cross-currency interest rate swaps. However, the Company will experience unrealized gains or losses related to the cross-currency interest rate swaps if the two underlying indices (and related forward curve) do not move in parallel.

Consolidated Financial Statement Impact Related to Derivatives

The following table summarizes the fair value of the Company's derivatives as reflected in the consolidated balance sheets:

	Fair value of asset derivatives		Fair value of liability derivatives	
	As of March 31, 2014	As of December 31, 2013	As of March 31, 2014	As of December 31, 2013
1:3 basis swaps	$19,600	18,490	—	—
Interest rate swaps - floor income hedges	7,607	7,183	12,915	15,849
Interest rate swaps - hybrid debt hedges	—	—	3,632	2,120
Cross-currency interest rate swaps	36,795	36,834	—	—
Total	$64,002	62,507	16,547	17,969

During the three months ended March 31, 2013, the Company terminated certain derivatives for gross proceeds and payments of $2.7 million and $2.9 million, respectively. There were no derivative terminations during the first quarter of 2014.

Offsetting of Derivative Assets/Liabilities

The Company records derivative instruments in the consolidated balance sheets on a gross basis as either an asset or liability measured at its fair value. Certain of the Company's derivative instruments are subject to right of offset provisions with counterparties. The following tables include the gross amounts related to the Company's derivative portfolio recognized in the consolidated balance sheets, reconciled to the net amount when excluding derivatives subject to enforceable master netting arrangements and cash collateral received/pledged:

		Gross amounts not offset in the consolidated balance sheets		
Derivative assets	Gross amounts of recognized assets presented in the consolidated balance sheets	Derivatives subject to enforceable master netting arrangement	Cash collateral received	Net asset (liability)
Balance as of March 31, 2014	$64,002	(15,313)	(323)	48,366
Balance as of December 31, 2013	62,507	(15,437)	(15,959)	31,111

		Gross amounts not offset in the consolidated balance sheets		
Derivative liabilities	Gross amounts of recognized liabilities presented in the consolidated balance sheets	Derivatives subject to enforceable master netting arrangement	Cash collateral pledged	Net asset (liability)
Balance as of March 31, 2014	$(16,547)	15,313	3,140	1,906
	(17,969)	15,437	3,630	1,098

Balance as of
December 31, 2013

14

The following table summarizes the effect of derivative instruments in the consolidated statements of income.

	Three months ended March 31,	
	2014	2013
Settlements:		
1:3 basis swaps	$881	911
Interest rate swaps - floor income hedges	(6,950)	(8,304)
Interest rate swaps - hybrid debt hedges	(252)	(645)
Cross-currency interest rate swaps	92	(146)
Total settlements - expense	(6,229)	(8,184)
Change in fair value:		
1:3 basis swaps	1,110	1,933
Interest rate swaps - floor income hedges	3,358	9,422
Interest rate swaps - hybrid debt hedges	(1,513)	3,640
Cross-currency interest rate swaps	(39)	(34,844)
Other	—	342
Total change in fair value - income (expense)	2,916	(19,507)
Re-measurement of Euro Notes (foreign currency transaction adjustment) - (expense) income	(952)	28,763
Derivative market value and foreign currency adjustments and derivative settlements, net - (expense) income	$(4,265)	1,072

5. Investments

A summary of the Company's investments and restricted investments follows:

	As of March 31, 2014				As of December 31, 2013			
	Amortized cost	Gross unrealized gains	Gross unrealized losses (a)	Fair value	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Investments:								
Available-for-sale investments:								
Student loan asset-backed and other debt securities (b)	$149,016	3,192	(824)	151,384	171,931	7,111	(1,241)	177,801
Equity securities	1,308	1,884	—	3,192	1,502	1,783	(3)	3,282
Total available-for-sale investments	$150,324	5,076	(824)	154,576	173,433	8,894	(1,244)	181,083
Trading investments:								
Student loan asset-backed and other debt securities				11,625				10,957
Total available-for-sale and trading investments				$166,201				192,040
Restricted Investments (c):								
Guaranteed investment contracts - held-to-maturity				$6,742				7,285

(a) As of March 31, 2014, the Company considered the decline in market value of its available-for-sale investments to be temporary in nature and did not consider any of its investments other-than-temporarily impaired.

(b) As of March 31, 2014, the stated maturities of the majority of the Company's student loan asset-backed and other debt securities classified as available-for-sale were greater than 10 years.

(c) Restricted investments are included in "restricted cash and investments" in the Company's consolidated balance sheets.

The amounts reclassified from accumulated other comprehensive income related to the realized gains and losses on available-for-sale-securities is summarized below.

	Three months ended March 31,	
Affected line item in the consolidated statements of income - income (expense):	2014	2013
Other income	$7,073	957
Income tax expense	(2,617)	(354)
Net	$4,456	603

6. Earnings per Common Share

Presented below is a summary of the components used to calculate basic and diluted earnings per share. The Company applies the two-class method in computing both basic and diluted earnings per share, which requires the calculation of separate earnings per share amounts for common stock and unvested share based awards. Unvested share-based awards that contain nonforfeitable rights to dividends are considered securities which participate in undistributed earnings with common stock.

	Three months ended March 31,					
	2014			2013		
	Common shareholders	Unvested restricted stock shareholders	Total	Common shareholders	Unvested restricted stock shareholders	Total
Numerator:						
Net income attributable to Nelnet, Inc.	$73,125	661	73,786	67,517	562	68,079
Denominator:						
Weighted-average common shares outstanding - basic and diluted	46,110,952	416,965	46,527,917	46,272,324	385,707	46,658,031
Earnings per share - basic and diluted	$1.59	1.59	1.59	1.46	1.46	1.46

Unvested restricted stock awards are the Company's only potential common shares and, accordingly, there were no awards that were antidilutive and not included in average shares outstanding for the diluted earnings per share calculation.

7. Segment Reporting

See note 13 of the notes to consolidated financial statements included in the 2013 Annual Report for a description of the Company's operating segments. The following tables include the results of each of the Company's operating segments reconciled to the consolidated financial statements.

	Three months ended March 31, 2014							
	Fee-Based							
	Student Loan and Guaranty Servicing	Tuition Payment Processing and Campus Commerce	Enrollment Services	Total Fee-Based	Asset Generation and Management	Corporate Activity and Overhead	Eliminations	Total
Total interest income	$11	—	—	11	157,003	2,658	(797)	158,875
Interest expense	—	—	—	—	59,476	1,325	(797)	60,004
Net interest income	11	—	—	11	97,527	1,333	—	98,871
Less provision for loan losses	—	—	—	—	2,500	—	—	2,500
Net interest income after provision for loan losses	11	—	—	11	95,027	1,333	—	96,371
Other income (expense):								
Loan and guaranty servicing revenue	64,757	—	—	64,757	—	—	—	64,757
Intersegment servicing revenue	14,221	—	—	14,221	—	—	(14,221)	—
Tuition payment processing and campus commerce revenue	—	25,235	—	25,235	—	—	—	25,235
Enrollment services revenue	—	—	22,011	22,011	—	—	—	22,011
Other income	—	—	—	—	4,164	13,967	—	18,131
Gain on sale of loans and debt repurchases	—	—	—	—	39	—	—	39
Derivative market value and foreign currency adjustments, net	—	—	—	—	3,477	(1,513)	—	1,964
Derivative settlements, net	—	—	—	—	(5,977)	(252)	—	(6,229)
Total other income (expense)	78,978	25,235	22,011	126,224	1,703	12,202	(14,221)	125,908
Operating expenses:								
Salaries and benefits	32,307	10,027	4,380	46,714	609	5,161	—	52,484
Cost to provide enrollment services	—	—	14,475	14,475	—	—	—	14,475
Depreciation and amortization	2,789	1,428	47	4,264	—	519	—	4,783
Other	18,452	2,647	1,449	22,548	7,146	5,933	—	35,627
	1,083	1,420	1,006	3,509	14,371	(3,659)	(14,221)	—

Intersegment expenses, net								
Total operating expenses	54,631	15,522	21,357	91,510	22,126	7,954	(14,221)	107,369
Income before income taxes and corporate overhead allocation	24,358	9,713	654	34,725	74,604	5,581	—	114,910
Corporate overhead allocation	(1,860)	(620)	(620)	(3,100)	(1,329)	4,429	—	—
Income before income taxes	22,498	9,093	34	31,625	73,275	10,010	—	114,910
Income tax expense	(8,549)	(3,455)	(13)	(12,017)	(27,844)	(750)	—	(40,611)
Net income	13,949	5,638	21	19,608	45,431	9,260	—	74,299
Net income attributable to noncontrolling interest	—	—	—	—	—	513	—	513
Net income attributable to Nelnet, Inc.	$13,949	5,638	21	19,608	45,431	8,747	—	73,786

	Three months ended March 31, 2013							
	Fee-Based							
	Student Loan and Guaranty Servicing	Tuition Payment Processing and Campus Commerce	Enrollment Services	Total Fee-Based	Asset Generation and Management	Corporate Activity and Overhead	Eliminations	Total
Total interest income	$10	—	—	10	155,654	2,311	(819)	157,156
Interest expense	—	—	—	—	57,482	1,695	(819)	58,358
Net interest income	10	—	—	10	98,172	616	—	98,798
Less provision for loan losses	—	—	—	—	5,000	—	—	5,000
Net interest income after provision for loan losses	10	—	—	10	93,172	616	—	93,798
Other income (expense):								
Loan and guaranty servicing revenue	55,601	—	—	55,601	—	—	—	55,601
Intersegment servicing revenue	14,953	—	—	14,953	—	—	(14,953)	—
Tuition payment processing and campus commerce revenue	—	23,411	—	23,411	—	—	—	23,411
Enrollment services revenue	—	—	28,957	28,957	—	—	—	28,957
Other income	—	—	—	—	4,196	5,220	—	9,416
Gain on sale of loans and debt repurchases	—	—	—	—	1,407	—	—	1,407
Derivative market value and foreign currency adjustments, net	—	—	—	—	5,275	3,981	—	9,256
Derivative settlements, net	—	—	—	—	(7,539)	(645)	—	(8,184)
Total other income (expense)	70,554	23,411	28,957	122,922	3,339	8,556	(14,953)	119,864
Operating expenses:								
Salaries and benefits	28,444	9,359	5,767	43,570	562	3,773	—	47,905
Cost to provide enrollment services	—	—	19,642	19,642	—	—	—	19,642
Depreciation and amortization	2,789	1,138	61	3,988	—	389	—	4,377
Other	18,390	2,287	1,651	22,328	7,513	5,100	—	34,941
Intersegment expenses, net	935	1,425	1,149	3,509	15,142	(3,698)	(14,953)	—
Total operating expenses	50,558	14,209	28,270	93,037	23,217	5,564	(14,953)	106,865
Income before income taxes and corporate overhead allocation	20,006	9,202	687	29,895	73,294	3,608	—	106,797

Corporate overhead allocation	(997)	(332)	(332)	(1,661)	(712)	2,373	—	—
Income before income taxes	19,009	8,870	355	28,234	72,582	5,981	—	106,797
Income tax expense	(7,223)	(3,371)	(135)	(10,729)	(27,581)	(137)	—	(38,447)
Net income	11,786	5,499	220	17,505	45,001	5,844	—	68,350
Net income attributable to noncontrolling interest	—	—	—	—	—	271	—	271
Net income attributable to Nelnet, Inc.	$11,786	5,499	220	17,505	45,001	5,573	—	68,079

8. Major Customer

The Company earns loan servicing revenue from a servicing contract with the U.S. Department of Education ("Department") that spans five years (through June 2014). Revenue earned by the Company's Student Loan and Guaranty Servicing operating segment related to this contract was $29.9 million and $20.3 million for the three months ended March 31, 2014 and 2013, respectively. The Department has the option to extend the contract for an additional five years. On October 25, 2013, the Company received a letter from the Department notifying the Company of the Department's intent to exercise its optional ordering period to extend the contract for an additional five years through June 16, 2019, with actual extension subject to the availability of government funds.

9. Related Party Transactions

The Company has entered into certain contractual arrangements with related parties as described in note 19 of the notes to consolidated financial statements included in the Company's 2013 Annual Report. The following provides an update for a related party transaction that occurred during the first quarter of 2014.

On January 1, 2014, the Company subparticipated the Company's participation interest in a loan receivable from an unrelated third party to Union Bank and Trust Company ("Union Bank"), an entity under common control with the Company. The participated portion of the loan was $1.7 million, with an obligation to fund an additional $1.4 million. As part of this agreement, Union Bank will pay the Company monthly servicing fees equal to 40 basis points on the participated portion of the outstanding principal balance of the loan.

10. Fair Value

The following tables present the Company’s financial assets and liabilities that are measured at fair value on a recurring basis. There were no transfers into or out of level 1, level 2, or level 3 for the three months ended March 31, 2014.

	As of March 31, 2014			As of December 31, 2013		
	Level 1	Level 2	Total	Level 1	Level 2	Total
Assets:						
Investments:						
Student loan asset-backed securities	$—	162,553	162,553	—	188,279	188,279
Equity securities	3,192	—	3,192	3,282	—	3,282
Debt securities	456	—	456	479	—	479
Total investments	3,648	162,553	166,201	3,761	188,279	192,040
Fair value of derivative instruments	—	64,002	64,002	—	62,507	62,507
Total assets	$3,648	226,555	230,203	3,761	250,786	254,547
Liabilities:						
Fair value of derivative instruments	$—	16,547	16,547	—	17,969	17,969
Total liabilities	$—	16,547	16,547	—	17,969	17,969

The following table summarizes the fair values of all of the Company’s financial instruments on the consolidated balance sheets:

	As of March 31, 2014				
	Fair value	Carrying value	Level 1	Level 2	Level 3
Financial assets:					
Student loans receivable	$26,671,284	25,607,143	—	—	26,671,284
Cash and cash equivalents	107,102	107,102	107,102	—	—
Investments	166,201	166,201	3,648	162,553	—
Restricted cash	699,147	699,147	699,147	—	—
Restricted cash – due to customers	180,469	180,469	180,469	—	—
Restricted investments	6,742	6,742	6,742	—	—
Accrued interest receivable	305,672	305,672	—	305,672	—
Derivative instruments	64,002	64,002	—	64,002	—
Financial liabilities:					
Bonds and notes payable	25,461,183	25,589,287	—	25,461,183	—
Accrued interest payable	22,338	22,338	—	22,338	—
Due to customers	180,469	180,469	180,469	—	—
Derivative instruments	16,547	16,547	—	16,547	—

19

	As of December 31, 2013				
	Fair value	Carrying value	Level 1	Level 2	Level 3
Financial assets:					
Student loans receivable	$26,641,383	25,907,589	—	—	26,641,383
Cash and cash equivalents	63,267	63,267	63,267	—	—
Investments	192,040	192,040	3,761	188,279	—
Restricted cash	727,838	727,838	727,838	—	—
Restricted cash – due to customers	167,576	167,576	167,576	—	—
Restricted investments	7,285	7,285	7,285	—	—
Accrued interest receivable	314,553	314,553	—	314,553	—
Derivative instruments	62,507	62,507	—	62,507	—
Financial liabilities:					
Bonds and notes payable	25,577,250	25,955,289	—	25,577,250	—
Accrued interest payable	21,725	21,725	—	21,725	—
Due to customers	167,576	167,576	167,576	—	—
Derivative instruments	17,969	17,969	—	17,969	—

The methodologies for estimating the fair value of financial assets and liabilities are described in note 20 of the notes to consolidated financial statements included in the 2013 Annual Report.

11. Legal Proceedings

General

The Company is subject to various legal proceedings that arise in the normal course of business, including the legal proceedings discussed below. These matters frequently involve claims by student loan borrowers disputing the manner in which their student loans have been serviced or the accuracy of reports to credit bureaus, claims by student loan borrowers or other consumers alleging that state or Federal consumer protection laws have been violated in the process of collecting loans or conducting other business activities, and disputes with other business entities. From time to time, lawsuits may be brought as, or subsequently amended to assert claims in the form of, putative class action cases.

In evaluating each of its legal proceedings, the Company considers many factors that involve significant risks and uncertainties inherent in the overall litigation process, including (i) the amount of damages and the nature of any other relief sought in the proceeding, if specified; (ii) whether the proceeding is at an early stage; (iii) the impact of discovery; (iv) whether novel or unsettled legal theories are at issue; (v) the outcome of pending motions or appeals; (vi) whether there are significant factual issues to be resolved; (vii) whether class action status is sought and the Company's views of the likelihood of a class being certified by the court and the ultimate size of the class; (viii) the jurisdiction in which the proceeding is pending; (ix) the Company's views of the merits of the claims and of the strength of the Company's defenses; and (x) the progress of any negotiations with opposing parties. In assessing whether a legal proceeding may be material, the Company considers these and other quantitative and qualitative factors, including whether disclosure of the proceeding might be important to a reader of the Company's financial statements in light of all of the information about the Company that is available to the reader.

Actions Requesting Certifications of Classes

Proceedings or complaints that involve or ask for certifications of classes generally expand the scope of legal defense costs, as well as alleged potential claim amounts. The Company is currently subject to legal proceedings in which the plaintiffs have made allegations that one or more putative classes should be certified by the applicable court. With

respect to the three proceedings discussed below, it is significant to note that no putative class has actually been certified in any of these proceedings, the Company's position is that class certification would be inappropriate in each such proceeding, the Company has entered into agreements in principle to resolve two of the matters for immaterial amounts through a court-approved class-wide settlement, and the Company intends to vigorously contest class certification in the remaining matter. The Company has accrued an immaterial amount related to the legal proceedings described below. However, due to the relatively early stage of these matters and the uncertainty and risks inherent in class determination and the overall litigation process, the Company believes that a meaningful estimate of its exposure to any reasonably possible losses or range of reasonably possible losses, in excess of the amount accrued, cannot currently be made.

Bais Yaakov of Spring Valley v. Peterson's Nelnet, LLC

On January 4, 2011, a complaint against Peterson's Nelnet, LLC (“Peterson's”), a subsidiary of Nelnet, Inc. ("Nelnet"), was filed in the U.S. Federal District Court for the District of New Jersey (the “New Jersey District Court”). The complaint alleges that Peterson's sent six advertising faxes to the named plaintiff in 2008-2009 that were not the result of express invitation or permission granted by the plaintiff and did not include certain opt out language. The complaint also alleges that such faxes violated the Federal Telephone Consumer Protection Act (the “TCPA”), purportedly entitling the plaintiff to $500 per violation, trebled for willful violations for each of the six faxes. The complaint further alleges that Peterson's had sent putative class members more than 10,000 faxes that violated the TCPA, amounting to more than $5 million in statutory penalty damages and more than $15 million if trebled for willful violations. The complaint seeks to establish a class action. On September 13, 2013, the named plaintiff filed a motion for class certification, and on October 7, 2013, Peterson's filed a motion to dismiss the named plaintiff's motion for class certification. As of the filing date of this report, the New Jersey District Court has not established, recognized, or certified a class. On January 23, 2014, Peterson's and the named plaintiff reached an agreement in principle whereby Peterson's would, without admitting any wrongdoing or liability, settle all claims in the lawsuit, including potential class action claims, for payment of an immaterial amount. The settlement agreement in principle is subject to finalization and court approval.

Than Zaw v. Nelnet, Inc.

On January 18, 2013, a Third Amended Complaint was served on Nelnet in connection with a lawsuit by Than Zaw against Nelnet (erroneously referred to in the lawsuit as Nelnet Business Solutions, Inc.) in the Superior Court of the State of California, Contra Costa County (the “California State Court”). The lawsuit was originally instituted on December 30, 2010, and alleges that Nelnet violated the California Fair Debt Collection Practices Act in its interactions with the plaintiff, a California resident. The plaintiff's Third Amended Complaint added additional allegations claiming that Nelnet violated Section 632 of the California Penal Code by allegedly recording one or more telephone calls to the plaintiff without the plaintiff's consent, and sought $5,000 in statutory damages per alleged violation. The Third Amended Complaint further alleged that Nelnet improperly recorded telephone calls to other California residents without such persons' consent, and sought to establish a class action with respect to the California Section 632 claim. As of the filing date of this report, the California State Court has not established, recognized, or certified a class. On October 16, 2013, Nelnet and the named plaintiff reached an agreement in principle whereby Nelnet would, without admitting any wrongdoing or liability, settle all claims in the lawsuit, including potential class action claims, for payment of an immaterial amount. The settlement agreement in principle is subject to finalization and court approval.

Grant Keating v. Peterson's Nelnet, LLC et al

On August 6, 2012, an Amended Complaint was served on Peterson's, CUnet, LLC (“CUnet”), a subsidiary of Nelnet, and on Nelnet (collectively, the "Keating Defendants"), in connection with a lawsuit by Grant Keating in the U.S. Federal District Court for the Northern District of Ohio (the “Ohio District Court”). The lawsuit was originally instituted on August 24, 2011, and alleges that the Keating Defendants sent an advertising text message to the named plaintiff in June 2011 using an automatic telephone dialing system, and without the plaintiff's express consent. The complaint also alleges that this text message violated the TCPA, purportedly entitling the plaintiff to $500, trebled for a willful violation. The complaint further alleges that the Keating Defendants sent putative class members similar text messages using an automatic telephone dialing system, without such purported class members' consent. The complaint seeks to establish a class action. On August 29, 2013, the Keating Defendants filed motions for summary judgment, and the named plaintiff filed a motion for class certification. As of the filing date of this report, the Ohio District Court has not established, recognized, or certified a class. The Keating Defendants intend to defend themselves vigorously

in this lawsuit.

12. Subsequent Events

On April 25, 2014, the Company completed the purchase of a total of $3.6 billion of FFELP student loans and related assets. The transaction included the purchase of residual interests in a total of $2.6 billion of securitized student loans and related assets under a stock purchase agreement, and the purchase of a total of approximately $950 million of unsecuritized student loans under three separate loan sale agreements.

The assets acquired under the stock purchase agreement include the rights to the residual interests in three FFELP student loan securitization trusts, which hold a total of $2.6 billion of FFELP student loans and related assets and have issued a corresponding amount of related student loan asset-backed debt. In addition, under the loan sale agreements, the Company purchased for cash unsecuritized FFELP loans totaling approximately $950 million, consisting primarily of FFELP consolidation loans, which were initially funded through the Company's existing student loan warehouse facilities. The aggregate cash purchase price for the assets acquired under the stock purchase agreement and the cash amount paid over the par value of the student loan portfolio and related

accrued interest under the loan sale agreements was $139 million, and was funded from the Company’s operating cash and unsecured line of credit. All acquired student loan assets and related debt will be included in the Company’s consolidated financial statements.

On April 30, 2014, the Company completed an asset-backed securitization totaling $719.8 million, which provided permanent funding for loans that were previously funded in the Company's warehouse facilities, including a portion of the $950 million of unsecuritized loans purchased in April 2014. As of April 30, 2014, after the completion of this asset-backed securitization, $1.1 billion was outstanding on the Company's warehouse facilities and $1.2 billion was available for future use.

ITEM 2. 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 three months ended March 31, 2014 and 2013. All dollars are in thousands, except per share amounts, unless otherwise noted.)

The following discussion and analysis provides information that the Company’s management believes is relevant to an assessment and understanding of the consolidated results of operations and financial condition of the Company. The discussion should be read in conjunction with the Company’s consolidated financial statements included in the 2013 Annual Report.

Forward-looking and cautionary statements

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,” “exp “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, assumptions, 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 the “Risk Factors” section of the 2013 Annual Report and elsewhere in this report, and include such risks and uncertainties as:

- student loan portfolio risks such as interest rate basis and repricing risk resulting from the fact that the interest rate characteristics of the 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 FFEL Program, risks related to the use of derivatives to manage exposure to interest rate fluctuations, uncertainties regarding the expected benefits from recently purchased securitized and unsecuritized FFELP student loans, and risks from changes in levels of student loan prepayment or default rates;

- financing and liquidity risks, including risks of changes in the general interest rate environment and in the securitization and other financing markets for student loans, which may increase the costs or limit the availability of financings necessary to purchase, refinance, or continue to hold student loans;

- risks from changes in the educational credit and services markets resulting from changes in applicable laws, regulations, and government programs and budgets, such as the expected decline over time in FFELP loan interest income and fee-based revenues due to the discontinuation of new FFELP loan originations in 2010 and potential government initiatives to consolidate existing FFELP loans to the Federal Direct Loan Program, risks related to the expected reduction in government payments to guaranty agencies to rehabilitate defaulted FFELP loans and services in support of those activities, risks related to the availability of government funds and actual extension of the Company's loan servicing contract with the Department, which accounted for 23 percent of the Company's fee-based revenue in 2013, for an additional five years, and the Company's ability to maintain or increase volumes under that contract, and the Company's ability to comply with agreements with third-party customers for the servicing of FFELP and Federal Direct Loan Program loans;

- risks related to a breach of or failure in the Company's operational or information systems or infrastructure, or those of third-party vendors;

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

- risks and uncertainties associated with litigation matters and with maintaining compliance with the extensive regulatory requirements applicable to the Company's businesses, 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.

OVERVIEW

The Company is an education services company focused primarily on providing fee-based processing services and quality education-related products and services in four core areas: asset management and finance, 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.

A reconciliation of the Company's GAAP net income to net income, excluding derivative market value and foreign currency adjustments, is provided below.

	Three months ended March 31,	
	2014	2013
GAAP net income attributable to Nelnet, Inc.	$73,786	68,079
Derivative market value and foreign currency adjustments, net of tax	(1,218)	(5,738)
Net income, excluding derivative market value and foreign currency adjustments (a)	$72,568	62,341
Earnings per share:		
GAAP net income attributable to Nelnet, Inc.	$1.59	1.46
Derivative market value and foreign currency adjustments, net of tax	(0.03)	(0.12)
Net income, excluding derivative market value and foreign currency adjustments (a)	$1.56	1.34

(a) The Company provides non-GAAP information that reflects specific items management believes to be important in the evaluation of its financial position and performance. "Derivative market value and foreign currency adjustments" include (i) the unrealized gains and losses that are caused by changes in fair values of derivatives which do not qualify for "hedge treatment" under GAAP; and (ii) the foreign currency transaction gains or losses caused by the re-measurement of the Company's Euro-denominated bonds to U.S. dollars. The Company believes these point-in-time estimates of asset and liability values related to these financial instruments that are subject to interest and currency rate fluctuations affect the period-to-period comparability of the results of operations. Accordingly, the Company provides operating results excluding these items for comparability purposes.

The increase in earnings for the 2014 period compared to the 2013 period was due to an increase in net income from the Company's Student Loan and Guaranty Servicing operating segment, an increase in income from providing

investment advisory services, and an increase in gains from investment activities.

The Company earns net interest income on its FFELP student loan portfolio in its Asset Generation and Management ("AGM") operating segment. This segment is expected to generate a stable net interest margin and significant amounts of cash as the FFELP portfolio amortizes. As of March 31, 2014, the Company had a $25.6 billion student loan portfolio that will amortize over the next approximately 20 years. The Company actively seeks to acquire additional FFELP loan portfolios to leverage its servicing scale and expertise to generate incremental earnings and cash flow. In April 2014, the Company purchased $3.6 billion of FFELP student loans and related assets as described in note 12 of the notes to consolidated financial statements included under Part I, Item 1 of this report. As of April 30, 2014, subsequent to the closing of this transaction, the Company's student loan portfolio was over $29 billion.

In addition, the Company earns fee-based revenue through the following reportable operating segments:

- Student Loan and Guaranty Servicing ("LGS") - referred to as Nelnet Diversified Solutions ("NDS")
- Tuition Payment Processing and Campus Commerce ("TPP&CC") - referred to as Nelnet Business Solutions ("NBS")
- Enrollment Services - commonly called Nelnet Enrollment Solutions ("NES")

The information below provides the operating results for each reportable operating segment for the three months ended March 31, 2014 and 2013 (dollars in millions).

(a) Revenue includes intersegment revenue of $14.2 million and $15.0 million for the three months ended March 31, 2014 and 2013, respectively, earned by LGS as a result of servicing loans for AGM.

(b) Total revenue includes "net interest income after provision for loan losses" and "total other income" from the Company's segment statements of income, excluding the impact from changes in fair values of derivatives and foreign currency transaction adjustments, which was income of $3.5 million and $5.3 million for the three months ended March 31, 2014 and 2013, respectively. Net income excludes changes in fair values of derivatives and foreign currency transaction adjustments, net of tax, which was income of $2.2 million and $3.3 million for the three months ended March 31, 2014 and 2013, respectively.

(c) Computed as income before income taxes divided by total revenue.

Student Loan and Guaranty Servicing

- As of March 31, 2014, the Company was servicing $147.9 billion in FFELP, private, and government owned student loans, as compared with $112.8 billion of loans as of March 31, 2013.

- Revenue increased in the three months ended March 31, 2014 compared to the same period in 2013 due to growth in servicing volume under the Company's contract with the Department, offset partially by a decrease in traditional FFELP servicing revenue. Revenue from the Department servicing contract increased to $29.9 million for the three months ended March 31, 2014, compared to $20.3 million for the same period in 2013. As of March 31, 2014, the Company was servicing $120.6 billion of loans for 5.4 million borrowers under this contract.

- Before tax operating margin was 28.5% in the three months ended March 31, 2014. Excluding the settlement of a billing dispute related to a prior period which increased revenue by $2.2 million, the before tax operating margin in this segment was 25.7% during the first quarter of 2014, as compared to 26.9% in the same period of 2013. Operating margin in this segment will continue to decrease as the volume of loans serviced under the Department servicing contract increases as a percentage of overall volume serviced.

- Recent federal budget provisions to become effective July 1, 2014 will reduce payments by the Department to guaranty agencies for assisting student loan borrowers with the rehabilitation of defaulted loans under FFELP. Rehabilitation collection revenue recognized by the Company for the three months ended March 31, 2014 and 2013 was $13.4 million and $12.1 million, respectively. The Company anticipates this revenue will be negatively impacted as a result of these federal budget provisions.

Tuition Payment Processing and Campus Commerce

- Revenue increased in the three months ended March 31, 2014 compared to the same period in 2013 due to increases in the number of managed tuition payment plans, campus commerce customer transaction volume, and new school customers.

- Before tax operating margin decreased in the three months ended March 31, 2014 compared to the same period in 2013, due to an increase in expenses associated with continued system maintenance and enhancements.

- This segment is subject to seasonal fluctuations. Based on the timing of when revenue is recognized and when expenses are incurred, revenue and operating margin are higher in the first quarter as compared to the remainder of the year.

Enrollment Services

- Revenue decreased in the three months ended March 31, 2014 compared to the same period in 2013 due to a decrease in inquiry management and generation revenue as a result of the regulatory uncertainty regarding recruiting and marketing to potential students in the for-profit college industry, which has caused schools to decrease spending on marketing efforts.

- The Company continues to focus on improving the profitability of this segment by reducing operating expenses in reaction to the ongoing decline in revenue and gross margin.

Asset Generation and Management

- The Company acquired $387.3 million of student loans during the first three months of 2014. The average loan portfolio balance for the three months ended March 31, 2014 and 2013 was $25.9 billion and $24.8 billion, respectively.

- Forecasted future cash flows from the Company's FFELP student loan portfolio financed in asset-backed securitization transactions are estimated to be approximately $2.17 billion as of March 31, 2014.

- Core student loan spread decreased to 1.44% for the three months ended March 31, 2014, compared to 1.56% and 1.50% for the three months ended December 31, 2013 and March 31, 2013, respectively. This decrease was the result of recent consolidation loan acquisitions, which have lower margins but longer terms.

- Due to historically low interest rates, the Company continues to earn significant fixed rate floor income. During the three months ended March 31, 2014 and 2013, the Company earned $37.8 million and $35.7 million, respectively, of fixed rate floor income (net of $7.0 million and $8.3 million of derivative settlements, respectively, used to hedge such loans).

Corporate Activities

- Whitetail Rock Capital Management, LLC ("WRCM"), the Company's SEC-registered investment advisory subsidiary, recognized investment advisory revenue of $5.2 million and $2.8 million for the three months ended March 31, 2014 and 2013, respectively. These amounts include performance fees earned from the sale of managed securities. As of March 31, 2014, WRCM was managing an investment portfolio of $752.5 million for third-party entities.

- The Company had $7.2 million in gains on investments during the three months ended March 31, 2014, compared to $1.2 million for the same period in 2013.

Subsequent Event

- In April 2014, the Company purchased a total of $3.6 billion of FFELP student loans and related assets. The transaction included the purchase of residual interests in a total of $2.6 billion of securitized student loans and related assets under a stock purchase agreement, and the purchase of a total of approximately $950 million of unsecuritized student loans under three separate loan sale agreements. The aggregate cash purchase price for the assets acquired under the stock purchase agreement and the cash amount paid over the par value of the student loan portfolio and related accrued interest under the loan sale agreements was $139 million, and was funded from the Company's operating cash and unsecured line of credit. All acquired student loan assets and related debt will be included in the Company's consolidated financial statements.

CONSOLIDATED RESULTS OF OPERATIONS

Analysis of the Company's operating results for the three months ended March 31, 2014 compared to the same period in 2013 is summarized below.

The Company’s operating results are primarily driven by the performance of its existing portfolio and the revenues generated by its fee-based businesses and the costs to provide such services. The performance of the Company’s portfolio is driven by net interest income (which includes financing costs) and losses related to credit quality of the assets, along with the cost to administer and service the assets and related debt.

The Company operates as four distinct operating segments as described previously. For a reconciliation of the segment operating results to the consolidated results of operations, see note 7 of the notes to consolidated financial statements included under Part I, Item 1 of this report. Since the Company monitors and assesses its operations and results based on these segments, the discussion following the consolidated results of operations is presented on a segment basis.

	Three months ended March 31,		
	2014	2013	Additional information
Loan interest	$156,896	155,539	Increase is due to an increase in the average student loan balance, gross fixed rate floor income, and student loan discount accretion (net), partially offset by a decrease in gross variable student loan yield.
Investment interest	1,979	1,617	Includes income from unrestricted interest-earning deposits and investments and funds in asset-backed securitizations. Average investment balances increased year over year.
Total interest income	158,875	157,156	
Interest expense	60,004	58,358	Increase due to an increase in average debt outstanding, partially offset by a decrease in the Company's cost of funds.
Net interest income	98,871	98,798	See table below for additional analysis.
Less provision for loan losses	2,500	5,000	Represents the periodic expense of maintaining an allowance appropriate to absorb losses inherent in the portfolio of student loans.
Net interest income after provision for loan losses	96,371	93,798	
Other income (expense):			
LGS revenue	64,757	55,601	See LGS operating segment - results of operations.
TPP&CC revenue	25,235	23,411	See TPP&CC operating segment - results of operations.
NES revenue	22,011	28,957	See NES operating segment - results of operations.
Other income	18,131	9,416	See table below for the components of "other income."
Gain on sale of loans and debt repurchases	39	1,407	Gains are primarily from the repurchase of the Company's own asset-backed debt securities.
Derivative settlements, net	(6,229)	(8,184)	The Company maintains an overall risk management strategy that incorporates the use of derivative instruments to reduce the economic effect of interest rate volatility. Derivative settlements for each applicable period should be evaluated with the Company's net interest income. See table below for additional analysis.
Derivative market value and foreign currency adjustments, net	1,964	9,256	Includes (i) the unrealized gains and losses that are caused by changes in fair values of derivatives which do not qualify for "hedge treatment" under GAAP; and (ii) the foreign

			currency transaction gains or losses caused by the re-measurement of the Company's Euro-denominated bonds to U.S. dollars.
Total other income	125,908	119,864	
Operating expenses:			
Salaries and benefits	52,484	47,905	Increase is due to additional personnel to support increased LGS servicing volume and TPP&CC revenue, partially offset by expense reductions at NES.
Cost to provide enrollment services	14,475	19,642	See NES operating segment - results of operations.
Depreciation and amortization	4,783	4,377	
Other	35,627	34,941	
Total operating expenses	107,369	106,865	
Income before income taxes	114,910	106,797	
Income tax expense	40,611	38,447	The effective tax rate was 35.5% and 36.0% in the three month period ended March 31, 2014 and 2013, respectively.
Net income	74,299	68,350	
Net income attributable to noncontrolling interest	513	271	
Net income attributable to Nelnet, Inc.	$73,786	68,079	
Additional information:			
Net income attributable to Nelnet, Inc.	$73,786	68,079	The Company provides non-GAAP information that reflects specific items management believes to be important in the evaluation of its operating results. The Company believes the point-in-time estimates of asset and liability values related to its derivatives and Euro-denominated bonds that are subject to interest and currency rate fluctuations affect the period-to-period comparability of the results of operations. These items are excluded here for comparability purposes.
Derivative market value and foreign currency adjustments	(1,964)	(9,256)	
Tax effect	746	3,518	
Net income attributable to Nelnet, Inc., excluding derivative market value and foreign currency adjustments	$72,568	62,341	

The following table summarizes the components of "net interest income" and "derivative settlements, net."

	Three months ended March 31,		
	2014	2013	Additional information
Variable student loan interest margin, net of settlements on derivatives	$54,396	55,621	Represents the yield the Company receives on its student loan portfolio less the cost of funding these loans. Variable student loan spread is also impacted by the amortization/accretion of loan premiums and discounts, the 1.05% per year consolidation loan rebate fee paid to the Department, and yield adjustments from borrower benefit programs. See AGM operating segment - results of operations.
Fixed rate floor income, net of settlements on derivatives	37,844	35,716	The Company has a portfolio of student loans that are earning interest at a fixed borrower rate which exceeds the statutorily defined variable lender rates, generating fixed rate floor income. See Item 3, "Quantitative and Qualitative Disclosures About Market Risk - Interest Rate Risk" for additional information.
Investment interest	1,979	1,617	Increase is due to an increase in average investment balance in 2014 compared to 2013.
Non-portfolio related derivative settlements	(252)	(645)	
Corporate debt interest expense	(1,325)	(1,695)	Includes interest expense on the Junior Subordinated Hybrid Securities and unsecured and secured lines of credit.
Net interest income (net of settlements on derivatives)	$92,642	90,614	

The following table summarizes the components of "other income."

	Three months ended March 31,	
	2014	2013
Borrower late fee income	$3,673	3,505
Investment advisory fees	5,220	2,830
Realized and unrealized gains/(losses) on investments, net	7,210	1,154
Other	2,028	1,927
Other income	$18,131	9,416

STUDENT LOAN AND GUARANTY SERVICING OPERATING SEGMENT – RESULTS OF OPERATIONS

Student Loan Servicing Volumes (dollars in millions)

Company owned	$23,727	$22,650	$21,237	$20,820	$20,629	$20,715	$21,397	$21,192
% of total	38.6%	29.8%	21.8%	18.5%	17.7%	15.3%	15.5%	14.3%
Number of servicing borrowers:								
Government servicing:	2,804,502	3,036,534	3,892,929	4,261,637	4,396,341	5,145,901	5,305,498	5,438,933
FFELP servicing:	1,912,748	1,799,484	1,626,146	1,586,312	1,529,203	1,507,452	1,462,122	1,426,435
Private servicing:	155,947	164,554	173,948	170,224	173,588	178,935	195,580	191,606
Total:	4,873,197	5,000,572	5,693,023	6,018,173	6,099,132	6,832,288	6,963,200	7,056,974
Number of remote hosted borrowers:	545,456	9,566,296	6,912,204	5,001,695	3,218,896	1,986,866	1,915,203	1,796,287

Summary and Comparison of Operating Results

	Three months ended March 31,		Additional information
	2014	2013	
Net interest income	$11	10	
Loan and guaranty servicing revenue	64,757	55,601	See table below for additional analysis.
Intersegment servicing revenue	14,221	14,953	Represents revenue earned by the LGS operating segment as a result of servicing loans for the AGM operating segment.
Total other income	78,978	70,554	
Salaries and benefits	32,307	28,444	Increase due to additional personnel to support the increase in volume under the government servicing contract.
Depreciation and amortization	2,789	2,789	
Other expenses	18,452	18,390	
Intersegment expenses, net	1,083	935	
Total operating expenses	54,631	50,558	
Income before income taxes and corporate overhead allocation	24,358	20,006	
Corporate overhead allocation	(1,860)	(997)	
Income before income taxes	22,498	19,009	
Income tax expense	(8,549)	(7,223)	
Net income	$13,949	11,786	
Before tax operating margin	28.5%	(1) 26.9%	

(1) Excluding the settlement of a billing dispute related to a prior period which increased revenue by $2.2 million, before tax operating margin was 25.7%.

The following table summarizes the components of "Loan and guaranty servicing revenue."

	Three months ended March 31,		Additional information
	2014	2013	
Government servicing	$29,859	20,322	Increase due to an increase in the number of borrowers serviced under the government servicing contract.
FFELP servicing	3,416	5,322	Decrease will continue as third-party customers' FFELP portfolios run off.
Private servicing	2,484	2,220	
FFELP guaranty servicing	3,122	3,114	Revenue from guaranty servicing will decrease going forward as FFELP portfolios run off and guaranty volume decreases.
FFELP guaranty collection	17,653	17,067	The Company earns revenue from getting defaulted FFELP loan assets current on behalf of guaranty agencies. Over time, this FFELP-related revenue source will decrease as FFELP portfolios continue to run off. Also, recent federal budget provisions to become effective July 1, 2014 will reduce payments by the Department to guaranty agencies for assisting student loan borrowers with the rehabilitation of defaulted loans under FFELP. Rehabilitation

			collection revenue recognized by the Company for the three months ended March 31, 2014 and 2013 was $13.4 million and $12.1 million, respectively. The Company anticipates this revenue will be negatively impacted as a result of these federal budget provisions.
Software services	7,631	7,278	A contract with a significant remote hosted customer expired in December 2013. Revenue earned from this customer for the three months ended March 31, 2013 was $2.3 million. During the first quarter of 2014, the Company settled a billing dispute related to a prior period and recognized revenue of $2.2 million. Excluding these two items, software services revenue increased due to an increase in the number of borrowers from other remote hosted customers.
Other	592	278	
Loan and guaranty servicing revenue	$64,757	55,601	

TUITION PAYMENT PROCESSING AND CAMPUS COMMERCE OPERATING SEGMENT – RESULTS OF OPERATIONS

This segment of the Company's business is subject to seasonal fluctuations which correspond, or are related to, the traditional school year. Tuition management revenue is recognized over the course of the academic term, but the peak operational activities take place in summer and early fall. Higher amounts of revenue are typically recognized during the first quarter due to fees related to grant and aid applications. The Company's operating expenses do not follow the seasonality of the revenues. This is primarily due to generally fixed year-round personnel costs and seasonal marketing costs. Based on the timing of revenue recognition and when expenses are incurred, revenue and pre-tax operating margin are higher in the first quarter as compared to the remainder of the year.

Summary and Comparison of Operating Results

	Three months ended March 31,		Additional information
	2014	2013	
Tuition payment processing and campus commerce revenue	$25,235	23,411	Increase due to an increase in the number of managed tuition payment plans, campus commerce customer transaction volume, and new school customers.
Salaries and benefits	10,027	9,359	Increase due to additional personnel to support the increase in payment plans and continued system maintenance and enhancements.
Depreciation and amortization	1,428	1,138	
Other expenses	2,647	2,287	Increase due to additional expenses to support the increase in payment plans and continued system maintenance and enhancements.
Intersegment expenses, net	1,420	1,425	
Total operating expenses	15,522	14,209	
Income before income taxes and corporate overhead allocation	9,713	9,202	
Corporate overhead allocation	(620)	(332)	
Income before income taxes	9,093	8,870	
Income tax expense	(3,455)	(3,371)	
Net income	$5,638	5,499	
Before tax operating margin	36.0%	37.9%	

ENROLLMENT SERVICES OPERATING SEGMENT – RESULTS OF OPERATIONS

Summary and Comparison of Operating Results

	Three months ended March 31,		Additional information
	2014	2013	
Enrollment services revenue	$22,011	28,957	See table below for additional analysis.
Salaries and benefits	4,380	5,767	Decrease due to cost saving measures initiated by the Company in reaction to the ongoing decline in revenue.
Cost to provide enrollment services	14,475	19,642	See table below for additional analysis.
Depreciation and amortization	47	61	
Other expenses	1,449	1,651	
Intersegment expenses, net	1,006	1,149	
Total operating expenses	21,357	28,270	
Income before income taxes and corporate overhead allocation	654	687	
Corporate overhead allocation	(620)	(332)	
Income before income taxes	34	355	
Income tax expense	(13)	(135)	
Net income	$21	220	
Before tax operating margin	0.2%	1.2%	

The following tables summarize the components of "Enrollment services revenue" and "Cost to provide enrollment services."

	Inquiry management (marketing) (a)	Inquiry management (software)	Inquiry generation (a)	Digital marketing	Content solutions (b)	Total
	Three months ended March 31, 2014					
Enrollment services revenue	$13,537	1,069	2,845	1,068	3,492	22,011
Cost to provide enrollment services	11,954	—	1,785	88	648	14,475
Gross profit	$1,583	1,069	1,060	980	2,844	7,536
Gross profit %	11.7%		37.3%			
	Three months ended March 31, 2013					
Enrollment services revenue	$18,017	1,095	4,427	1,086	4,332	28,957
Cost to provide enrollment services	16,097	—	2,756	86	703	19,642
Gross profit	$1,920	1,095	1,671	1,000	3,629	9,315
Gross profit %	10.7%		37.7%			

(a) Inquiry management (marketing) revenue decreased $4.5 million (24.9%) and inquiry generation revenue decreased $1.6 million (35.7%) for the three months ended March 31, 2014 compared to the same period in 2013. Revenues from these services have been affected by the ongoing regulatory uncertainty regarding recruiting and marketing to potential students in the for-profit college industry, which has caused schools to decrease spending on

marketing efforts.

(b) Content solutions revenue decreased $0.8 million (19.4%) for the three months ended March 31, 2014 compared to the same period in 2013 due to the divesture of the Company's list marketing business in March 2013.

ASSET GENERATION AND MANAGEMENT OPERATING SEGMENT – RESULTS OF OPERATIONS

Student Loan Portfolio

As of March 31, 2014, the Company had a $25.6 billion student loan portfolio that will amortize over the next approximately 20 years. For a summary of the Company's student loan portfolio as of March 31, 2014 and December 31, 2013, see note 2 of the notes to consolidated financial statements included under Part I, Item 1 of this report.

Loan Activity

The following table sets forth the activity of loans:

	Three months ended March 31,	
	2014	2013
Beginning balance	$26,121,306	24,995,880
Loan acquisitions	387,258	743,766
Repayments, claims, capitalized interest, participations, and other	(548,705)	(554,250)
Consolidation loans lost to external parties	(145,664)	(143,151)
Loans sold	—	(11,648)
Ending balance	$25,814,195	25,030,597

In April 2014, the Company purchased a total of $3.6 billion of FFELP student loans and related assets. See note 12 of the notes to consolidated financial statements included under Part I, Item 1 of this report for additional information.

Allowance for Loan Losses, Loan Repurchase Obligations, and Loan Delinquencies

The Company maintains an allowance appropriate to absorb losses, net of recoveries, inherent in the portfolio of student loans, which results in periodic expense provisions for loan losses. In addition, the Company's servicing operations are obligated to repurchase certain non-federally insured loans subject to participation interests in the event such loans become 60 or 90 days delinquent, and the Company has also retained credit risk related to certain non-federally insured loans sold and will pay cash to purchase back any of these loans which become 60 days delinquent. Further, delinquencies have the potential to adversely impact the Company's earnings through increased servicing and collection costs and account charge-offs.

For a summary of the activity in the allowance for loan losses and accrual related to the Company's loan repurchase obligations for the three months ended March 31, 2014 and 2013, and a summary of the Company's student loan delinquency amounts as of March 31, 2014, December 31, 2013, and March 31, 2013, see note 2 of the notes to consolidated financial statements included under Part I, Item 1 of this report.

The provision for loan losses and charge-offs of federally insured loans decreased during the first quarter of 2014 as compared to the same period in 2013 as a result of improving economic conditions.

Student Loan Spread Analysis

The following table analyzes the student loan spread on the Company's portfolio of student loans, which represents the spread between the yield earned on student loan assets and the costs of the liabilities and derivative instruments used to fund the assets.

	Three months ended		
	March 31, 2014	December 31, 2013	March 31, 2013
Variable student loan yield, gross	2.50 %	2.58 %	2.57 %
Consolidation rebate fees	(0.80)	(0.78)	(0.77)
Discount accretion, net of premium and deferred origination costs amortization	0.05	0.05	0.03
Variable student loan yield, net	1.75	1.85	1.83
Student loan cost of funds - interest expense	(0.92)	(0.90)	(0.93)
Student loan cost of funds - derivative settlements	0.02	0.01	0.01
Variable student loan spread	0.85	0.96	0.91
Fixed rate floor income, net of settlements on derivatives	0.59	0.60	0.59
Core student loan spread	1.44 %	1.56 %	1.50 %
Average balance of student loans	$25,915,053	25,770,607	24,781,426
Average balance of debt outstanding	25,826,656	25,687,958	24,823,397

A trend analysis of the Company's core and variable student loan spreads is summarized below.

(a) The interest earned on a large portion of the Company's FFELP student loan assets is indexed to the one-month LIBOR rate. The Company funds the majority of its assets with three-month LIBOR indexed floating rate securities. The relationship between the indices in which the Company earns interest on its loans and funds such loans has a significant impact on student loan spread. This table (the right axis) shows the difference between the Company's liability base rate and the one-month LIBOR rate by quarter.

Variable student loan spread decreased during the three months ended March 31, 2014 as a result of recent consolidation loan acquisitions, which have lower margins but longer terms.

The primary difference between variable student loan spread and core student loan spread is fixed rate floor income. A summary of fixed rate floor income and its contribution to core student loan spread follows:

	Three months ended		
	March 31, 2014	December 31, 2013	March 31, 2013
Fixed rate floor income, gross	$44,794	45,854	44,020
Derivative settlements (a)	(6,950)	(7,006)	(8,304)
Fixed rate floor income, net	$37,844	38,848	35,716
Fixed rate floor income contribution to spread, net	0.59%	0.60%	0.59%

(a) Includes settlement payments on derivatives used to hedge student loans earning fixed rate floor income.

The high levels of fixed rate floor income earned during 2014 and 2013 are due to historically low interest rates. If interest rates remain low, the Company anticipates continuing to earn significant fixed rate floor income in future periods. See Item 3, “Quantitative and Qualitative Disclosures About Market Risk,” which provides additional detail on the Company’s portfolio earning fixed rate floor income and the derivatives used by the Company to hedge these loans.

Summary and Comparison of Operating Results

	Three months ended March 31,		Additional information
	2014	2013	
Net interest income after provision for loan losses	$95,027	93,172	See table below for additional analysis.
Other income	4,164	4,196	The primary component of other income is borrower late fees, which were $3.7 million and $3.5 million in 2014 and 2013, respectively.
Gain on sale of loans and debt repurchases	39	1,407	Gains are primarily from the Company repurchasing its own asset-backed debt securities.
Derivative market value and foreign currency adjustments, net	3,477	5,275	Includes (i) the unrealized gains and losses that are caused by changes in fair values of derivatives which do not qualify for "hedge treatment" under GAAP; and (ii) the foreign currency transaction gains or losses caused by the re-measurement of the Company's Euro-denominated bonds to U.S. dollars.
Derivative settlements, net	(5,977)	(7,539)	The Company maintains an overall risk management strategy that incorporates the use of derivative instruments to reduce the economic effect of interest rate volatility. Derivative settlements for each applicable period should be evaluated with the Company's net interest income as reflected in the table below.
Total other income	1,703	3,339	
Salaries and benefits	609	562	
Other expenses	7,146	7,513	The Company pays higher third-party servicing fees on delinquent loans. At the end of 2012, the Company purchased a portfolio of severely delinquent rehabilitation loans, and paid higher third-party servicing fees on such loans throughout 2013. Many of these loans have since defaulted, leaving the Company with a more current third-party serviced loan portfolio and a decrease in third-party servicing fees in the first quarter of 2014 compared to the same period in 2013.
Intersegment expenses, net	14,371	15,142	Amount includes fees paid to the LGS operating segment for the servicing of the Company’s student loan

			portfolio. Such amounts have decreased as the AGM portfolio serviced by LGS has run off.
Total operating expenses	22,126	23,217	
Income before income taxes and corporate overhead allocation	74,604	73,294	
Corporate overhead allocation	(1,329)	(712)	
Income before income taxes	73,275	72,582	
Income tax expense	(27,844)	(27,581)	
Net income	$45,431	45,001	
Additional information:			
Net income	$45,431	45,001	The Company provides non-GAAP information that reflects specific items management believes to be important in the evaluation of its operating results. The Company believes the point-in-time estimates of asset and liability values related to its derivatives and Euro-denominated bonds that are subject to interest and currency rate fluctuations affect the period-to-period comparability of the results of operations. These items are excluded here for comparability purposes.
Derivative market value and foreign currency adjustments, net	(3,477)	(5,275)	
Tax effect	1,321	2,005	
Net income, excluding derivative market value and foreign currency adjustments	$43,275	41,731	

The following table summarizes the components of "net interest income after provision for loan losses" and "derivative settlements, net."

	Three months ended March 31,		Additional information
	2014	2013	
Variable interest income, net of settlements on derivatives	$160,949	157,548	Increase due to an increase in the average student loan portfolio, partially offset by a decrease in the yield earned on student loans, net of settlements on derivatives.
Consolidation rebate fees	(51,323)	(47,208)	Increase due to an increase in the average consolidation loan balance.
Discount accretion, net of premium and deferred origination costs amortization	3,449	1,943	Increase due to the Company's purchase of loans at a net discount over the last several years.
Interest on bonds and notes payable	(58,679)	(56,662)	Increase due to an increase in the average debt outstanding, partially offset by a decrease in the Company's cost of funds.
Variable student loan interest margin, net of settlements on derivatives	54,396	55,621	
Fixed rate floor income, net of settlements on derivatives	37,844	35,716	The high levels of fixed rate floor income earned are due to historically low interest rates.
Investment interest	107	115	
Intercompany interest	(797)	(819)	
Provision for loan losses - federally insured	(3,000)	(6,000)	
Recovery of loan losses - nonfederally insured	500	1,000	
Net interest income after provision for loan losses (net of settlements on derivatives)	$89,050	85,633	

LIQUIDITY AND CAPITAL RESOURCES

The Company’s fee generating businesses are non-capital intensive and all produce positive operating cash flows. As such, a minimal amount of debt and equity capital is allocated to the fee-based segments and any liquidity or capital needs are satisfied using cash flow from operations. Therefore, the Liquidity and Capital Resources discussion is concentrated on the Company’s liquidity and capital needs to meet existing debt obligations in the Asset Generation and Management operating segment.

2014 Significant Loan Acquisition

On April 25, 2014, the Company completed the purchase of a total of $3.6 billion of FFELP student loans and related assets. The transaction included the purchase of residual interests in a total of $2.6 billion of securitized student loans and related assets under a stock purchase agreement, and the purchase of a total of approximately $950 million of unsecuritized student loans under three separate loan sale agreements.

The assets acquired under the stock purchase agreement include the rights to the residual interests in three FFELP student loan securitization trusts, which hold a total of $2.6 billion of FFELP student loans and related assets and have issued a corresponding amount of related student loan asset-backed debt. In addition, under the loan sale agreements,

the Company purchased for cash unsecuritized FFELP loans totaling approximately $950 million, consisting primarily of FFELP consolidation loans, which were initially funded through the Company’s existing student loan warehouse facilities. The aggregate cash purchase price for the assets acquired under the stock purchase agreement and the cash amount paid over the par value of the student loan portfolio and related accrued interest under the loan sale agreements was $139 million, and was funded from the Company’s operating cash and unsecured line of credit. All acquired student loan assets and related debt will be included in the Company’s consolidated financial statements.

On April 30, 2014, the Company completed an asset-backed securitization totaling $719.8 million, which provided permanent funding for loans that were previously funded in the Company's warehouse facilities, including a portion of the $950 million of unsecuritized loans purchased in April 2014. As of April 30, 2014, after the completion of this asset-backed securitization, $1.1 billion was outstanding on the Company's warehouse facilities and $1.2 billion was available for future use.

Sources of Liquidity Currently Available

As of March 31, 2014, the Company had cash and investments of $273.3 million. In addition, the Company has historically generated positive cash flow from operations. For the three months ended March 31, 2014 and the year ended December 31, 2013, the Company's net cash provided by operating activities was $88.6 million and $387.2 million, respectively.

In addition, the Company has an unsecured line of credit that matures on March 28, 2018. As of March 31, 2014, no amount was borrowed on the unsecured line of credit. As of April 30, 2014, subsequent to the purchase of the $3.6 billion of loans described above, $160.0 million was outstanding on the unsecured line of credit and $115.0 million was available for future use.

As part of the Company’s asset-backed securitizations, the Company has purchased certain of the Class B subordinated note tranches. In addition, the Company has repurchased certain of its own asset-backed securities (bonds and notes payable) in the secondary market. For accounting purposes, these notes are effectively retired and are not included on the Company’s consolidated balance sheet. However, these securities are legally outstanding at the trust level and the Company could sell these notes to third parties or redeem the notes at par as cash is generated by the trust estate. Upon a sale of these notes to third parties, the Company would obtain cash proceeds equal to the market value of the notes on the date of such sale. As of March 31, 2014, the Company holds $228.0 million (face amount) of its own asset-backed securities that are not included in the consolidated financial statements.

The Company intends to use its liquidity position to capitalize on market opportunities, including FFELP student loan acquisitions; strategic acquisitions and investments, including continued investments in its core business areas of asset management and finance, loan servicing, payment processing, and enrollment services; and capital management initiatives, including stock repurchases, debt repurchases, and dividend distributions.

Cash Flows

During the three months ended March 31, 2014, the Company generated $88.6 million from operating activities, compared to $85.0 million for the same period in 2013. The increase in cash provided by operating activities reflects the higher level of net income in 2014 and the impacts of the non-cash foreign currency translation adjustment related to the Company's Euro denominated bonds payable. The increase in cash provided by operating activities was partially offset by the impacts of changes in non-cash fair value adjustments for derivatives.

The primary items included in the statement of cash flows for investing activities are the purchase and repayment of student loans. The primary items included in financing activities are the proceeds from the issuance of and payments on bonds and notes payable used to fund student loans. Cash provided by investing activities and cash used in financing activities for the three months ended March 31, 2014 was $340.5 million and $385.3 million, respectively. Investing and financing activities are further addressed in the discussion that follows.

Liquidity Needs and Sources of Liquidity Available to Satisfy Debt Obligations Secured by Student Loan Assets and Related Collateral

The following table shows the Company's debt obligations outstanding that are secured by student loan assets and related collateral.

	As of March 31, 2014	
	Carrying amount	Final maturity

Bonds and notes issued in asset-backed securitizations	$24,912,972	5/25/18 - 8/26/52
FFELP warehouse facilities	772,435	1/17/16 - 9/30/16
Other borrowings	61,374	8/11/14 - 11/11/15
	$25,746,781	

Bonds and Notes Issued in Asset-backed Securitizations

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, thereby minimizing liquidity risk. In addition, due to (i) the difference between the yield the Company receives on the loans and cost of financing within these transactions, and (ii) the servicing and administration fees the Company earns from these transactions, the Company has created a portfolio that will generate earnings and significant cash flow over the life of these transactions.

As of March 31, 2014, 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 $2.17 billion as detailed below. The $2.17 billion includes approximately $532.1 million (as of March 31, 2014) of overcollateralization included in the asset-backed securitizations. These excess net asset positions are reflected variously in the following balances in the consolidated balance sheet: "student loans receivable," "restricted cash and investments," and "accrued interest receivable."

The forecasted cash flow presented below includes all loans funded in asset-backed securitizations as of March 31, 2014. As of March 31, 2014, the Company had $24.9 billion of loans included in asset-backed securitizations, which represented 96.9 percent of its total FFELP student loan portfolio. The forecasted cash flow does not include cash flows that the Company expects to receive related to loans currently funded in its warehouse facilities or loans acquired subsequent to March 31, 2014.

FFELP Asset-backed Securitization Cash Flow Forecast
$2.17 billion
(dollars in millions)

The Company uses various assumptions, including prepayments and future interest rates, when preparing its cash flow forecast. These assumptions are further discussed below.

Prepayments: The primary variable in establishing a life of loan estimate is the level and timing of prepayments. Prepayment rates equal the amount of loans that prepay annually as a percentage of the beginning of period balance, net of scheduled principal payments. A number of factors can affect estimated prepayment rates, including the level of consolidation activity and default rates. Should any of these factors change, management may revise its assumptions, which in turn would impact the projected future cash flow. The Company's cash flow forecast above assumes prepayment rates that are generally consistent with those utilized in the Company's recent asset-backed securitization transactions. If management used a prepayment rate assumption two times greater than what was used to forecast the cash flow, the cash flow forecast would be reduced by approximately $230 million to $290 million.

Interest rates: The Company funds a large portion of its student loans with three-month LIBOR indexed floating rate securities. Meanwhile, the interest earned on the Company's student loan assets is indexed primarily to a one-month LIBOR rate. The different interest rate characteristics of the Company's loan assets and liabilities funding these assets result in basis risk. The Company's cash flow forecast assumes three-month LIBOR will exceed one-month LIBOR by 12 basis points for the life of the portfolio, which approximates the historical relationship between these indices. If the forecast is computed assuming a spread of 24 basis points between three-month and one-month LIBOR for the life of the portfolio, the cash flow forecast would be reduced by approximately $110 million to $150 million.

The Company uses the current forward interest rate yield curve to forecast cash flows. A change in the forward interest rate curve would impact the future cash flows generated from the portfolio. An increase in future interest rates will reduce the amount of fixed rate floor income the Company is currently receiving. The Company attempts to mitigate the impact of a rise in short-term rates by hedging interest rate risks. As of March 31, 2014, the net fair value of the Company's interest rate derivatives used to hedge loans earning fixed rate floor income was a net liability of $5.3 million. See Item 3, "Quantitative and Qualitative Disclosures About Market Risk — Interest Rate Risk."

FFELP Warehouse Facilities

The Company funds a portion of its FFELP loan acquisitions using its FFELP warehouse facilities. Student loan warehousing allows the Company to buy and manage student loans prior to transferring them into more permanent financing arrangements. As of March 31, 2014, the Company had three FFELP warehouse facilities with an aggregate maximum financing amount available of $1.8 billion, of which $0.8 billion was outstanding. On April 15, 2014, the Company amended the agreement for one of its warehouse facilities to temporarily increase the maximum financing amount from $500 million to $1.0 billion. The maximum financing amount on this facility is scheduled to decrease $100.0 million a month beginning in June 2014 until it returns to $500.0 million in size. Of the three facilities, one facility provides for formula-based advance rates, depending on FFELP loan type, up to a maximum of the principal and interest of loans financed. The advance rate for collateral may increase or decrease based on market conditions. The other two FFELP warehouse facilities have static advance rates that require initial equity for loan funding, but do not require increased equity based on market movements. As of April 30, 2014, subsequent to the temporary increase in the maximum financing amount under one of the warehouse agreements and the purchase of $3.6 billion of student loans, both described previously, $1.1 billion was outstanding on the Company's FFELP warehouse facilities and $1.2 billion was available for future use. A summary of the warehouse facilities as of April 30, 2014 is shown below:

	NHELP-III	NFSLW-I	NHELP-II	Total
Maximum financing amount	$ 750,000	1,000,000	500,000	2,250,000
Amount outstanding	541,162	308,947	243,101	1,093,210
Amount available	$ 208,838	691,053	256,899	1,156,790
Expiration of liquidity provisions	February 5, 2015	June 11, 2015	September 30, 2014	
Final maturity date	January 17, 2016	June 11, 2017	September 30, 2016	
Maximum advance rates	92.2 - 95.0%	92.0 - 98.0%	84.5 - 94.5%	
Minimum advance rates	92.2 - 95.0%	84.0 - 90.0%	84.5 - 94.5%	

Upon termination or expiration of the warehouse facilities, the Company would expect to access the securitization market, obtain replacement warehouse facilities, use operating cash, consider the sale of assets, or transfer collateral to satisfy any remaining obligations.

Other Uses of Liquidity

Effective July 1, 2010, no new loan originations can be made under the FFEL Program and all new federal loan originations must be made through the Federal Direct Loan Program. As a result, the Company no longer originates new FFELP loans, but continues to acquire FFELP loan portfolios from third parties and believes additional loan purchase opportunities exist.

The Company plans to fund future FFELP student loan acquisitions using current cash and investments; using its Union Bank participation agreement (as described below); using its FFELP warehouse facilities (as described above); and continuing to access the asset-backed securitization market.

Union Bank Participation Agreement

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. As of March 31, 2014, $317.7 million of loans were subject to outstanding participation interests held by Union Bank, as trustee, under this agreement. The agreement automatically renews annually and is terminable by either party upon five business days notice. This agreement provides beneficiaries of Union Bank's grantor trusts with access to investments in interests in student loans, while providing liquidity to the Company. The Company

can participate loans to Union Bank to the extent of availability under the grantor trusts, up to $750 million or an amount in excess of $750 million if mutually agreed to by both parties. Loans participated under this agreement have been accounted for by the Company as loan sales. Accordingly, the participation interests sold are not included in the Company’s consolidated balance sheets.

Asset-backed Securitization Transactions

During the first four months of 2014, the Company completed three asset-backed securitizations totaling $1.7 billion. Depending on market conditions, the Company anticipates continuing to access the asset-backed securitization market. Asset-backed securitization transactions would be used to refinance student loans included in the FFELP warehouse facilities, including additional purchased FFELP loans, and/or existing asset-backed securitizations.

Liquidity Impact Related to Hedging Activities

The Company utilizes derivative instruments to manage interest rate sensitivity. By using derivative instruments, the Company is exposed to market risk which could impact its liquidity. Based on the derivative portfolio outstanding as of March 31, 2014, the Company does not currently anticipate any movement in interest rates having a material impact on its capital or liquidity profile, nor does the Company expect that any movement in interest rates would have a material impact on its ability to meet potential collateral deposits with its counterparties. However, if interest rates move materially and negatively impact the fair value of the Company's derivative portfolio or if the Company enters into additional derivatives for which the fair value becomes negative, the Company could be required to deposit additional collateral with its derivative instrument counterparties. The collateral deposits, if significant, could negatively impact the Company's liquidity and capital resources. As of March 31, 2014, the fair value of the Company's derivatives which had a negative fair value (a liability in the Company's balance sheet), was $16.5 million, and the Company had $3.1 million posted as collateral to derivative counterparties.

Other Debt Facilities

As previously discussed, the Company has a $275.0 million unsecured line of credit with a maturity date of March 28, 2018. As of March 31, 2014, no amounts were outstanding on the unsecured line of credit. As of April 30, 2014, subsequent to the purchase of $3.6 billion of student loans as discussed previously, $160.0 million was outstanding on the unsecured line of credit and $115.0 million was available for future use.

The Company has issued Hybrid Securities that have a final maturity of September 15, 2061. The Hybrid Securities are unsecured obligations of the Company. As of March 31, 2014, $96.5 million of Hybrid Securities were outstanding.

Debt Repurchases

Due to the Company's positive liquidity position and opportunities in the capital markets, the Company has repurchased its own debt over the last several years, and may continue to do so in the future. Gains recorded by the Company from the repurchase of debt are included in "gain on sale of loans and debt repurchases" on the Company’s consolidated statements of income. For the three months ended March 31, 2014, the Company recognized a gain of approximately $39,000 from the repurchase of $1.4 million (face amount) of its own asset-backed debt securities.

Dividends

On March 14, 2014, the Company paid a first quarter 2014 cash dividend on the Company's Class A and Class B common stock of $0.10 per share. In addition, the Company's Board of Directors declared a second quarter 2014 cash

dividend on the Company's outstanding shares of Class A and Class B common stock of $0.10 per share. The second quarter cash dividend will be paid on June 13, 2014, to shareholders of record at the close of business on May 30, 2014.

The Company currently plans to continue making regular 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 Hybrid Securities, which generally provide that if the Company defers interest payments on those securities it cannot pay dividends on its capital stock.

RECENT ACCOUNTING PRONOUNCEMENTS

In January 2014, the FASB issued accounting guidance regarding the accounting for investments by a reporting entity in flow-through limited liability entities that manage or invest in affordable housing projects that qualify for the low-income housing tax credit. The Company has relatively small investments in affordable housing projects that qualify for the low-income housing tax credits, and currently accounts for these investments using the equity method. The Company plans to continue using the equity method to account for these investments, thus the adoption of this standard will not have an impact on its financial position or results of operations.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK
(All dollars are in thousands, except share amounts, unless otherwise noted)

Interest Rate Risk

The Company's primary market risk exposure arises from fluctuations in its borrowing and lending rates, the spread between which could impact the Company due to shifts in market interest rates.

The following table sets forth the Company's loan assets and debt instruments by interest rate characteristics:

	As of March 31, 2014			As of December 31, 2013		
	Dollars	Percent		Dollars	Percent	
Fixed-rate loan assets	$10,963,939	42.5	%	$11,090,583	42.5	%
Variable-rate loan assets	14,850,256	57.5		15,030,723	57.5	
Total	$25,814,195	100.0	%	$26,121,306	100.0	%
Fixed-rate debt instruments	$—	—	%	$—	—	%
Variable-rate debt instruments	25,843,238	100.0		26,213,345	100.0	
Total	$25,843,238	100.0	%	$26,213,345	100.0	%

FFELP loans originated prior to April 1, 2006 generally earn interest at the higher of the borrower rate, which is fixed over a period of time, or a floating rate based on the Special Allowance Payments ("SAP") formula set by the Department. The SAP rate is based on an applicable index plus a fixed spread that depends on loan type, origination date, and repayment status. The Company generally finances its student loan portfolio with variable rate debt. In low and/or certain declining interest rate environments, when the fixed borrower rate is higher than the SAP rate, these student loans earn at a fixed rate while the interest on the variable rate debt typically continues to reflect the low and/or declining interest rates. 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. All FFELP loans first originated on or after April 1, 2006 effectively earn at the SAP rate, since lenders are required to rebate fixed rate floor income and variable rate floor income for those loans to the Department.

No variable-rate floor income was earned by the Company during 2013 and 2014. A summary of fixed rate floor income earned by the Company follows.

	Three months ended March 31,	
	2014	2013

Fixed rate floor income, gross	$44,794	44,020
Derivative settlements (a)	(6,950)	(8,304)
Fixed rate floor income, net	$37,844	35,716

(a) Includes settlement payments on derivatives used to hedge student loans earning fixed rate floor income.

The high levels of fixed rate floor income earned during 2014 and 2013 are due to historically low interest rates. If interest rates remain low, the Company anticipates continuing to earn significant fixed rate floor income in future periods.

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 SAP 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 following graph depicts fixed rate floor income for a borrower with a fixed rate of 6.75% and a SAP rate of 2.64%:

The following table shows the Company's student loan assets that were earning fixed rate floor income as of March 31, 2014:

Fixed interest rate range	Borrower/ lender weighted average yield	Estimated variable conversion rate (a)	Loan balance
< 3.0%	2.87%	0.23%	$1,726,929
3.0 - 3.49%	3.20%	0.56%	2,074,849
3.5 - 3.99%	3.65%	1.01%	1,897,192
4.0 - 4.49%	4.20%	1.56%	1,430,798
4.5 - 4.99%	4.72%	2.08%	836,949
5.0 - 5.49%	5.24%	2.60%	573,901
5.5 - 5.99%	5.67%	3.03%	345,903
6.0 - 6.49%	6.18%	3.54%	400,247
6.5 - 6.99%	6.70%	4.06%	365,058
7.0 - 7.49%	7.17%	4.53%	151,669
7.5 - 7.99%	7.71%	5.07%	257,631
8.0 - 8.99%	8.17%	5.53%	608,080
> 9.0%	9.04%	6.40%	294,733
			$10,963,939

(a) The estimated variable conversion rate is the estimated short-term interest rate at which loans would convert to a variable rate. As of March 31, 2014, the weighted average estimated variable conversion rate was 1.84% and the short-term interest rate was 16 basis points.

The following table summarizes the outstanding derivative instruments as of March 31, 2014 used by the Company to economically hedge loans earning fixed rate floor income.

Maturity	Notional amount	Weighted average fixed rate paid by the Company (a)	
2014	$1,750,000	0.71	%
2015	1,100,000	0.89	
2016	750,000	0.85	
2017	1,250,000	0.86	
	$4,850,000	0.81	%

(a) For all interest rate derivatives, the Company receives discrete three-month LIBOR.

The Company is also 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 those assets. The following table presents the Company's FFELP student loan assets and related funding for those assets arranged by underlying indices as of March 31, 2014:

Index	Frequency of variable resets	Assets	Debt outstanding that funded student loan assets
1 month LIBOR (a)	Daily	$24,741,325	—
3 month Treasury bill	Daily	1,004,330	—
3 month LIBOR (a) (b)	Quarterly	—	15,841,530
1 month LIBOR	Monthly	—	8,316,538
Auction-rate or remarketing (c)	Varies	—	1,132,900
Asset-backed commercial paper (d)	Varies	—	394,439
Other (e)		1,126	61,374
		$25,746,781	25,746,781

(a) The Company has certain basis swaps outstanding in which the Company receives three-month LIBOR and pays one-month LIBOR plus or minus a spread as defined in the agreements (the "1:3 Basis Swaps"). The Company entered into these derivative instruments to better match the interest rate characteristics on its student loan assets and the debt funding such assets. The following table summarizes these derivatives as of March 31, 2014:

Maturity		Notional amount	
2021		$250,000	
2022		1,900,000	
2023		3,650,000	
2024		250,000	
2026		800,000	
2028		100,000	
2036		700,000	
2039	(a)	150,000	
2040	(b)	200,000	
		$8,000,000	(c)

(a) This derivative has a forward effective start date in 2015.

(b) This derivative has a forward effective start date in 2020.

(c) The weighted average rate paid by the Company on the 1:3 Basis Swaps as of March 31, 2014 was one-month LIBOR plus 3.5 basis points.

(b) The Company has Euro-denominated notes that reprice on the EURIBOR index. The Company has entered into a derivative instrument (cross-currency interest rate swap) that converts the EURIBOR index to three-month LIBOR. As a result, these notes are reflected in the three-month LIBOR category in the above table. See "Foreign Currency

Exchange Risk."

(c) 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 a remarketing utilizing remarketing agents (“Variable Rate Demand Notes”). As of March 31, 2014, the Company was sponsor for $913.7 million of Auction Rate Securities and $219.2 million of Variable Rate Demand Notes.

Since February 2008, problems in the auction rate securities market as a whole have led to failures of the auctions pursuant to which the Company's Auction Rate Securities' interest rates are set. As a result, the Auction Rate Securities generally pay interest to the holder at a maximum rate as defined by the indenture. While these rates will vary, they will generally be based on a spread to LIBOR or Treasury Securities, or the Net Loan Rate as defined in the financing documents.

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 Variable Rate Demand Notes will generally pay interest to the holder at a rate as defined in the indenture.

(d) The interest rates on certain of the Company's warehouse facilities are indexed to asset-backed commercial paper rates.

(e) Assets include restricted cash and investments and other assets. Debt outstanding includes other debt obligations secured by student loan assets and related collateral.

Sensitivity Analysis

The following tables summarize the effect on the Company’s earnings, based upon a sensitivity analysis performed by the Company assuming hypothetical increases in interest rates of 100 basis points and 300 basis points while funding spreads remain constant. In addition, a sensitivity analysis was performed assuming the funding index increases 10 basis points and 30 basis points while holding the asset index constant, if the funding index is different than the asset index. The sensitivity analysis was performed on the Company’s variable rate assets (including loans earning fixed rate floor income) and liabilities. The analysis includes the effects of the Company’s interest rate and basis swaps in existence during these periods.

	Interest rates				Asset and funding index mismatches			
	Change from increase of 100 basis points		Change from increase of 300 basis points		Increase of 10 basis points		Increase of 30 basis points	
	Dollars	Percent	Dollars	Percent	Dollars	Percent	Dollars	Percent
	Three months ended March 31, 2014							
Effect on earnings:								
Decrease in pre-tax net income before impact of derivative settlements	$(16,934)	(14.7)%	$(28,643)	(24.9)%	$(4,076)	(3.5)%	$(12,228)	(10.6)%
Impact of derivative settlements	11,959	10.4	35,877	31.2	1,886	1.6	5,659	4.9
Increase (decrease) in net income before taxes	$(4,975)	(4.3)%	$7,234	6.3 %	$(2,190)	(1.9)%	$(6,569)	(5.7)%
Increase (decrease) in basic and diluted earnings per share	$(0.07)		$0.10		$(0.03)		$(0.09)	
	Three months ended March 31, 2013							
Effect on earnings:								

Decrease in pre-tax net income before impact of derivative settlements	$(16,419)	(15.4	)%	$(27,819)	(26.0	)%	$(4,490)	(4.2	)%	$(13,470)	(12.6	)%
Impact of derivative settlements	17,260	16.2		51,781	48.5		1,482	1.4		4,447	4.2	
Increase (decrease) in net income before taxes	$841	0.8	%	$23,962	22.5	%	$(3,008)	(2.8	)%	$(9,023)	(8.4	)%
Increase (decrease) in basic and diluted earnings per share	$(0.01)			$0.32			$(0.04)			$(0.12)		

Foreign Currency Exchange Risk

The Company has issued 352.7 million Euro-denominated notes with interest rates based on a spread to the EURIBOR index. As a result, the Company is exposed to the market risk related to fluctuations in foreign currency exchange rates between the U.S. dollar and Euro. The Company has entered into a cross-currency interest rate swap in connection with the issuance of the Euro Notes. See note 4 of the notes to consolidated financial statements included under Part I, Item 1 of this report for additional information, including a summary of the terms of this derivative instrument agreement and the related financial statement impact.

Financial Statement Impact – Derivatives and Foreign Currency Transaction Adjustments

For a table summarizing the effect of derivative instruments in the consolidated statements of income, including the components of "derivative market value and foreign currency adjustments and derivative settlements, net" included in the consolidated statements of income, see note 4 of the notes to consolidated financial statements included under Part I, Item 1 of this report.

ITEM 4. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

Under supervision and with the participation of certain members of the Company’s management, including the chief executive and chief financial officers, the Company completed an evaluation of the effectiveness of the design and operation of its disclosure controls and procedures (as defined in SEC Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934). Based on this evaluation, the Company’s principal executive and principal financial officers concluded that the disclosure controls and procedures were effective as of the end of the period covered by this report to provide reasonable assurance that information required to be disclosed in reports the Company files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized, and reported, within the time periods specified in the SEC's rules and forms, and is accumulated and communicated to the Company's management, including the chief executive and chief financial officers, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

There was no change in the Company’s internal control over financial reporting during the Company’s last fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company’s internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The information required by this Item is incorporated herein by reference to Note 11 - Legal Proceedings, of the notes to consolidated financial statements included under Part I, Item 1 of this report.

ITEM 1A. RISK FACTORS

There have been no material changes from the risk factors described in the Company’s Annual Report on Form 10-K for the year ended December 31, 2013 in response to Item 1A of Part I of such Form 10-K.

46

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Stock Repurchases

The following table summarizes the repurchases of Class A common stock during the first quarter of 2014 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 (a)	Average price paid per share	Total number of shares purchased as part of publicly announced plans or programs (b)	Maximum number of shares that may yet be purchased under the plans or programs (b)
January 1 - January 31, 2014	1,132	$41.73	—	3,875,367
February 1 - February 28, 2014	664	36.28	—	3,875,367
March 1 - March 31, 2014	18,768	42.51	—	3,875,367
Total	20,564	$42.27	—	

(a) The total number of shares represents shares owned and tendered by employees to satisfy tax withholding obligations upon the vesting of restricted shares. 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.

(b) On May 9, 2012, the Company 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 during the three-year period ending May 24, 2015.

Working capital and dividend restrictions/limitations

The Company's credit facilities, including its revolving line of credit which is available through March 28, 2018, impose restrictions with respect to the Company's minimum consolidated net worth, the ratio of the Company's adjusted EBITDA to corporate debt interest, the indebtedness of the Company's subsidiaries, and the ratio of non-FFELP loans to all loans in the Company's portfolio. In addition, trust indentures and other financing agreements governing debt issued by the Company's education lending subsidiaries may have general limitations on the amounts of funds that can be transferred to the Company by its subsidiaries through cash dividends.

The supplemental indenture for the Company's Hybrid Securities issued in September 2006 provides that so long as any Hybrid Securities remain outstanding, if the Company gives notice of its election to defer interest payments but the related deferral period has not yet commenced or a deferral period is continuing, then the Company will not, and will not permit any of its subsidiaries to:

- declare or pay any dividends or distributions on, or redeem, purchase, acquire or make a liquidation payment regarding, any of the Company's capital stock.

- except as required in connection with the repayment of principal, and except for any partial payments of deferred interest that may be made through the alternative payment mechanism described in the Hybrid Securities indenture, make any payment of principal of, or interest or premium, if any, on, or repay, repurchase, or redeem any of the Company's debt securities that rank pari passu with or junior to the Hybrid Securities.

-

make any guarantee payments regarding any guarantee by the Company of the subordinated debt securities of any of the Company's subsidiaries if the guarantee ranks pari passu with or junior in interest to the Hybrid Securities.

In addition, if any deferral period lasts longer than one year, the limitation on the Company's ability to redeem or repurchase any of its securities that rank pari passu with or junior in interest to the Hybrid Securities will continue until the first anniversary of the date on which all deferred interest has been paid or canceled.

If the Company is involved in a business combination where immediately after its consummation more than 50% of the surviving entity's voting stock is owned by the shareholders of the other party to the business combination, then the immediately preceding sentence will not apply to any deferral period that is terminated on the next interest payment date following the date of consummation of the business combination.

However, at any time, including during a deferral period, the Company will be permitted to:

- pay dividends or distributions in additional shares of the Company's capital stock.
- declare or pay a dividend in connection with the implementation of a shareholders' rights plan, or issue stock under such a plan, or redeem or repurchase any rights distributed pursuant to such a plan.
- purchase common stock for issuance pursuant to any employee benefit plans.

ITEM 6. EXHIBITS

2.1+	Stock Purchase Agreement dated as of April 10, 2014 among Nelnet Finance Corp., Nelnet, Inc. Student Loan Xpress, Inc., and CIT Group Inc., filed as Exhibit 2.1 to the registrant's Current Report on Form 8-K filed on April 16, 2014 and incorporated by reference herein.
2.2+	Loan Sale Agreement dated as of April 10, 2014 among National Education Loan Network, Inc., Student Loan Xpress, Inc., Fifth Third Bank, Union Bank and Trust Company, and CIT Group Inc., filed as Exhibit 2.2 to the registrant's Current Report on Form 8-K filed on April 16, 2014 and incorporated by reference herein.
2.3+	Loan Sale Agreement dated as of April 10, 2014 among National Education Loan Network, Inc., CIT Education Loan Trust 2012-1, Manufacturers and Traders Trust Company, Union Bank and Trust Company, and CIT Group Inc., filed as Exhibit 2.3 to the registrant's Current Report on Form 8-K filed on April 16, 2014 and incorporated by reference herein.
2.4+	Loan Sale Agreement dated as of April 10, 2014 among National Education Loan Network, Inc., CIT Education Loan Trust 2011-1, Manufacturers and Traders Trust Company, Union Bank and Trust Company, and CIT Group Inc., filed as Exhibit 2.4 to the registrant's Current Report on Form 8-K filed on April 16, 2014 and incorporated by reference herein.
10.1*	Subparticipation Agreement dated as of January 1, 2014 between Nelnet, Inc. and Union Bank and Trust Company.
31.1*	Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 of Chief Executive Officer Jeffrey R. Noordhoek.
31.2*	Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 of Chief Financial Officer James D. Kruger.
32**	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS*	XBRL Instance Document
101.SCH*	XBRL Taxonomy Extension Schema Document
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB*	XBRL Taxonomy Extension Label Linkbase Document
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document

* Filed herewith

** Furnished herewith

+ Pursuant to Item 601(b)(2) of Regulation S-K, certain schedules and similar attachments to the exhibit have been omitted. The registrant hereby agrees to furnish supplementally a copy of any omitted schedule or attachment to the

U.S. Securities and Exchange Commission upon request. The exhibit is not intended to be, and should not be relied upon as, including disclosures regarding any facts and circumstances relating to the registrant or any of its subsidiaries or affiliates. The exhibit contains representations and warranties by the registrant and the other parties that were made only for purposes of the agreement set forth in the exhibit and as of specified dates. The representations, warranties, and covenants in the agreement were made solely for the benefit of the parties to the agreement, may be subject to limitations agreed upon by the contracting parties (including being qualified by confidential disclosures made for the purposes of allocating contractual risk between the parties to the agreement instead of establishing these matters as facts), and may apply contractual standards of materiality or material adverse effect that generally differ from those applicable to investors. In addition, information concerning the subject matter of the representations, warranties, and covenants may change after the date of the agreement, which subsequent information may or may not be fully reflected in the registrant's public disclosures.

SIGNATURES

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

NELNET, INC.

Date: May 8, 2014

By: /s/ JEFFREY R. NOORDHOEK
Name: Jeffrey R. Noordhoek
Title: Chief Executive Officer
Principal Executive Officer

By: /s/ JAMES D. KRUGER
Name: James D. Kruger
Title: Chief Financial Officer
Principal Financial Officer and Principal Accounting Officer