NELNET INC
Form 10-Q
May 10, 2010

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

FORM 10-Q

(Mark One)
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2010
or

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

For the transition period from to .

COMMISSION FILE NUMBER 001-31924

NELNET, INC.

(Exact name of registrant as specified in its charter)

NEBRASKA	84-0748903
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
121 SOUTH 13TH STREET, SUITE 201 LINCOLN, NEBRASKA	68508
(Address of principal executive offices)	(Zip Code)

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§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 whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer [ ]	Accelerated filer [X]
Non-accelerated filer [ ]	Smaller reporting company [ ]

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

As of April 30, 2010, there were 38,589,242 and 11,495,377 shares of Class A Common Stock and Class B Common Stock, par value $0.01 per share, outstanding, respectively (excluding 11,317,364 shares of Class A Common Stock held by wholly owned subsidiaries).

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March 31, 2010

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

NELNET, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Dollars in thousands, except share data)

	As of March 31, 2010 (unaudited)	As of December 31, 2009
Assets:		
Student loans receivable (net of allowance for loan losses of		
$49,400 and $50,887 respectively)	$24,835,493	23,926,957
Cash and cash equivalents:		
Cash and cash equivalents - not held at a related party	34,107	12,301
Cash and cash equivalents - held at a related party	295,972	325,880
Total cash and cash equivalents	330,079	338,181
Restricted cash and investments	727,858	625,492
Restricted cash - due to customers	39,199	91,741
Accrued interest receivable	336,242	329,313
Accounts receivable (net of allowance for doubtful accounts of		
$1,125 and $1,198, respectively)	60,704	42,043
Goodwill	143,717	143,717
Intangible assets, net	54,940	53,538
Property and equipment, net	27,649	26,606
Other assets	157,005	104,940
Fair value of derivative instruments	129,059	193,899
Total assets	$26,841,945	25,876,427
Liabilities:		
Bonds and notes payable	$25,756,182	24,805,289
Accrued interest payable	16,814	19,831
Other liabilities	184,463	172,514
Due to customers	39,199	91,741
Fair value of derivative instruments	6,074	2,489
Total liabilities	26,002,732	25,091,864
Shareholders' equity:		
Preferred stock, $0.01 par value. Authorized 50,000,000 shares;		
no shares issued or outstanding	—	—
Common stock:		
Class A, $0.01 par value. Authorized 600,000,000 shares;		
issued and outstanding 38,587,293 shares as of March 31,		
2010 and 38,396,791 shares as of December 31, 2009	386	384
Class B, convertible, $0.01 par value. Authorized 60,000,000 shares;		

issued and outstanding 11,495,377 shares as of March 31,		
2010 and December 31, 2009	115	115
Additional paid-in capital	112,980	109,359
Retained earnings	726,982	676,154
Employee notes receivable	(1,250)	(1,449)
Total shareholders' equity	839,213	784,563
Commitments and contingencies		
Total liabilities and shareholders' equity	$26,841,945	25,876,427

See accompanying notes to consolidated financial statements.

NELNET, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(Dollars in thousands, except share data)
(unaudited)

	Three months ended March 31, 2010	2009
Interest income:		
Loan interest	$134,967	170,919
Investment interest	1,001	4,091
Total interest income	135,968	175,010
Interest expense:		
Interest on bonds and notes payable	50,859	146,502
Net interest income	85,109	28,508
Less provision for loan losses	5,000	7,500
Net interest income after provision for loan losses	80,109	21,008
Other income (expense):		
Loan and guaranty servicing revenue	36,394	26,471
Tuition payment processing and campus commerce revenue	17,382	15,538
Enrollment services revenue	33,271	28,771
Software services revenue	4,344	5,705
Other income	7,260	8,787
Gain on sale of loans and debt repurchases, net	10,177	7,869
Derivative market value and foreign currency adjustments and derivative settlements, net	1,682	19,478
Total other income	110,510	112,619
Operating expenses:		
Salaries and benefits	41,641	38,226
Other operating expenses:		
Cost to provide enrollment services	22,025	17,793
Professional and other services	11,241	6,077
Depreciation and amortization	8,491	10,083
Occupancy and communications	3,588	5,354
Advertising and marketing	3,459	1,710
Postage and distribution	2,869	2,656
Trustee and other debt related fees	1,202	2,868
Other	9,188	7,804
Total other operating expenses	62,063	54,345
Total operating expenses	103,704	92,571
Income before income taxes	86,915	41,056
Income tax expense	(32,593)	(15,601)
Net income	$54,322	25,455

Earnings per common share:		
Net earnings - basic	$1.09	0.51
Net earnings - diluted	1.08	0.51
Dividends paid per common share	$0.07	—
Weighted average common shares outstanding:		
Basic	49,716,696	49,142,324
Diluted	49,912,589	49,334,981

See accompanying notes to consolidated financial statements.

NELNET, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY AND COMPREHENSIVE INCOME
(Dollars in thousands, except share data)
(unaudited)

	Preferred stock shares	Common stock shares		Preferred stock	Class A common stock	Class B common stock	Additional paid-in capital	Retained earnings	Employee notes receivable	Total shareholders' equity
		Class A	Class B							
Balance as of December 31, 2008	—	37,794,067	11,495,377	$—	378	115	103,762	540,521	(1,550)	643,226
Comprehensive income:										
Net income	—	—	—	—	—	—	—	25,455	—	25,455
Issuance of common stock, net of forfeitures	—	486,583	—	—	5	—	2,345	—	—	2,350
Compensation expense for stock based awards	—	—	—	—	—	—	607	—	—	607
Repurchase of common stock	—	(3,780)	—	—	—	—	(36)	—	—	(36)
Balance as of March 31, 2009	—	38,276,870	11,495,377	$—	383	115	106,678	565,976	(1,550)	671,602
Balance as of December 31, 2009	—	38,396,791	11,495,377	$—	384	115	109,359	676,154	(1,449)	784,563
Comprehensive income:										
Net income	—	—	—	—	—	—	—	54,322	—	54,322
Cash dividend on Class A and Class B common stock - $0.07 per share	—	—	—	—	—	—	—	(3,494)	—	(3,494)
Issuance of common stock, net of forfeitures	—	203,438	—	—	2	—	3,532	—	—	3,534
Compensation expense for	—	—	—	—	—	—	325	—	—	325

stock based awards										
Repurchase of common stock	—	(12,936)	—	—	—	—	(236)	—	—	(236)
Reduction of employee notes receivable	—	—	—	—	—	—	—	—	199	199
Balance as of March 31, 2010	—	38,587,293	11,495,377	$—	386	115	112,980	726,982	(1,250)	839,213

See accompanying notes to consolidated financial statements.

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NELNET, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in thousands)
(unaudited)

	Three months ended March 31, 2010	2009
Net income	$54,322	25,455
Adjustments to reconcile income to net cash provided by operating activities, net of business acquisition:		
Depreciation and amortization, including loan premiums and deferred origination costs	26,864	30,134
Provision for loan losses	5,000	7,500
Derivative market value adjustment	67,570	52,122
Foreign currency transaction adjustment	(71,675)	(47,242)
Proceeds to terminate and/or amend derivative instruments	855	50
Payments to terminate and/or amend derivative instruments	—	(11,760)
Gain from repurchase of bonds and notes payable	(10,177)	(8,075)
Loss on sale of loans, net	—	206
Deferred income tax expense	7,509	1,323
Non-cash compensation expense	523	723
Other non-cash items	254	301
(Increase) decrease in accrued interest receivable	(6,929)	83,563
Increase in accounts receivable	(18,661)	(487)
(Increase) decrease in other assets	(51,071)	7,236
Decrease in accrued interest payable	(3,017)	(33,500)
Increase in other liabilities	1,319	2,817
Net cash provided by operating activities	2,686	110,366
Cash flows from investing activities, net of business acquisition:		
Originations and purchases of student loans, including loan premiums and deferred origination costs	(1,027,883)	(972,450)
Purchases of student loans, including loan premiums, from a related party	(535,907)	(13,803)
Net proceeds from student loan repayments, claims, capitalized interest, participations, and other	615,431	734,445
Proceeds from sale of student loans	20,032	125
Proceeds from sale of student loans to a related party	—	20,016
Purchases of property and equipment, net	(2,883)	(62)
Increase in restricted cash and investments, net	(102,366)	(221,240)
Business acquisition, net of cash acquired	(3,000)	—
Net cash used in investing activities	(1,036,576)	(452,969)
Cash flows from financing activities:		
Payments on bonds and notes payable	(1,028,622)	(642,115)
Proceeds from issuance of bonds and notes payable	2,061,893	1,039,942
Payments of debt issuance costs	(4,069)	(1,448)
Dividends paid	(3,494)	—
Proceeds from issuance of common stock	117	118

Repurchases of common stock	(236)	(36)
Payments received on employee stock notes receivable	199	—
Net cash provided by financing activities	1,025,788	396,461
Net (decrease) increase in cash and cash equivalents	(8,102)	53,858
Cash and cash equivalents, beginning of period	338,181	189,847
Cash and cash equivalents, end of period	$330,079	243,705
Supplemental disclosures of cash flow information:		
Interest paid	$49,777	177,210
Income taxes paid, net of refunds	$25,123	8,096

See accompanying notes to consolidated financial statements.

NELNET, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Information as of March 31, 2010 and for the three months ended
March 31, 2010 and 2009 is unaudited)
(Dollars in thousands, except per share amounts, unless otherwise noted)

1. Basis of Financial Reporting

The accompanying unaudited consolidated financial statements of Nelnet, Inc. and subsidiaries (the "Company") as of March 31, 2010 and for the three months ended March 31, 2010 and 2009 have been prepared on the same basis as the audited consolidated financial statements for the year ended December 31, 2009 and, in the opinion of the Company's management, the unaudited consolidated financial statements reflect all adjustments, consisting of normal recurring adjustments, necessary for a fair presentation of results of operations for the interim periods presented. The preparation of financial statements in conformity with 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, 2010 are not necessarily indicative of the results for the year ending December 31, 2010. 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, 2009. Management has evaluated subsequent events, and the impact on the reported results and disclosures through the date these financial statements were filed with the Securities and Exchange Commission ("SEC").

Reclassifications

Certain amounts previously reported have been reclassified to conform to the current period presentation. The reclassifications were made to change the income statement presentation to provide the users of the financial statements additional information related to the operating results of the Company. These reclassifications include reclassifying the Company's gains on debt repurchases to "gain on sale of loans and debt repurchases, net" which were previously included in "other income." The reclassifications had no effect on consolidated net income or consolidated assets and liabilities.

2. Recent Developments

On March 30, 2010, President Obama signed into law the Health Care and Education Reconciliation Act of 2010 (the "Reconciliation Act of 2010"). Effective July 1, 2010, this law prohibits new loan originations under the Federal Family Education Loan Program ("FFELP") and requires that all new federal loan originations be made through the Federal Direct Loan Program (the "Direct Loan Program"). If a first disbursement has been made on a FFELP loan prior to July 1, 2010, subsequent disbursements of that loan may still be made under the FFELP. The new law does not alter or affect the terms and conditions of existing FFELP loans.

As a result of the Reconciliation Act of 2010, the Company will no longer originate FFELP loans after 2010. During 2009, the Company recognized a gain of $36.6 million from selling $2.1 billion of 2008-2009 academic year loans to the Department of Education (the "Department") under the Loan Purchase Commitment Program (the "Purchase Program"). The Company continues to use the Department's Participation Program to fund loans originated for the 2009-2010 academic year. The Company has not yet determined if it will sell these loans to the Department under the Purchase Program. However, based on the number of 2009-2010 academic year loans held by the Company that are eligible for this program ($1.0 billion as of March 31, 2010), the Company estimates that it would recognize a gain of approximately $16 million to $18 million if it chose to sell these loans under this program. This amount does not include loans originated and/or acquired after March 31, 2010 which would increase the gain recognized by the Company. In addition, as a result of the Reconciliation Act of 2010, net interest income on the Company's existing FFELP loan portfolio, as well as fee-based revenue from guarantee and third-party FFELP servicing and education loan software licensing and consulting fees will decline over time as the Company and its customers' FFELP loan portfolios pay down.

In June 2009, the Company was one of four private sector companies awarded a student loan servicing contract by the Department. As of April 30, 2010, the Company was servicing $9.5 billion of FFELP loans now owned by the Department, and by August 2010 the Company expects to also begin servicing new loans originated under the Direct Loan Program. The Department has estimated $116 billion of new student loan originations will be funded through the Direct Loan Program for the 2010-2011 academic year. This volume will be allocated by the Department to the four servicers based on performance factors such as customer satisfaction levels and default rates. The Company believes revenue earned under the Department servicing contract and growth in non-FFELP fee-based operating segments in the future will partially offset the loss of future revenue due to the elimination of the FFELP.

Due to the legislative changes in the student loan industry, the Company also believes there will be opportunities to purchase FFELP loan portfolios and/or expand its current level of guarantee and third-party FFELP servicing volume on behalf of current FFELP participants looking to modify their involvement in FFELP and/or exit the market. For example, since April 1, 2010, the Company has purchased approximately $2 billion of FFELP student loans from various third-parties. These loans are not included in the March 31, 2010 balance sheet.

3. Student Loans Receivable and Allowance for Loan Losses

Student loans receivable consisted of the following:

	As of March 31, 2010	As of December 31, 2009
Federally insured loans	$24,412,262	23,472,553
Non-federally insured loans	138,890	163,321
	24,551,152	23,635,874
Unamortized loan premiums and deferred origination costs	333,741	341,970
Allowance for loan losses – federally insured loans	(30,744)	(30,102)
Allowance for loan losses – non-federally insured loans	(18,656)	(20,785)
	$24,835,493	23,926,957
Allowance for federally insured loans as a percentage of such loans	0.13%	0.13%
Allowance for non-federally insured allowance as a percentage of such loans	13.43%	12.73%

The Company has provided for an allowance for loan losses related to its student loan portfolio. Activity in the allowance for loan losses for the three months ended March 31, 2010 and 2009 is shown below:

	2010	2009
Beginning balance	$50,887	50,922
Provision for loan losses	5,000	7,500
Loans charged off, net of recoveries	(5,197)	(3,905)
Purchase of loans	710	—
Sale of loans	(2,000)	(6,020)
Ending balance	$49,400	48,497

As of March 31, 2010, the Company has participated $115.5 million of non-federally insured loans to third parties, including $20.0 million during the first quarter of 2010. Loans participated under these agreements have been accounted for by the Company as loan sales. Accordingly, the participation interests sold are not included on the Company's consolidated balance sheet. The loss on the sale of these loans was not material. 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. The activity in the accrual account during the three months ended March 31, 2010 and 2009 related to this repurchase obligation, which is included in "other liabilities" in the accompanying consolidated balance sheets, is detailed below.

	2010	2009
Beginning balance	$ 10,600	—
Transfer from allowance for loan losses	2,000	5,500
Ending balance	$ 12,600	5,500

Related Party Loan Activity

During 2008 and 2009, the Company sold $611.9 million of FFELP student loans (the "FFELP Loans") to Union Bank & Trust Company ("Union Bank"), an entity under common control with the Company. These loans were sold pursuant to an affiliate transaction exemption granted by the Federal Reserve Board which allowed Union Bank to purchase FFELP loans from the Company. In connection with the exemption and the loan purchases by Union Bank, an

Assurance Commitment Agreement (the "Commitment Agreement") was also entered into, by and among, the Company, Union Bank, and Michael S. Dunlap, the Company's Chairman, Chief Executive Officer, and a principal shareholder of the Company. Per the terms of the Commitment Agreement, the Company provided certain assurances to Union Bank designed to mitigate potential losses related to the FFELP Loans, including holding amounts in escrow equal to the unguaranteed portion and reimbursing Union Bank for losses, if any, related to the portfolio. As part of this agreement, the Company was also obligated to buy back loans once they were 30 days delinquent. During the first quarter 2010, the Company purchased $535.9 million (par value) of federally insured student loans from Union Bank, which represented all outstanding FFELP loans remaining under the provisions of the Commitment Agreement. As a result of this loan purchase, the Company no longer has a commitment to hold amounts in escrow, reimburse Union Bank for losses, and buy back delinquent loans related to this portfolio.

4. Bonds and Notes Payable

The Company has historically utilized operating cash flow, secured financing transactions (which include warehouse facilities, asset-backed securitizations, and the government's Participation and Conduit Programs), operating lines of credit, and other borrowing arrangements to fund its Asset Generation and Management operations and student loan acquisitions. In addition, the Company has used operating cash flow, borrowings on its unsecured line of credit, and unsecured debt offerings to fund corporate activities, business acquisitions, and repurchases of common stock.

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

	As of March 31, 2010				
		Carrying amount	Interest rate range		Final maturity
Variable-rate bonds and notes (a):					
Bonds and notes based on indices	$	20,904,154	0.24% - 6.90	%	05/26/14 - 11/25/43
Bonds and notes based on auction or remarketing		1,370,510	0.30% - 1.75	%	05/01/11 - 07/01/43
Total variable-rate bonds and notes		22,274,664			
Commercial paper - FFELP facility (b)		80,051	0.22% - 0.33	%	08/03/12
Unsecured debt - Senior Notes		66,716	5.125	%	06/01/10
Unsecured debt - Junior Subordinated Hybrid Securities		198,250	7.40	%	09/15/61
Unsecured line of credit		691,500	0.73	%	05/08/12
Department of Education Participation		1,028,402	0.71	%	09/30/10
Department of Education Conduit		1,384,819	0.23	%	05/08/14
Other borrowings		31,780	0.23% - 5.10	%	11/14/10 - 11/01/15
	$	25,756,182			

	As of December 31, 2009		
	Carrying amount	Interest rate range	Final maturity
Variable-rate bonds and notes (a):			