**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

**FORM 10-Q**

**(Mark One)**

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

**For the quarterly period ended March 31, 2019**

**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 100** | **68508** |  |
| **LINCOLN, NEBRASKA** |  |
| (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 every Interactive Data File required to be submitted 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 such files). Yes [X] No [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a 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 [X] Accelerated filer [ ]

Non-accelerated filer [ ] Smaller reporting company [ ]

Emerging growth company [ ]

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to

Section 13(a) of the Exchange Act. [ ]

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

Securities registered pursuant to Section 12(b) of the Act:

|  |  |  |
| --- | --- | --- |
| Title of each class | Trading Symbol | Name of each exchange on which registered |
|  |  |  |
| Class A Common Stock, Par Value $0.01 per Share | NNI | New York Stock Exchange |
|  |  |  |

As of April 30, 2019, there were 28,438,279 and 11,459,641 shares of Class A Common Stock and Class B Common Stock, par value $0.01 per share, outstanding, respectively (excluding a total of 11,305,731 shares of Class A Common Stock held by wholly owned subsidiaries).

**NELNET, INC.**

**FORM 10-Q**

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**March 31, 2019**

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**PART I. FINANCIAL INFORMATION**

**ITEM 1. FINANCIAL STATEMENTS**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **NELNET, INC. AND SUBSIDIARIES** |  |  |  |  |  |
| **CONSOLIDATED BALANCE SHEETS** |  |  |  |  |  |
| **(Dollars in thousands, except share data)** |  |  |  |  |  |
| **(unaudited)** |  |  |  |  |  |
|  |  | **As of** | | **As of** |  |
|  |  | **March 31, 2019** | | **December 31, 2018** |  |
| Assets: |  |  |  |  |  |
| Loans receivable (net of allowance for loan losses of $61,778 and $60,388, respectively) | $ | 21,946,153 |  | 22,377,142 |  |
| Cash and cash equivalents: |  |  |  |  |  |
| Cash and cash equivalents - not held at a related party |  | 11,844 |  | 9,472 |  |
| Cash and cash equivalents - held at a related party |  | 63,037 |  | 111,875 |  |
| Total cash and cash equivalents |  | 74,881 |  | 121,347 |  |
| Investments and notes receivable |  | 230,512 |  | 249,370 |  |
| Restricted cash |  | 760,273 |  | 701,366 |  |
| Restricted cash - due to customers |  | 216,471 |  | 369,678 |  |
| Accrued interest receivable |  | 715,838 |  | 679,197 |  |
| Accounts receivable (net of allowance for doubtful accounts of $3,777 and $3,271, respectively) |  | 76,013 |  | 59,531 |  |
| Goodwill |  | 156,912 |  | 156,912 |  |
| Intangible assets, net |  | 105,795 |  | 114,290 |  |
| Property and equipment, net |  | 335,070 |  | 344,784 |  |
| Other assets |  | 103,841 |  | 45,533 |  |
| Fair value of derivative instruments |  | 168 |  | 1,818 |  |
| Total assets | $ | 24,721,927 |  | 25,220,968 |  |
| Liabilities: |  |  |  |  |  |
|  |  |  |  |  |
| Bonds and notes payable | $ | 21,835,723 |  | 22,218,740 |  |
| Accrued interest payable |  | 62,158 |  | 61,679 |  |
| Other liabilities |  | 277,281 |  | 256,092 |  |
| Due to customers |  | 216,471 |  | 369,678 |  |
| Total liabilities |  | 22,391,633 |  | 22,906,189 |  |
| Commitments and contingencies |  |  |  |  |  |
| Equity: |  |  |  |  |  |
| Nelnet, Inc. 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 28,628,528 |  |  |  |  |  |
| shares and 28,798,464 shares, respectively |  | 286 |  | 288 |  |
| Class B, convertible, $0.01 par value. Authorized 60,000,000 shares; issued and outstanding |  |  |  |  |  |
| 11,459,641 shares |  | 115 |  | 115 |  |
| Additional paid-in capital |  | 636 |  | 622 |  |
| Retained earnings |  | 2,321,407 |  | 2,299,556 |  |
| Accumulated other comprehensive earnings |  | 3,552 |  | 3,883 |  |
| Total Nelnet, Inc. shareholders' equity |  | 2,325,996 |  | 2,304,464 |  |
| Noncontrolling interests |  | 4,298 |  | 10,315 |  |
| Total equity |  | 2,330,294 |  | 2,314,779 |  |
| Total liabilities and equity | $ | 24,721,927 |  | 25,220,968 |  |
|  |  |  |  |  |  |
|  |  |  |  |  |  |
| **Supplemental information - assets and liabilities of consolidated education lending variable interest entities:** |  |  |  |  |  |
| Student loans receivable | $ | 21,962,743 |  | 22,359,655 |  |
| Restricted cash |  | 732,335 |  | 677,611 |  |
| Loan accrued interest receivable and other assets |  | 716,820 |  | 679,735 |  |
| Bonds and notes payable |  | (21,775,724) |  | (22,146,374) |  |
| Accrued interest payable and other liabilities |  | (189,112) |  | (163,327) |  |
| Net assets of consolidated education lending variable interest entities | $ | 1,447,062 |  | 1,407,300 |  |
|  |  |  |  |  |  |

See accompanying notes to consolidated financial statements.

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**NELNET, INC. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF INCOME**

**(Dollars in thousands, except share data)**

**(unaudited)**

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  |  | **Three months ended** | | |  |  |
|  |  | **March 31,** | | |  |  |
|  |  |  |  |  |  |  |
|  | **2019** |  |  |  | **2018** |  |
|  |  |  |  |  |  |  |
| Interest income: |  |  |  |  |  |  |
| Loan interest | $ | 242,333 |  |  | 197,723 |  |
|  |  |  |  |  |  |  |
| Investment interest |  | 8,253 |  |  | 5,134 |  |
| Total interest income |  | 250,586 |  |  | 202,857 |  |
|  |  |  |  |  |  |  |
| Interest expense: |  |  |  |  |  |  |
| Interest on bonds and notes payable |  | 191,770 |  |  | 135,550 |  |
|  |  |  |  |  |  |  |
| Net interest income |  | 58,816 |  |  | 67,307 |  |
| Less provision for loan losses |  | 7,000 |  |  | 4,000 |  |
|  |  |  |  |  |  |  |
| Net interest income after provision for loan losses |  | 51,816 |  |  | 63,307 |  |
| Other income: |  |  |  |  |  |  |
|  |  |  |  |  |  |  |
| Loan servicing and systems revenue |  | 114,898 |  |  | 100,141 |  |
| Education technology, services, and payment processing revenue |  | 79,159 |  |  | 60,221 |  |
| Communications revenue |  | 14,543 |  |  | 9,189 |  |
| Other income |  | 9,067 |  |  | 18,557 |  |
|  |  |  |  |  |  |  |
| Derivative market value adjustments and derivative settlements, net |  | (11,539) |  |  | 66,799 |  |
| Total other income |  | 206,128 |  |  | 254,907 |  |
|  |  |  |  |  |  |  |
| Cost of services: |  |  |  |  |  |  |
| Cost to provide education technology, services, and payment processing services |  | 21,059 |  |  | 13,683 |  |
| Cost to provide communications services |  | 4,759 |  |  | 3,717 |  |
| Total cost of services |  | 25,818 |  |  | 17,400 |  |
|  |  |  |  |  |  |  |
| Operating expenses: |  |  |  |  |  |  |
| Salaries and benefits |  | 111,059 |  |  | 96,643 |  |
|  |  |  |  |  |  |  |
| Depreciation and amortization |  | 24,213 |  |  | 18,457 |  |
| Loan servicing fees to third parties |  | 2,893 |  |  | 3,136 |  |
|  |  |  |  |  |  |  |
| Other expenses |  | 40,923 |  |  | 33,417 |  |
| Total operating expenses |  | 179,088 |  |  | 151,653 |  |
|  |  |  |  |  |  |  |
| Income before income taxes |  | 53,038 |  |  | 149,161 |  |
| Income tax expense |  | 11,391 |  |  | 35,976 |  |
|  |  |  |  |  |  |  |
| Net income |  | 41,647 |  |  | 113,185 |  |
| Net (income) loss attributable to noncontrolling interests |  | (56) |  |  | 740 |  |
| Net income attributable to Nelnet, Inc. | $ | 41,591 |  |  | 113,925 |  |
| Earnings per common share: |  |  |  |  |  |  |
|  |  |  |  |  |  |
|  |  |  |  |  |  |  |
| Net income attributable to Nelnet, Inc. shareholders - basic and diluted | $ | 1.03 |  |  | 2.78 |  |
|  |  |  |  |  |  |  |
| Weighted average common shares outstanding - basic and diluted |  | 40,373,295 |  |  | 40,950,528 |  |

See accompanying notes to consolidated financial statements.

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**NELNET, INC. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

**(Dollars in thousands)**

**(unaudited)**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  |  | **Three months ended** | | |  |
|  |  | **March 31,** | | |  |
|  |  |  |  |  |  |
|  | **2019** |  |  |  | **2018** |
|  |  |  |  |  |  |
| Net income | $ | 41,647 |  |  | 113,185 |
| Other comprehensive loss: |  |  |  |  |  |
|  |  |  |  |  |  |
| Available-for-sale securities: |  |  |  |  |  |
| Unrealized holding losses arising during period, net of gains |  | (436) |  |  | (1,061) |
|  |  |  |  |  |  |
| Reclassification adjustment for gains recognized in net income, net of losses |  | — | | | (47) |
| Income tax effect |  | 105 |  |  | 256 |
|  |  |  |  |  |  |
| Total other comprehensive loss |  | (331) |  |  | (852) |
| Comprehensive income |  | 41,316 |  |  | 112,333 |
|  |  |  |  |  |  |
| Comprehensive (income) loss attributable to noncontrolling interests |  | (56) |  |  | 740 |
| Comprehensive income attributable to Nelnet, Inc. | $ | 41,260 |  |  | 113,073 |
|  |  |  |  |  |  |

See accompanying notes to consolidated financial statements.

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**NELNET, INC. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY**

**(Dollars in thousands, except share data)**

**(unaudited)**

**Nelnet, Inc. Shareholders**



|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  | **Common stock shares** | | | |  |  |  |  |  |  |  |  |  |  |  | **Accumulated other** | |  |  |  |  |
|  | **Preferred stock** | |  |  |  |  |  |  |  | **Class A** | | **Class B** | | **Additional paid-in** | |  |  | **comprehensive (loss)** | |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | **shares** |  | **Class A** |  | **Class B** |  | **Preferred stock** | |  | **common stock** |  | **common stock** |  | **capital** |  | **Retained earnings** |  | **earnings** |  | **Noncontrolling interests** |  | **Total equity** |  |
| Balance as of December 31, 2017 | — | | 29,341,517 |  | 11,468,587 |  | $ | — | | 293 |  | 115 |  | 521 |  | 2,143,983 |  | 4,617 |  | 15,858 |  | 2,165,387 |  |
| Issuance of noncontrolling interests | — | | — | | — | |  | — | | — | | — | | — | | — | | — | | 26 |  | 26 |  |
| Net income (loss) | — | | — | | — | |  | — | | — | | — | | — | | 113,925 |  | — | | (740) |  | 113,185 |  |
| Other comprehensive loss | — | | — | | — | |  | — | | — | | — | | — | | — | | (852) |  | — | | (852) |  |
| Distribution to noncontrolling interests | — | | — | | — | |  | — | | — | | — | | — | | — | | — | | (19) |  | (19) |  |
| Cash dividend on Class A and Class B common stock |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| - $0.16 per share | — | | — | | — | |  | — | | — | | — | | — | | (6,506) |  | — | | — | | (6,506) |  |
| Issuance of common stock, net of forfeitures | — | | 170,346 |  | — | |  | — | | 2 |  | — | | 2,171 |  | — | | — | | — | | 2,173 |  |
| Compensation expense for stock based awards | — | | — | | — | |  | — | | — | | — | | 1,087 |  | — | | — | | — | | 1,087 |  |
| Repurchase of common stock | — | | (222,174) |  | — | |  | — | | (2) |  | — | | (3,331) |  | (8,085) |  | — | | — | | (11,418) |  |
| Impact of adoption of new accounting standards | — | | — | | — | |  | — | | — | | — | | — | | 2,007 |  | (743) |  | — | | 1,264 |  |
| Acquisition of noncontrolling interest | — |  | — |  | — |  |  | — |  | — |  | — |  | — |  | (13,449) |  | — |  | (5,652) |  | (19,101) |  |
| Balance as of March 31, 2018 | — | | 29,289,689 |  | 11,468,587 |  | $ | — | | 293 |  | 115 |  | 448 |  | 2,231,875 |  | 3,022 |  | 9,473 |  | 2,245,226 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Balance as of December 31, 2018 | — | | 28,798,464 |  | 11,459,641 |  | $ | — | | 288 |  | 115 |  | 622 |  | 2,299,556 |  | 3,883 |  | 10,315 |  | 2,314,779 |  |
| Issuance of noncontrolling interests | — | | — | | — | |  | — | | — | | — | | — | | — | | — | | 26 |  | 26 |  |
| Net income | — | | — | | — | |  | — | | — | | — | | — | | 41,591 |  | — | | 56 |  | 41,647 |  |
| Other comprehensive loss | — | | — | | — | |  | — | | — | | — | | — | | — | | (331) |  | — | | (331) |  |
| Distribution to noncontrolling interests | — | | — | | — | |  | — | | — | | — | | — | | — | | — | | (22) |  | (22) |  |
| Cash dividend on Class A and Class B common stock |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| - $0.18 per share | — | | — | | — | |  | — | | — | | — | | — | | (7,232) |  | — | | — | | (7,232) |  |
| Issuance of common stock, net of forfeitures | — | | 131,391 |  | — | |  | — | | 1 |  | — | | 2,493 |  | — | | — | | — | | 2,494 |  |
| Compensation expense for stock based awards | — | | — | | — | |  | — | | — | | — | | 1,368 |  | — | | — | | — | | 1,368 |  |
| Repurchase of common stock | — | | (301,327) |  | — | |  | — | | (3) |  | — | | (3,847) |  | (12,508) |  | — | | — | | (16,358) |  |
| Impact of adoption of new accounting standard | — |  | — |  | — |  |  | — |  | — |  | — |  | — |  | — |  | — |  | (6,077) |  | (6,077) |  |
| Balance as of March 31, 2019 | — | | 28,628,528 |  | 11,459,641 |  | $ | — | | 286 |  | 115 |  | 636 |  | 2,321,407 |  | 3,552 |  | 4,298 |  | 2,330,294 |  |

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,**



**2019** **2018**



Net income attributable to Nelnet, Inc.

Net income (loss) attributable to noncontrolling interests



Net income

Adjustments to reconcile net income to net cash (used in) provided by operating activities, net of acquisition:

|  |  |  |  |
| --- | --- | --- | --- |
| $ | 41,591 |  | 113,925 |
|  | 56 |  | (740) |
|  |  |  |  |
|  | 41,647 |  | 113,185 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Depreciation and amortization, including debt discounts and loan premiums and deferred origination costs |  | 46,948 |  | 43,301 |
| Loan discount accretion |  | (9,693) |  | (11,691) |
|  |  |  |  |  |
| Provision for loan losses |  | 7,000 |  | 4,000 |
| Derivative market value adjustments |  | 30,574 |  | (60,033) |
|  |  |  |  |  |
| Proceeds from termination of derivative instruments |  | 2,119 |  | — |
| (Payments to) proceeds from clearinghouse - initial and variation margin, net |  | (13,974) |  | 62,689 |
|  |  |  |  |  |
| Gain from debt repurchases |  | — | | (359) |
| Loss (gain) from investments and notes receivable, net |  | 1,151 |  | (8,249) |
|  |  |  |  |  |
| Deferred income tax (benefit) expense |  | (2,807) |  | 16,883 |
| Non-cash compensation expense |  | 1,476 |  | 1,161 |
|  |  |  |  |  |
| Other |  | (20) |  | (2,891) |
| Increase in accrued interest receivable |  | (36,722) |  | (59,038) |
|  |  |  |  |  |
| (Increase) decrease in accounts receivable |  | (16,571) |  | 177 |
| (Increase) decrease in other assets |  | (32,324) |  | 49,415 |
|  |  |  |  |  |
| Increase in accrued interest payable |  | 479 |  | 4,213 |
| Decrease in other liabilities |  | (5,741) |  | (36,205) |
|  |  |  |  |  |
| Decrease in due to customers |  | (153,207) |  | (58,606) |
| Net cash (used in) provided by operating activities |  | (139,665) |  | 57,952 |
|  |  |  |  |  |
| Cash flows from investing activities, net of acquisition: |  |  |  |  |
| Purchases of loans |  | (344,631) |  | (610,855) |
| Net proceeds from loan repayments, claims, capitalized interest, and other |  | 769,996 |  | 863,270 |
| Purchases of available-for-sale securities |  | — | | (28,164) |
|  |  |  |  |  |
| Proceeds from sales of available-for-sale securities |  | — | | 21,951 |
| Purchases of investments and issuance of notes receivable |  | (15,970) |  | (16,370) |
| Proceeds from investments and notes receivable |  | 1,719 |  | 9,718 |
| Purchases of property and equipment |  | (24,813) |  | (28,068) |
|  |  |  |  |  |
| Business acquisition, net of cash and restricted cash acquired |  | — | | (109,152) |
| Net cash provided by investing activities |  | 386,301 |  | 102,330 |
|  |  |  |  |  |
| Cash flows from financing activities: |  |  |  |  |
| Payments on bonds and notes payable |  | (932,007) |  | (901,008) |
|  |  |  |  |  |
| Proceeds from issuance of bonds and notes payable |  | 570,532 |  | 756,700 |
| Payments of debt issuance costs |  | (2,776) |  | (1,650) |
|  |  |  |  |  |
| Dividends paid |  | (7,232) |  | (6,506) |
| Repurchases of common stock |  | (16,358) |  | (11,418) |
|  |  |  |  |  |
| Proceeds from issuance of common stock |  | 461 |  | 274 |
| Acquisition of noncontrolling interest |  | — | | (13,449) |
|  |  |  |  |  |
| Distribution to noncontrolling interests |  | (22) |  | (19) |
| Net cash used in financing activities |  | (387,402) |  | (177,076) |
|  |  |  |  |  |
| Net decrease in cash, cash equivalents, and restricted cash |  | (140,766) |  | (16,794) |
| Cash, cash equivalents, and restricted cash, beginning of period |  | 1,192,391 |  | 942,066 |
|  |  |  |  |  |
| Cash, cash equivalents, and restricted cash, end of period | $ | 1,051,625 |  | 925,272 |
|  |  |  |  |  |

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**NELNET, INC. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)**

**(Dollars in thousands)**

**(unaudited)**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  |  | **Three months ended** | | | |
|  |  | **March 31,** | | |  |
|  |  |  |  |  |  |
|  |  | **2019** |  |  | **2018** |
|  |  |  |  |  |  |
| **Supplemental disclosures of cash flow information:** |  |  |  |  |  |
| Cash disbursements made for interest | $ | 176,876 |  |  | 114,243 |
|  |  |  |  |  |  |
| Cash refunds received for income taxes, net of payments | $ | 9 |  |  | 30,569 |
|  |  |  |  |  |  |

Supplemental disclosures of noncash activities regarding the adoption of the new lease standard on January 1, 2019 are contained in note 1.

The following table provides a reconciliation of cash, cash equivalents, and restricted cash reported in the consolidated balance sheets to the total of the amounts reported in the consolidated statements of cash flows.

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **As of** | | **As of** | | **As of** | | **As of** |  |
|  |  | **March 31, 2019** | | **December 31, 2018** | | **March 31, 2018** | | **December 31, 2017** |  |
|  |  |  |  |  |  |  |  |  |  |
| Total cash and cash equivalents | $ | 74,881 |  | 121,347 |  | 69,286 |  | 66,752 |  |
| Restricted cash |  | 760,273 |  | 701,366 |  | 727,471 |  | 688,193 |  |
|  |  |  |  |  |  |  |  |  |  |
| Restricted cash - due to customers |  | 216,471 |  | 369,678 |  | 128,515 |  | 187,121 |  |
| Cash, cash equivalents, and restricted cash | $ | 1,051,625 |  | 1,192,391 |  | 925,272 |  | 942,066 |  |
|  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |

See accompanying notes to consolidated financial statements.

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**NELNET, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Dollars in thousands, except per share amounts, unless otherwise noted)**

**(unaudited)**

**1. Basis of Financial Reporting**

The accompanying unaudited consolidated financial statements of Nelnet, Inc. and subsidiaries (the “Company”) as of March 31, 2019 and for the three months ended March 31, 2019 and 2018 have been prepared on the same basis as the audited consolidated financial statements for the year ended December 31, 2018 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, 2019 are not necessarily indicative of the results for the year ending December 31, 2019. 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, 2018 (the "2018 Annual Report").

***Accounting Standard Adopted in 2019***

In the first quarter of 2019, the Company adopted the following new accounting standard:

*Leases*

In February 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Codification Topic 842, *Leases* ("ASC Topic 842"). The standard requires the identification of arrangements that should be accounted for as leases by lessees and the disclosure of key information about leasing arrangements. The standard establishes a right-of-use ("ROU") model that requires a lessee to recognize a ROU asset and lease liability for all leases with a term longer than twelve months and classify the lease as operating or financing, with the income statement reflecting lease expense for operating leases and amortization/interest expense for financing leases.

The Company adopted the standard effective January 1, 2019, using the effective date as its date of initial application. Consequently, financial information is not updated and the disclosures required under the new standard are not provided for dates and periods before January 1, 2019. The Company elected to utilize the ‘package of practical expedients’, which permitted it to not reassess under the new standard its prior conclusions about lease identification, lease classification, and initial direct costs.

The most significant impact of the standard relates to (1) the recognition of new ROU assets and lease liabilities on the Company's balance sheet; (2) the deconsolidation of assets and liabilities for certain sale-leaseback transactions arising from build-to-suit lease arrangements for which construction was completed and the Company is leasing the constructed assets that did not qualify for sale accounting prior to the adoption of the new standard; and (3) significant new disclosures about the Company’s leasing activities. The build-to-suit lease arrangements have been reassessed as operating leases as of the effective date under ASC Topic 842.

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Adoption of the new standard resulted in recognizing lease liabilities of $33.7 million based on the present value of the remaining minimum rental payments. In addition, the Company recognized ROU assets of $32.8 million, which corresponds to the lease liabilities reduced by deferred rent expense as of the effective date. The Company also deconsolidated total assets of $43.8 million and total liabilities of $34.8 million for entities that had been consolidated due to sale-leaseback transactions that failed to qualify for recognition as sales under the prior guidance. Deconsolidation of these entities reduced noncontrolling interests by $6.1 million. The cumulative effect of the changes made to the Company's consolidated balance sheet as of January 1, 2019 for the adoption of the new lease standard was as follows:

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | **Balances at December** | | | **Adjustments from adoption of** | | **Balances at January 1,** |
|  |  | **31, 2018** |  | **new lease standard** | | **2019** |
|  |  |  |  |  |  |  |
| **Assets** |  |  |  |  |  |  |
| Cash and cash equivalents | $ | 121,347 |  | (646) |  | 120,701 |
|  |  |  |  |  |  |  |
| Investments and notes receivable |  | 249,370 |  | (23,134) |  | 226,236 |
| Accounts receivable |  | 59,531 |  | (89) |  | 59,442 |
|  |  |  |  |  |  |  |
| Property and equipment, net |  | 344,784 |  | (16,974) |  | 327,810 |
| Other assets |  | 45,533 |  | 32,804 |  | 78,337 |
|  |  |  |  |  |  |  |
| **Liabilities** |  |  |  |  |  |  |
| Bonds and notes payable |  | 22,218,740 |  | (33,182) |  | 22,185,558 |
| Other liabilities |  | 256,092 |  | 31,220 |  | 287,312 |
| **Equity** |  |  |  |  |  |  |
|  |  |  |  |  |  |  |
| Noncontrolling interests |  | 10,315 |  | (6,077) |  | 4,238 |
|  |  |  |  |  |  |  |

At the inception of an arrangement, the Company determines if the arrangement is, or contains, a lease and records the lease in the consolidated financial statements upon lease commencement, which is the date when the underlying asset is made available by the lessor. The Company primarily leases dark fiber to support its telecommunications operations and office and data center space. Leases with an initial term of 12 months or less are not recorded on the balance sheet. The lease expense for these leases is recognized on a straight-line basis over the lease term. All other lease assets and lease liabilities are recognized based on the present value of lease payments over the lease term at the commencement date. When the discount rate implicit in the lease cannot be readily determined, the Company uses its incremental borrowing rate.

The Company has elected to utilize the practical expedient to account for lease and non-lease components together as a single, combined lease component for its office and data center space. In addition, the Company has identified itself as the lessor in its Communications operating segment for services provided to customers that include customer-premise equipment. The Company has also elected to utilize the practical expedient to account for those services and associated leases as a single, combined component. The non-lease services are 'predominant' in those contracts. Therefore, the combined component is considered a single performance obligation under ASC Topic 606.

Most leases include one or more options to renew, with renewal terms that can be extended. The exercise of lease renewal options for the majority of leases is at the Company's discretion. Renewal options that the Company is reasonably certain to exercise are included in the lease term.

Certain leases include escalating rental payments or rental payments adjusted periodically for inflation. None of the lease agreements include any residual value guarantees, a transfer of title, or a purchase option that is reasonably certain to be exercised.

The following table provides supplemental balance sheet information related to leases:

|  |  |  |  |
| --- | --- | --- | --- |
|  |  | **As of** |  |
|  |  | **March 31, 2019** |  |
|  |  |  |  |
| Operating lease ROU assets, which is included in "other assets" on the | $ | 33,928 |  |
| consolidated balance sheet |  |
| Operating lease liabilities, which is included in "other liabilities" on the |  |  |  |
| $ | 34,891 |  |
| consolidated balance sheet |  |
|  |  |  |  |

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The following table provides components of lease expense:

|  |  |  |
| --- | --- | --- |
|  |  | **Three months ended March 31,** |
|  |  | **2019** |
|  |  |  |
| Rental expense, which is included in "other expenses" on the |  |  |
| consolidated statement of income (a) | $ | 2,795 |
| Rental expense, which is included in "cost to provide communications |  |  |
| services" on the consolidated statement of income |  | 79 |
|  |  |  |
| Total operating rental expense | $ | 2,874 |
|  |  |  |

1. Includes short-term and variable lease costs, which are immaterial.

The following table provides supplemental cash flow information related to leases:

|  |  |  |
| --- | --- | --- |
|  |  | **Three months ended March 31,** |
|  |  | **2019** |
|  |  |  |
| Cash paid for amounts included in the measurement of lease liabilities: |  |  |
| Operating cash flows from operating leases | $ | 2,376 |
|  |  |  |
| ROU assets obtained in exchange for lease obligations, excluding |  |  |
| impact of adoption: |  |  |
| Operating leases | $ | 3,233 |
|  |  |  |

Weighted average remaining lease term and discount rate are shown below:

|  |  |
| --- | --- |
|  | **As of** |
|  | **March 31, 2019** |
|  |  |
| Weighted average remaining lease term | 6.08 years |
| Weighted average discount rate | 4.00 % |

Maturity of lease liabilities are shown below:

|  |  |  |
| --- | --- | --- |
| 2019 (excluding the three months ended March 31, 2019) | $ | 7,354 |
| 2020 |  | 8,962 |
|  |  |  |
| 2021 |  | 6,356 |
| 2022 |  | 4,229 |
|  |  |  |
| 2023 |  | 3,395 |
| 2024 and thereafter |  | 9,187 |
|  |  |  |
| Total lease payments |  | 39,483 |
| Imputed interest |  | (4,592) |
|  |  |  |
| Total | $ | 34,891 |
|  |  |  |

The Company adopted the new lease standard using the effective date as its date of initial application as noted above, and as required, the following disclosure is provided for periods prior to adoption. Future minimum lease payments as of December 31, 2018 are shown below:

|  |  |  |
| --- | --- | --- |
| 2019 | $ | 9,181 |
| 2020 |  | 8,261 |
|  |  |  |
| 2021 |  | 5,776 |
| 2022 |  | 3,745 |
|  |  |  |
| 2023 |  | 2,904 |
| 2024 and thereafter |  | 5,479 |
|  |  |  |
| Total minimum lease payments | $ | 35,346 |
|  |  |  |

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**2. Loans Receivable and Allowance for Loan Losses**

Loans receivable consisted of the following:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  |  | **As of** | | **As of** |
|  |  | **March 31, 2019** | | **December 31, 2018** |
|  |  |  |  |  |
| Federally insured student loans: |  |  |  |  |
| Stafford and other | $ | 4,901,934 |  | 4,969,667 |
|  |  |  |  |  |
| Consolidation |  | 16,778,679 |  | 17,186,229 |
| Total |  | 21,680,613 |  | 22,155,896 |
|  |  |  |  |  |
| Private education loans |  | 211,029 |  | 225,975 |
| Consumer loans |  | 191,001 |  | 138,627 |
|  |  |  |  |  |
|  |  | 22,082,643 |  | 22,520,498 |
| Loan discount, net of unamortized loan premiums and deferred origination costs |  | (43,602) |  | (53,572) |
| Non-accretable discount |  | (31,110) |  | (29,396) |
| Allowance for loan losses: |  |  |  |  |
|  |  |  |  |  |
| Federally insured loans |  | (40,934) |  | (42,310) |
| Private education loans |  | (10,587) |  | (10,838) |
|  |  |  |  |  |
| Consumer loans |  | (10,257) |  | (7,240) |
|  | $ | 21,946,153 |  | 22,377,142 |
|  |  |  |  |  |
|  |  |  |  |  |

***Activity in the Allowance for Loan Losses***

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

|  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  | **Three months ended March 31, 2019** | | | |  |  |  |
|  |  | | |  | |  |  |  |  |  |  |  |
|  | **Balance at beginning** | | | **Provision for loan** | |  |  |  |  |  |  | **Balance at end of** |
|  |  | **of period** | | **losses** | | **Charge-offs** | | **Recoveries** | | **Other** | | **period** |
|  |  |  |  |  |  |  |  |  |  |  |  |  |
| Federally insured loans | $ | 42,310 |  | 2,000 |  | (3,376) |  | — | | — | | 40,934 |
| Private education loans |  | 10,838 |  | — | | (482) |  | 231 |  | — | | 10,587 |
|  |  |  |  |  |  |  |  |  |  |  |  |  |
| Consumer loans |  | 7,240 |  | 5,000 |  | (2,006) |  | 23 |  | — | | 10,257 |
|  | $ | 60,388 |  | 7,000 |  | (5,864) |  | 254 |  | — |  | 61,778 |
|  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  | **Three months ended March 31, 2018** | | |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Federally insured loans | $ | 38,706 |  | 2,000 |  | (3,332) |  |  | — | | 1,000 |  | 38,374 |
| Private education loans |  | 12,629 |  | — | | (539) |  |  | 165 |  | — | | 12,255 |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Consumer loans |  | 3,255 |  | 2,000 |  | (595) |  |  | 5 |  | — | | 4,665 |
|  | $ | 54,590 |  | 4,000 |  | (4,466) |  |  | 170 |  | 1,000 |  | 55,294 |

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***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 table below shows the Company’s loan delinquency amounts.

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **As of March 31, 2019** | | |  |  |  |  | **As of December 31, 2018** | | |  |  |  |  | **As of March 31, 2018** | | |  |  |  |
| **Federally insured loans:** |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Loans in-school/grace/deferment | $ | 1,288,011 |  |  |  |  |  | $ | 1,298,493 |  |  |  |  |  | $ | 1,312,319 |  |  |  |  |  |
| Loans in forbearance |  | 1,358,343 |  |  |  |  |  |  | 1,430,291 |  |  |  |  |  |  | 1,650,913 |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Loans in repayment status: |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Loans current |  | 16,550,665 |  |  | 87.0 | % |  |  | 16,882,252 |  |  | 86.9 | % |  |  | 16,368,668 |  |  | 88.5 | % |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Loans delinquent 31-60 days |  | 666,668 |  |  | 3.5 |  |  |  | 683,084 |  |  | 3.5 |  |  |  | 669,490 |  |  | 3.6 |  |  |
| Loans delinquent 61-90 days |  | 425,098 |  |  | 2.2 |  |  |  | 427,764 |  |  | 2.2 |  |  |  | 426,696 |  |  | 2.3 |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Loans delinquent 91-120 days |  | 296,242 |  |  | 1.6 |  |  |  | 283,831 |  |  | 1.5 |  |  |  | 252,659 |  |  | 1.4 |  |  |
| Loans delinquent 121-270 days |  | 718,409 |  |  | 3.8 |  |  |  | 806,692 |  |  | 4.2 |  |  |  | 570,538 |  |  | 3.1 |  |  |
| Loans delinquent 271 days or greater |  | 377,177 |  |  | 1.9 |  |  |  | 343,489 |  |  | 1.7 |  |  |  | 210,265 |  |  | 1.1 |  |  |
| Total loans in repayment |  | 19,034,259 |  |  | 100.0 | % |  |  | 19,427,112 |  |  | 100.0 | % |  |  | 18,498,316 |  |  | 100.0 | % |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Total federally insured loans | $ | 21,680,613 |  |  |  |  |  | $ | 22,155,896 |  |  |  |  |  | $ | 21,461,548 |  |  |  |  |  |
| **Private education loans:** |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Loans in-school/grace/deferment | $ | 4,208 |  |  |  |  |  | $ | 4,320 |  |  |  |  |  | $ | 5,532 |  |  |  |  |  |
| Loans in forbearance |  | 1,473 |  |  |  |  |  |  | 1,494 |  |  |  |  |  |  | 2,574 |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Loans in repayment status: |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Loans current |  | 196,122 |  |  | 95.5 | % |  |  | 208,977 |  |  | 95.0 | % |  |  | 178,976 |  |  | 96.1 | % |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Loans delinquent 31-60 days |  | 2,292 |  |  | 1.1 |  |  |  | 3,626 |  |  | 1.6 |  |  |  | 1,630 |  |  | 0.9 |  |  |
| Loans delinquent 61-90 days |  | 1,481 |  |  | 0.7 |  |  |  | 1,560 |  |  | 0.7 |  |  |  | 1,110 |  |  | 0.6 |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Loans delinquent 91 days or greater |  | 5,453 |  |  | 2.7 |  |  |  | 5,998 |  |  | 2.7 |  |  |  | 4,488 |  |  | 2.4 |  |  |
| Total loans in repayment |  | 205,348 |  |  | 100.0 | % |  |  | 220,161 |  |  | 100.0 | % |  |  | 186,204 |  |  | 100.0 | % |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Total private education loans | $ | 211,029 |  |  |  |  |  | $ | 225,975 |  |  |  |  |  | $ | 194,310 |  |  |  |  |  |
| **Consumer loans:** |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Loans in repayment status: |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Loans current | $ | 187,983 |  |  | 98.4 | % |  | $ | 136,130 |  |  | 98.2 | % |  | $ | 76,401 |  |  | 98.1 | % |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Loans delinquent 31-60 days |  | 1,162 |  |  | 0.6 |  |  |  | 1,012 |  |  | 0.7 |  |  |  | 748 |  |  | 1.0 |  |  |
| Loans delinquent 61-90 days |  | 917 |  |  | 0.5 |  |  |  | 832 |  |  | 0.6 |  |  |  | 369 |  |  | 0.5 |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Loans delinquent 91 days or greater |  | 939 |  |  | 0.5 |  |  |  | 653 |  |  | 0.5 |  |  |  | 337 |  |  | 0.4 |  |  |
| Total loans in repayment |  | 191,001 |  |  | 100.0 | % |  |  | 138,627 |  |  | 100.0 | % |  |  | 77,855 |  |  | 100.0 | % |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Total consumer loans | $ | 191,001 |  |  |  |  |  | $ | 138,627 |  |  |  |  |  | $ | 77,855 |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

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**3. Bonds and Notes Payable**

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

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  | **As of March 31, 2019** | |  |  |
|  |  |  |  |  | |  |  |
|  |  | **Carrying** |  | **Interest rate** | | **Final maturity** |  |
|  |  | **amount** |  | **range** | |  |
| Variable-rate bonds and notes issued in FFELP loan asset-backed securitizations: |  |  |  |  |  |  |  |
| Bonds and notes based on indices | $ | 19,969,336 | 2.69% - 4.30% | |  | 11/25/24 - 4/25/67 |  |
|  |  |  |  |  |  |  |  |
| Bonds and notes based on auction |  | 787,676 | 3.18% - 3.83% | |  | 3/22/32 - 11/26/46 |  |
| Total FFELP variable-rate bonds and notes |  | 20,757,012 |  |  |  |  |  |
|  |  |  |  |  |  |  |  |
| FFELP warehouse facilities |  | 792,658 | 2.70% / 2.75% | |  | 5/20/20 / 5/31/21 |  |
| Consumer loan warehouse facility |  | 63,732 | 4.14% | |  | 1/10/22 |  |
|  |  |  |  |  |  |  |  |
| Variable-rate bonds and notes issued in private education loan asset-backed securitization |  | 46,330 | 4.24% | |  | 12/26/40 |  |
| Fixed-rate bonds and notes issued in private education loan asset-backed securitization |  | 59,609 | 3.60% / 5.35% | |  | 12/26/40 / 12/28/43 |  |
| Unsecured line of credit |  | 320,000 | 3.98% - 4.00% | |  | 6/22/23 |  |
| Unsecured debt - Junior Subordinated Hybrid Securities |  | 20,381 | 5.97% | |  | 9/15/61 |  |
|  |  |  |  |  |  |  |  |
| Other borrowings |  | 81,969 | 3.19% - 3.99% | |  | 4/1/19 - 12/20/19 |  |
|  |  | 22,141,691 |  |  |  |  |  |
|  |  |  |  |  |  |  |  |
| Discount on bonds and notes payable and debt issuance costs |  | (305,968) |  |  |  |  |  |
| Total | $ | 21,835,723 |  |  |  |  |  |
|  |  |  |  |  |  |  |  |

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  | **As of December 31, 2018** | |  |  |
|  |  |  |  |  | |  |  |
|  |  | **Carrying** |  | **Interest rate** | | **Final maturity** |  |
|  |  | **amount** |  | **range** | |  |
| Variable-rate bonds and notes issued in FFELP loan asset-backed securitizations: |  |  |  |  |  |  |  |
| Bonds and notes based on indices | $ | 20,192,123 | 2.59% - 4.52% | |  | 11/25/24 - 2/25/67 |  |
|  |  |  |  |  |  |  |  |
| Bonds and notes based on auction |  | 793,476 | 2.84% - 3.55% | |  | 3/22/32 - 11/26/46 |  |
| Total FFELP variable-rate bonds and notes |  | 20,985,599 |  |  |  |  |  |
|  |  |  |  |  |  |  |  |
| FFELP warehouse facilities |  | 986,886 | 2.65% / 2.71% | |  | 5/20/20 / 5/31/21 |  |
| Variable-rate bonds and notes issued in private education loan asset-backed securitization |  | 50,720 | 4.26% | |  | 12/26/40 |  |
| Fixed-rate bonds and notes issued in private education loan asset-backed securitization |  | 63,171 | 3.60% / 5.35% | |  | 12/26/40 / 12/28/43 |  |
| Unsecured line of credit |  | 310,000 | 3.92% - 4.01% | |  | 6/22/23 |  |
|  |  |  |  |  |  |  |  |
| Unsecured debt - Junior Subordinated Hybrid Securities |  | 20,381 | 6.17% | |  | 9/15/61 |  |
| Other borrowings |  | 120,342 | 3.05% - 5.22% | |  | 1/3/19 - 12/15/45 |  |
|  |  |  |  |  |  |  |  |
|  |  | 22,537,099 |  |  |  |  |  |
| Discount on bonds and notes payable and debt issuance costs |  | (318,359) |  |  |  |  |  |
|  |  |  |  |  |  |  |  |
| Total | $ | 22,218,740 |  |  |  |  |  |
|  |  |  |  |  |  |  |  |

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***FFELP Warehouse Facilities***

The Company funds the majority of its Federal Family Education Loan Program (the "FFEL Program" or "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, 2019, the Company had two FFELP warehouse facilities as summarized below.

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
|  | **NFSLW-I (a)** |  |  | **NHELP-II** |  |  | **Total** |
|  |  |  |  |  |  |  |  |
| Maximum financing amount | $ | 500,000 |  |  | 500,000 |  | 1,000,000 |
| Amount outstanding |  | 447,564 |  |  | 345,094 |  | 792,658 |
|  |  |  |  |  |  |  |  |
| Amount available | $ | 52,436 |  |  | 154,906 |  | 207,342 |
|  |  | |  |  |  |  |  |
| Expiration of liquidity provisions | May 20, 2019 | | | | May 31, 2019 | |  |
| Final maturity date | May 20, 2020 | | | | May 31, 2021 | |  |
| Advanced as equity support | $ | 24,314 |  |  | 26,255 |  | 50,569 |

(a) On March 8, 2019, the Company decreased the maximum financing amount for this warehouse facility to $500 million.

***Asset-Backed Securitizations***

The following table summarizes the asset-backed securitization transactions completed during the first three months of 2019.

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  | **2019-1** |  |  |  |
|  |  |  | |  | |  |  |
|  |  | Class A-1 Notes | | Class A-2 Notes | | 2019-1 total |  |
|  |  |  |  |  |  |  |  |
| Date securities issued |  | 2/27/19 |  | 2/27/19 |  | 2/27/19 |  |
|  |  |  |  |  |  |  |  |
| Class A senior notes: |  |  |  |  |  |  |  |
| Total principal amount | $ | 35,700 |  | 448,000 |  | 483,700 |  |
|  |  |  |  |  |  |  |  |
| Cost of funds (1-month LIBOR plus:) |  | 0.30% |  | 0.75% |  |  |  |
| Final maturity date |  | 4/25/67 |  | 4/25/67 |  |  |  |
|  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |
| Class B subordinated notes: |  |  |  |  |  |  |  |
| Total principal amount |  |  |  |  |  | 13,100 |  |
|  |  |  |  |  |  |  |  |
| Cost of funds (1-month LIBOR plus:) |  |  |  |  |  | 1.40% |  |
| Final maturity date |  |  |  |  |  | 4/25/67 |  |
| Total principal amount issued | $ | 35,700 |  | 448,000 |  | 496,800 |  |
|  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |

***Consumer Loan Warehouse Facility***

On January 11, 2019, the Company closed on a consumer loan warehouse facility with an aggregate maximum financing amount available of $100.0 million, an advance rate of 70 or 75 percent depending on type of collateral and subject to certain concentration limits, and a maturity date of January 10, 2022. As of March 31, 2019, $63.7 million was outstanding under this warehouse facility and $36.3 million was available for future funding. Additionally, as of March 31, 2019, the Company had $26.5 million advanced as equity support under this facility.

***Unsecured Line of Credit***

The Company has a $382.5 million unsecured line of credit that has a maturity date of June 22, 2023. As of March 31, 2019, $320.0 million was outstanding under the line of credit and $62.5 million was available for future use. The line of credit provides that the Company may increase the aggregate financing commitments, through the existing lenders and/or through new lenders, up to a total of $400.0 million, subject to certain conditions.

***Other Borrowings***

The Company has two repurchase agreements, the proceeds of which are collateralized by FFELP asset-backed security investments and private education loans, respectively. Included in "other borrowings" as of March 31, 2019 and December 31, 2018 was a total of $82.0 million and $86.4 million, respectively, subject to these repurchase agreements.

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The Company had other notes payable included in its consolidated financial statements which were issued by partnerships for certain real estate development projects. Although the Company's ownership of these partnerships are 50 percent or less, because the Company was the developer of and is a current tenant in the associated buildings, the operating results of these partnerships were included in the Company's consolidated financial statements. On January 1, 2019, the Company adopted a new accounting standard for leases (see note 1). As a result of the adoption of this new standard, these real estate entities were deconsolidated, including $33.9 million of related debt. Prior to January 1, 2019, this debt was included in "other borrowings."

**4. Derivative Financial Instruments**

The Company uses derivative financial instruments to manage interest rate risk. Derivative instruments used as part of the Company's risk management strategy are further described in note 5 of the notes to consolidated financial statements included in the 2018 Annual Report. A tabular presentation of such derivatives outstanding as of March 31, 2019 and December 31, 2018 is presented below.

***Basis Swaps***

The following table summarizes the Company’s outstanding basis swaps 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").

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  | **As of March 31,** | | | **As of December 31,** | |  |
|  |  |  |  | **2019** |  |  | **2018** |  |  |
|  | **Maturity** |  |  |  |  |  |  |  |  |
|  |  |  | **Notional amount** |  |  | **Notional amount** |  |  |
|  | 2019 | $ | | 3,250,000 |  |  | 3,500,000 |  |  |
| 2020 | | (a) | | 1,000,000 |  |  | 1,000,000 |  |  |
|  | 2021 | (a) | | 250,000 |  |  | 250,000 |  |  |
| 2022 | | (b) | | 2,000,000 |  |  | 2,000,000 |  |  |
|  | 2023 |  |  | 750,000 |  |  | 750,000 |  |  |
| 2024 | |  |  | 250,000 |  |  | 250,000 |  |  |
|  | |  |  |  |  |  |  |  |  |
|  | 2026 |  |  | 1,150,000 |  |  | 1,150,000 |  |  |
| 2027 | |  |  | 375,000 |  |  | 375,000 |  |  |
|  | |  |  |  |  |  |  |  |  |
|  | 2028 |  |  | 325,000 |  |  | 325,000 |  |  |
| 2029 | |  |  | 100,000 |  |  | 100,000 |  |  |
|  | |  |  |  |  |  |  |  |  |
|  | 2031 |  |  | 300,000 |  |  | 300,000 |  |  |
|  |  |  | $ | 9,750,000 |  |  | 10,000,000 |  |  |
|  |  | |  | |  |  |  |  |  |
| (a) These derivatives have a forward effective start date in May 2019. | | | | | | |  |  |  |
| (b) $250 million and $750 million of the notional amount of these derivatives have forward effective start dates in | | | | | | | May 2019 and May 2020, respectively. | |  |

The weighted average rate paid by the Company on the 1:3 Basis Swaps as of March 31, 2019 and December 31, 2018 was one-month LIBOR plus 9.5 basis points and 9.4 basis points, respectively.

***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, 2019** | | |  |  |  | **As of December 31, 2018** | | |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  | **Weighted average fixed rate** |  |  |  |  |  | **Weighted average fixed rate** |  |
| **Maturity** | |  | **Notional amount** | | **paid by the Company (a)** |  |  |  | **Notional amount** | | **paid by the Company (a)** |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |
| 2019 |  | $ | 1,500,000 |  | 0.98 | % |  | $ | 3,250,000 |  | 0.97 | % |
| 2020 |  |  | 1,500,000 |  | 1.01 |  |  |  | 1,500,000 |  | 1.01 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |
| 2021 |  |  | 100,000 |  | 2.95 |  |  |  | 100,000 |  | 2.95 |  |
| 2023 |  |  | 400,000 |  | 2.24 |  |  |  | 400,000 |  | 2.24 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |
| 2024 |  |  | 200,000 |  | 2.27 |  |  |  | 300,000 |  | 2.28 |  |
| 2027 |  |  | — | | — |  |  |  | 25,000 |  | 2.35 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  | $ | 3,700,000 |  | 1.25 | % |  | $ | 5,575,000 |  | 1.18 | % |
|  |  |  |  |  |  |  |  |  |  |  |  |  |

1. For all interest rate derivatives, the Company receives discrete three-month LIBOR.

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***Interest Rate Swap Options – Floor Income Hedges***

During 2014 and 2018, the Company paid $9.1 million and $4.6 million, respectively, for interest rate swap options to economically hedge loans earning fixed rate floor income. The interest rate swap options give the Company the right, but not the obligation, to enter into interest rate swaps in which the Company would pay a fixed amount and receive discrete one-month LIBOR. The following table summarizes these derivative instruments as of March 31, 2019.

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  | **Weighted average fixed rate** | |  |  |
| **If exercised effective date** | |  | **Notional amount** | | **paid by the Company** |  |  | **If exercised maturity date** |
|  |  |  |  |  |  |  |  |  |
| August 21, 2019 | | $ | 750,000 |  | 3.28 | % |  | August 21, 2024 |
| September 25, 2019 | |  | 250,000 |  | 3.00 |  |  | September 25, 2024 |
|  |  |  |  |  |  |  |  |  |
|  |  | $ | 1,000,000 |  | 3.21 | % |  |  |
|  |  |  |  |  |  |  |  |  |

***Interest Rate Caps***

During 2015, the Company paid $2.9 million for two interest rate cap contracts with a total notional amount of $275.0 million to mitigate a rise in interest rates and its impact on earnings related to its student loan portfolio earning a fixed rate. The first interest rate cap has a notional amount of $125.0 million and a one-month LIBOR strike rate of 2.50%, and the second interest rate cap has a notional amount of $150.0 million and a one-month LIBOR strike rate of 4.99%. In the event that the one-month LIBOR rate rises above the applicable strike rate, the Company would receive monthly payments related to the spread difference. Both interest rate cap contracts have a maturity date of July 15, 2020.

***Consolidated Financial Statement Impact Related to Derivatives***

*Balance Sheet*

The following table summarizes the fair value of the Company’s derivatives as reflected in the consolidated balance sheets. There is no difference between the gross amounts of recognized assets presented in the consolidated balance sheets related to the Company's derivative portfolio and the net amount when excluding derivatives subject to enforceable master netting arrangements and cash collateral received.

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Fair value of asset derivatives** | | | | | **Fair value of liability derivatives** | | |
|  |  |  |  |  |  |  | |  |
|  | **As of March 31, 2019** |  |  | **As of December 31, 2018** | | **As of March 31, 2019** | | **As of December 31, 2018** |
|  |  |  |  |  |  |  |  |  |
| Interest rate swap options - floor income hedges | $ | 90 |  | 1,465 |  | — | | — |
| Interest rate caps |  | 78 |  | 353 |  | — | | — |
|  |  |  |  |  |  |  |  |  |
| Total | $ | 168 |  | 1,818 |  | — | | — |
|  |  |  |  |  |  |  |  |  |

*Income Statement Impact*

The following table summarizes the components of "derivative market value adjustments and derivative settlements, net" included in the consolidated statements of income.

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | **Three months ended March 31,** | | | |  |
|  |  |  | | |  |
|  | **2019** | **2018** | | |  |
|  |  |  |  |  |  |
| Settlements: |  |  |  |  |  |
| 1:3 basis swaps | $ | 2,334 |  |  | (1,664) |
|  |  |  |  |  |  |
| Interest rate swaps - floor income hedges |  | 16,701 |  |  | 8,590 |
| Interest rate swaps - hybrid debt hedges |  | — | | | (160) |
|  |  |  |  |  |  |
| Total settlements - income |  | 19,035 |  |  | 6,766 |
| Change in fair value: |  |  |  |  |  |
|  |  |  |  |  |  |
| 1:3 basis swaps |  | (2,212) |  |  | 13,297 |
| Interest rate swaps - floor income hedges |  | (26,712) |  |  | 44,201 |
|  |  |  |  |  |  |
| Interest rate swap options - floor income hedges |  | (1,376) |  |  | 747 |
| Interest rate caps |  | (274) |  |  | 326 |
|  |  |  |  |  |  |
| Interest rate swaps - hybrid debt hedges |  | — | | | 1,462 |
| Total change in fair value - (expense) income |  | (30,574) |  |  | 60,033 |
| Derivative market value adjustments and derivative settlements, net - (expense) income | $ | (11,539) |  |  | 66,799 |
|  |  |  |  |  |  |

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**5. Investments and Notes Receivable**

A summary of the Company's investments and notes receivable follows:

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  | **As of March 31, 2019** | | | |  |  |  |  | **As of December 31, 2018** | | | |  |  |
|  |  |  |  |  | |  | |  |  |  |  |  | |  | |  |  |
|  |  |  |  | **Gross unrealized** | | **Gross unrealized** | |  |  |  |  | **Gross unrealized** | | **Gross unrealized** | |  |  |
|  |  | **Amortized cost** | | **gains** | | **losses** | | **Fair value** |  | **Amortized cost** | | **gains** | | **losses** | | **Fair value** |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **Investments (at fair value):** |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Student loan asset-backed and other debt | $ | 47,994 |  | 4,673 |  | — | | 52,667 | 47,931 | |  | 5,109 |  | — | | 53,040 |  |
| securities - available-for-sale |  |  |  |  |  |
| Equity securities |  | 13,405 |  | 6,002 |  | (1,037) |  | 18,370 | 12,909 | |  | 5,145 |  | (407) |  | 17,647 |  |
| Total investments (at fair value) | $ | 61,399 |  | 10,675 |  | (1,037) |  | 71,037 |  | 60,840 |  | 10,254 |  | (407) |  | 70,687 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **Other Investments and Notes Receivable (not** |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **measured at fair value):** |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Venture capital and funds: |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Measurement alternative |  |  |  |  |  |  |  | 71,129 |  |  |  |  |  |  |  | 70,939 |  |
| Equity method |  |  |  |  |  |  |  | 15,714 |  |  |  |  |  |  |  | 19,230 |  |
| Other |  |  |  |  |  |  |  | 800 |  |  |  |  |  |  |  | 900 |  |
| Total venture capital and funds |  |  |  |  |  |  |  | 87,643 |  |  |  |  |  |  |  | 91,069 |  |
| Real estate: |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |



Equity method

Other

Total real estate

Notes receivable

Tax liens and affordable housing

Total investments and notes receivable (not

measured at fair value)

Total investments and notes receivable

|  |  |  |  |
| --- | --- | --- | --- |
|  | 39,489 |  | 29,168 |
|  | 9,193 |  | 34,211 |
|  |  |  |  |
|  | 48,682 |  | 63,379 |
|  |  |  |  |
|  | 16,183 |  | 16,373 |
|  | 6,967 |  | 7,862 |
|  |  |  |  |
|  | 159,475 |  | 178,683 |
|  |  |  |  |
| $ | 230,512 |  | 249,370 |
|  |  |  |  |
|  |  |  |  |



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**6. Intangible Assets**

Intangible assets consist of the following:



Amortizable intangible assets, net:

Customer relationships (net of accumulated amortization of $40,635 and $33,968, respectively)



Trade names (net of accumulated amortization of $6,672 and $5,825, respectively)

Computer software (net of accumulated amortization of $9,268 and $15,420, respectively)



Total - amortizable intangible assets, net

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Weighted average** | |  | **As of** | | **As of** |  |
| **remaining useful life as of** | |  |  |
| **March 31, 2019 (months)** | |  | **March 31, 2019** | | **December 31, 2018** |  |
|  |  |  |  |  |  |  |
| 82 |  | $ | 91,818 |  | 98,484 |  |
| 88 |  |  | 10,020 |  | 10,868 |  |
| 21 |  |  | 3,957 |  | 4,938 |  |
|  |  |  |  |  |  |  |
| 81 |  | $ | 105,795 |  | 114,290 |  |
|  |  |  |  |  |  |  |

The Company recorded amortization expense on its intangible assets of $8.5 million and $6.2 million during the three months ended March 31, 2019 and 2018, respectively. The Company will continue to amortize intangible assets over their remaining useful lives. As of March 31, 2019, the Company estimates it will record amortization expense as follows:

|  |  |  |
| --- | --- | --- |
| 2019 (April 1 - December 31) | $ | 24,263 |
| 2020 |  | 29,515 |
|  |  |  |
| 2021 |  | 18,761 |
| 2022 |  | 7,172 |
|  |  |  |
| 2023 |  | 6,925 |
| 2024 and thereafter |  | 19,159 |
|  |  |  |
|  | $ | 105,795 |
|  |  |  |

**7. Goodwill**

The carrying amount of goodwill as of December 31, 2018 and March 31, 2019 by reportable operating segment was as follows:

|  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  | **Education** | |  |  |  |  |  |  |  |
|  |  |  |  | **Technology, Services,** | |  |  |  |  |  |  |  |
|  | **Loan Servicing and** | | | **and Payment** | |  |  | **Asset Generation and** | | **Corporate and Other** | |  |
|  |  | **Systems** |  | **Processing** |  | **Communications** |  | **Management** |  | **Activities** |  | **Total** |
| Goodwill balance | $ | 23,639 |  | 70,278 |  | 21,112 |  | 41,883 |  | — | | 156,912 |

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**8. Property and Equipment**

Property and equipment consisted of the following:

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  | **As of** | | **As of** |
|  | **Useful life** | |  | **March 31, 2019** | | **December 31, 2018** |
|  |  |  |  |  |  |  |
| **Non-communications:** |  |  |  |  |  |  |
| Computer equipment and software | 1-5 years | | $ | 145,600 |  | 137,705 |
|  |  |  |  |  |  |  |
| Building and building improvements | 5-48 years | |  | 37,526 |  | 50,138 |
| Office furniture and equipment | 1-10 years | |  | 23,169 |  | 22,796 |
|  |  |  |  |  |  |  |
| Leasehold improvements | 1-15 years | |  | 8,844 |  | 9,327 |
| Transportation equipment | 5-10 years | |  | 5,067 |  | 5,123 |
|  |  |  |  |  |  |  |
| Land | — | |  | 1,400 |  | 3,328 |
| Construction in progress | — | |  | 2,568 |  | 3,578 |
|  |  |  |  |  |  |  |
|  |  |  |  | 224,174 |  | 231,995 |
| Accumulated depreciation - non-communications |  |  |  | (129,747) |  | (123,003) |
|  |  |  |  |  |  |  |
| **Non-communications, net property and equipment** |  |  |  | 94,427 |  | 108,992 |
|  |  |  |  |  |  |  |
| **Communications:** |  |  |  |  |  |  |
| Network plant and fiber | 5-15 years | |  | 225,570 |  | 215,787 |
| Customer located property | 3-7 years | |  | 23,470 |  | 21,234 |
| Central office | 5-15 years | |  | 16,443 |  | 15,688 |
| Transportation equipment | 4-10 years | |  | 6,685 |  | 6,580 |
| Computer equipment and software | 1-5 years | |  | 5,035 |  | 4,943 |
| Other | 1-39 years | |  | 3,294 |  | 3,219 |
| Land | — | |  | 70 |  | 70 |
| Construction in progress | — | |  | 5,256 |  | 6,344 |
|  |  |  |  | 285,823 |  | 273,865 |
|  |  |  |  |  |  |  |
| Accumulated depreciation - communications |  |  |  | (45,180) |  | (38,073) |
| **Communications, net property and equipment** |  |  |  | 240,643 |  | 235,792 |
| **Total property and equipment, net** |  |  | $ | 335,070 |  | 344,784 |
|  |  |  |  |  |  |  |

The Company recorded depreciation expense on its property and equipment of $15.7 million and $12.2 million during the three months ended March 31, 2019 and 2018, respectively.

**9. 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.

Numerator:

Net income attributable to Nelnet, Inc.

Denominator:

Weighted-average common shares outstanding - basic and diluted

Earnings per share - basic and diluted

**Three months ended March 31,**



|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  | **2019** |  |  |  |  |  | **2018** |  |  |
|  |  | |  | |  |  |  |  |  | |  |
|  | Common | | Unvested restricted | |  |  |  |  | Unvested restricted | |  |
|  | shareholders | | stock shareholders | | Total | | Common shareholders | | stock shareholders | | Total |
|  |  |  |  |  |  |  |  |  |  |  |  |
| $ | 41,057 |  | 534 |  | 41,591 |  | 112,788 |  | 1,137 |  | 113,925 |
|  | 39,855,122 |  | 518,173 |  | 40,373,295 |  | 40,541,870 |  | 408,658 |  | 40,950,528 |
| $ | 1.03 |  | 1.03 |  | 1.03 |  | 2.78 |  | 2.78 |  | 2.78 |
|  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |



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**10. Segment Reporting**

See note 14 of the notes to consolidated financial statements included in the 2018 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, 2019** | | | | |  |  |  |  |  |
|  |  |  |  | **Education Technology,** | |  |  | **Asset** | | |  |  |  |  |  |
|  |  | **Loan Servicing and** | | **Services, and Payment** | |  |  | **Generation and** | | | **Corporate and** | |  |  |  |
|  |  | **Systems** | | **Processing** | | **Communications** | | **Management** | | | **Other Activities** | | **Eliminations** | | **Total** |
| Total interest income | $ | 497 |  | 2,017 |  | 2 |  | 246,867 |  |  | 2,053 |  | (851) |  | 250,586 |
| Interest expense |  | — |  | 8 |  | — |  | 188,799 |  |  | 3,814 |  | (851) |  | 191,770 |
| Net interest income (expense) |  | 497 |  | 2,009 |  | 2 |  | 58,068 |  |  | (1,761) |  | — | | 58,816 |
| Less provision for loan losses |  | — |  | — |  | — |  | 7,000 |  |  | — |  | — |  | 7,000 |
| Net interest income (loss) after provision for loan losses |  | 497 |  | 2,009 |  | 2 |  | 51,068 |  |  | (1,761) |  | — | | 51,816 |
| Other income: |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Loan servicing and systems revenue |  | 114,898 |  | — | | — | | — | | | — | | — | | 114,898 |
| Intersegment servicing revenue |  | 12,217 |  | — | | — | | — | | | — | | (12,217) |  | — |
| Education technology, services, and payment processing revenue |  | — | | 79,159 |  | — | | — | | | — | | — | | 79,159 |
| Communications revenue |  | — | | — | | 14,543 |  | — | | | — | | — | | 14,543 |
| Other income |  | 2,074 |  | — | | 125 |  | 3,525 |  |  | 3,344 |  | — | | 9,067 |
| Derivative settlements, net |  | — | | — | | — | | 19,035 |  |  | — | | — | | 19,035 |
| Derivative market value adjustments, net |  | — | | — | | — | | (30,574) |  |  | — | | — | | (30,574) |
| Total other income |  | 129,189 |  | 79,159 |  | 14,668 |  | (8,014) |  |  | 3,344 |  | (12,217) |  | 206,128 |
| Cost of services: |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Cost to provide education technology, services, and payment processing services |  | — | | 21,059 |  | — | | — | | | — | | — | | 21,059 |
| Cost to provide communications services |  | — |  | — |  | 4,759 |  | — |  |  | — |  | — |  | 4,759 |
| Total cost of services |  | — | | 21,059 |  | 4,759 |  | — | | | — | | — | | 25,818 |
| Operating expenses: |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Salaries and benefits |  | 66,220 |  | 23,008 |  | 4,737 |  | 378 |  |  | 16,716 |  | — | | 111,059 |
| Depreciation and amortization |  | 8,871 |  | 3,510 |  | 7,362 |  | — | | | 4,469 |  | — | | 24,213 |
| Loan servicing fees to third parties |  | — | | — | | — | | 2,893 |  |  | — | | — | | 2,893 |
| Other expenses |  | 18,928 |  | 5,311 |  | 3,477 |  | 944 |  |  | 12,262 |  | — | | 40,923 |
| Intersegment expenses, net |  | 13,758 |  | 3,299 |  | 664 |  | 12,287 |  |  | (17,791) |  | (12,217) |  | — |
| Total operating expenses |  | 107,777 |  | 35,128 |  | 16,240 |  | 16,502 |  |  | 15,656 |  | (12,217) |  | 179,088 |
| Income (loss) before income taxes |  | 21,909 |  | 24,981 |  | (6,329) |  | 26,552 |  |  | (14,073) |  | — | | 53,038 |
| Income tax (expense) benefit |  | (5,258) |  | (5,995) |  | 1,519 |  | (6,372) |  |  | 4,716 |  | — |  | (11,391) |
| Net income (loss) |  | 16,651 |  | 18,986 |  | (4,810) |  | 20,180 |  |  | (9,357) |  | — | | 41,647 |
| Net income attributable to noncontrolling interests |  | — |  | — |  | — |  | — |  |  | (56) |  | — |  | (56) |
| Net income (loss) attributable to Nelnet, Inc. | $ | 16,651 |  | 18,986 |  | (4,810) |  | 20,180 |  |  | (9,413) |  | — | | 41,591 |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Total assets as of March 31, 2019 | $ | 273,065 |  | 294,019 |  | 297,196 |  | 23,475,113 |  |  | 546,987 |  | (164,453) |  | 24,721,927 |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

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|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  | **Three months ended March 31, 2018** | | | | |  |  |  |  |  |  |
|  |  | **Loan Servicing and** | | **Education Technology,** | |  |  | **Asset** | | | **Corporate and** | |  |  |  |  |
|  |  | **Services, and Payment** | | **Communications** | | **Generation and** | | | **Other** | | **Eliminations** | | **Total** |  |
|  |  | **Systems** | | **Processing** | | **Management** | | | **Activities** | |  |
| Total interest income | $ | 257 |  | 665 |  | 1 |  | 200,334 |  |  | 4,751 |  | (3,150) |  | 202,857 |  |
| Interest expense |  | — |  | — |  | 2,509 |  | 134,233 |  |  | 1,958 |  | (3,150) |  | 135,550 |  |
| Net interest income (expense) |  | 257 |  | 665 |  | (2,508) |  | 66,101 |  |  | 2,793 |  | — | | 67,307 |  |
| Less provision for loan losses |  | — |  | — |  | — |  | 4,000 |  |  | — |  | — |  | 4,000 |  |
| Net interest income (loss) after provision for loan losses |  | 257 |  | 665 |  | (2,508) |  | 62,101 |  |  | 2,793 |  | — | | 63,307 |  |
| Other income: |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Loan servicing and systems revenue |  | 100,141 |  | — | | — | | — | | | — | | — | | 100,141 |  |
| Intersegment servicing revenue |  | 10,771 |  | — | | — | | — | | | — | | (10,771) |  | — |  |
| Education technology, services, and payment processing revenue |  | — | | 60,221 |  | — | | — | | | — | | — | | 60,221 |  |
| Communications revenue |  | — | | — | | 9,189 |  | — | | | — | | — | | 9,189 |  |
| Other income |  | 1,292 |  | — | | — | | 3,351 |  |  | 13,914 |  | — | | 18,557 |  |
| Derivative settlements, net |  | — | | — | | — | | 6,926 |  |  | (160) |  | — | | 6,766 |  |
| Derivative market value adjustments, net |  | — | | — | | — | | 58,571 |  |  | 1,462 |  | — | | 60,033 |  |
| Total other income |  | 112,204 |  | 60,221 |  | 9,189 |  | 68,848 |  |  | 15,216 |  | (10,771) |  | 254,907 |  |
| Cost of services: |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Cost to provide education technology, services, and payment processing services |  | — | | 13,683 |  | — | | — | | | — | | — | | 13,683 |  |
| Cost to provide communications services |  | — |  | — |  | 3,717 |  | — |  |  | — |  | — |  | 3,717 |  |
| Total cost of services |  | — | | 13,683 |  | 3,717 |  | — | | | — | | — | | 17,400 |  |
| Operating expenses: |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Salaries and benefits |  | 58,537 |  | 19,067 |  | 4,063 |  | 382 |  |  | 14,594 |  | — | | 96,643 |  |
| Depreciation and amortization |  | 6,069 |  | 3,341 |  | 4,921 |  | — | | | 4,126 |  | — | | 18,457 |  |
| Loan servicing fees to third parties |  | — | | — | | — | | 3,136 |  |  | — | | — | | 3,136 |  |
| Other expenses |  | 14,463 |  | 4,624 |  | 2,638 |  | 848 |  |  | 10,845 |  | — | | 33,417 |  |
| Intersegment expenses, net |  | 13,356 |  | 2,567 |  | 605 |  | 10,865 |  |  | (16,622) |  | (10,771) |  | — |  |
| Total operating expenses |  | 92,425 |  | 29,599 |  | 12,227 |  | 15,231 |  |  | 12,943 |  | (10,771) |  | 151,653 |  |
| Income (loss) before income taxes |  | 20,036 |  | 17,604 |  | (9,263) |  | 115,718 |  |  | 5,066 |  | — | | 149,161 |  |
| Income tax (expense) benefit |  | (5,003) |  | (4,225) |  | 2,223 |  | (27,773) |  |  | (1,199) |  | — |  | (35,976) |  |
| Net income (loss) |  | 15,033 |  | 13,379 |  | (7,040) |  | 87,945 |  |  | 3,867 |  | — | | 113,185 |  |
| Net loss (income) attributable to noncontrolling interests |  | 808 |  | — |  | — |  | — |  |  | (68) |  | — |  | 740 |  |
| Net income (loss) attributable to Nelnet, Inc. | $ | 15,841 |  | 13,379 |  | (7,040) |  | 87,945 |  |  | 3,799 |  | — | | 113,925 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Total assets as of March 31, 2018 | $ | 281,208 |  | 193,283 |  | 228,750 |  | 22,804,734 |  |  | 718,251 |  | (327,824) |  | 23,898,402 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

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**11. Disaggregated Revenue and Deferred Revenue**

The following tables provide disaggregated revenue by service offering and/or customer type for the Company's fee-based reportable operating segments.

***Loan Servicing and Systems***

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  |  | **Three months ended March 31,** | | | |  |
|  |  |  |  | | |  |
|  |  | **2019** | **2018** | | |  |
|  |  |  |  |  |  |  |
|  | Government servicing - Nelnet | $ | 39,640 |  |  | 39,327 |
|  | Government servicing - Great Lakes |  | 47,077 |  |  | 30,754 |
|  |  |  |  |  |  |  |
|  | Private education and consumer loan servicing |  | 9,480 |  |  | 13,101 |
|  | FFELP servicing |  | 6,695 |  |  | 7,691 |
|  | Software services |  | 9,741 |  |  | 7,589 |
| Outsourced services and other | |  | 2,265 |  |  | 1,679 |
|  | Loan servicing and systems revenue | $ | 114,898 |  |  | 100,141 |
|  |  |  |  |  |  |  |

***Education Technology, Services, and Payment Processing***



Tuition payment plan services

Payment processing



Education technology and services

Other



Education technology, services, and payment processing revenue

***Communications***



Internet

Television



Telephone

Other



Communications revenue



Residential revenue

Business revenue



Other

Communications revenue

***Other Income***

The following table provides the components of "other income" on the consolidated statements of income:



Borrower late fee income

Management fee revenue



Investment advisory fees

(Loss) gain on investments and notes receivable, net



Other

Other income

**Three months ended March 31,**



|  |  |  |  |
| --- | --- | --- | --- |
|  | **2019** |  | **2018** |
|  |  |  |  |
| $ | 30,173 |  | 23,043 |
|  | 28,979 |  | 19,926 |
|  | 19,709 |  | 16,975 |
|  | 298 |  | 277 |
|  |  |  |  |
| $ | 79,159 |  | 60,221 |
|  |  |  |  |
|  |  |  |  |

**Three months ended March 31,**



|  |  |  |  |
| --- | --- | --- | --- |
|  | **2019** |  | **2018** |
|  |  |  |  |
| $ | 8,449 |  | 4,696 |
|  | 3,898 |  | 2,784 |
|  | 2,167 |  | 1,691 |
|  | 29 |  | 18 |
|  |  |  |  |
| $ | 14,543 |  | 9,189 |
|  |  |  |  |
|  |  |  |  |
| $ | 11,065 |  | 6,747 |
|  | 3,414 |  | 2,381 |
|  | 64 |  | 61 |
|  |  |  |  |
| $ | 14,543 |  | 9,189 |
|  |  |  |  |
|  |  |  |  |

**Three months ended March 31,**



|  |  |  |  |
| --- | --- | --- | --- |
|  | **2019** |  | **2018** |
| $ | 3,512 |  | 2,983 |
|  | 1,872 |  | 1,161 |
|  | 711 |  | 1,593 |
|  | (427) |  | 8,688 |
|  | 3,399 |  | 4,132 |
|  |  |  |  |
| $ | 9,067 |  | 18,557 |
|  |  |  |  |
|  |  |  |  |

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***Deferred Revenue***

Activity in the deferred revenue balance, which is included in "other liabilities" on the consolidated balance sheets, is shown below:

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  | **Three months ended March 31, 2019** | | | | | | | | |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  | **Education** | | | |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  | **Technology, Services,** | | | |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  | **Loan Servicing and** | | | | | **and Payment** | | | |  |  |  |  | **Corporate and Other** | | | |  |  |  |
|  |  |  |  | **Systems** | |  | | **Processing** | |  | | **Communications** | |  | |  | **Activities** |  | |  | **Total** |  |
|  | Balance, beginning of period | $ | | 4,413 |  |  |  | 30,556 |  |  |  | 2,551 |  |  |  |  | 1,602 |  |  | 39,122 | |  |
|  | Deferral of revenue |  |  | 1,116 |  |  |  | 13,962 |  |  |  | 8,266 |  |  |  |  | 736 |  |  | 24,080 | |  |
|  | Recognition of revenue |  |  | (1,582) | |  |  | (26,049) | |  |  | (8,061) | |  |  |  | (784) |  |  | (36,476) | |  |
|  | Other |  |  | — | |  | | 29 |  |  |  | — | |  | |  | (2) |  |  | 27 | |  |
|  | Balance, end of period | $ | | 3,947 |  |  |  | 18,498 |  |  |  | 2,756 |  |  |  |  | 1,552 |  |  | 26,753 | |  |
|  |  |  |  |  |  |  |  | **Three months ended March 31, 2018** | | | | | | | | |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  | **Education** | | | |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  | **Technology, Services,** | | | |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  | **Loan Servicing and** | | | | | **and Payment** | | | |  |  |  |  | **Corporate and Other** | | | |  |  |  |
|  |  |  |  | **Systems** |  | |  | **Processing** |  | |  | **Communications** |  | |  | | **Activities** | |  |  | **Total** | |
| Balance, beginning of period | | $ | | 4,968 |  |  |  | 24,164 |  |  |  | 1,665 |  |  |  |  | 1,479 |  |  | 32,276 | |  |
|  | Deferral of revenue |  |  | 253 |  |  |  | 10,774 |  |  |  | 5,375 |  |  |  |  | 648 |  |  | 17,050 | |  |
|  | Recognition of revenue |  |  | (1,094) |  |  |  | (19,836) |  |  |  | (5,213) |  |  |  |  | (659) | |  | (26,802) | | |
|  | Other |  |  | 45 |  |  |  | 146 |  |  |  | — |  | |  | | — | |  |  | 191 |  |
| Balance, end of period | | $ | | 4,172 |  |  |  | 15,248 |  |  |  | 1,827 |  |  |  |  | 1,468 |  |  | 22,715 | |  |

**12. Major Customer**

Nelnet Servicing, LLC ("Nelnet Servicing"), a subsidiary of the Company, earns loan servicing revenue from a servicing contract with the Department of Education (the "Department") that currently provides for expiration on June 16, 2019. Revenue earned by Nelnet Servicing related to this contract was $39.6 million and $39.3 million for the three months ended March 31, 2019 and 2018, respectively.

In addition, Great Lakes Educational Loan Services, Inc. ("Great Lakes"), which was acquired by the Company on February 7, 2018, also earns loan servicing revenue from a similar servicing contract with the Department that currently provides for expiration on June 16, 2019. Revenue earned by Great Lakes related to this contract was $47.1 million for the three months ended March 31, 2019 and $30.8 million for the period from February 7, 2018 to March 31, 2018.

On April 24, 2019, Nelnet Servicing and Great Lakes received correspondence from the Department's Office of Federal Student Aid ("FSA") indicating the FSA's intent to exercise a six-month extension of the current servicing contracts, from June 16, 2019 to December 15, 2019. The correspondence served only as a non-binding notice of intent, and any formal extension of the contracts will occur only upon a signed modification to the contracts.

In addition, Nelnet Servicing's current Authority to Operate as a loan servicer for the Department expires on May 31, 2019, and is currently under review for renewal.

FSA is conducting a contract procurement process entitled Next Generation Financial Services Environment (“NextGen”) for a new framework for the servicing of all student loans owned by the

Department. On January 15, 2019, FSA issued solicitations for three NextGen components:

* NextGen Enhanced Processing Solution ("EPS")
* NextGen Business Process Operations ("BPO")
* NextGen Optimal Processing Solution ("OPS")

On April 1, 2019, the Company responded to the EPS component. In addition, the Company is part of teams that currently intend to respond to the BPO and OPS components. The Company cannot predict the timing, nature, or outcome of these solicitations.

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**13. Fair Value**

The following tables present the Company’s financial assets and liabilities that are measured at fair value on a recurring basis.

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  | **As of March 31, 2019** | | | |  |  |  | **As of December 31, 2018** | | | | |  |  |
|  |  |  |  |  | | |  |  |  |  |  |  | | |  |  |
|  |  | **Level 1** |  | **Level 2** | | | **Total** | | **Level 1** |  |  | **Level 2** | | | **Total** |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Assets: |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Investments: |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Student loan and other asset-backed | $ | — | 52,563 | |  |  | 52,563 |  | — | 52,936 | | |  |  | 52,936 |  |
| securities - available-for-sale |  |  |  |  |  |  |
| Equity securities |  | 3,089 |  | — | | | 3,089 |  | 2,722 |  |  | — | | | 2,722 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Equity securities measured at net asset |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| value (a) |  |  |  |  |  |  | 15,281 |  |  |  |  |  |  |  | 14,925 |  |
| Debt securities - available-for-sale |  | 104 |  | — | | | 104 |  | 104 |  |  | — | | | 104 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Total investments |  | 3,193 | 52,563 | |  |  | 71,037 |  | 2,826 | 52,936 | | |  |  | 70,687 |  |
| Derivative instruments |  | — |  | 168 |  |  | 168 |  | — |  |  | 1,818 |  |  | 1,818 |  |
| Total assets | $ | 3,193 | 52,731 | |  |  | 71,205 |  | 2,826 | 54,754 | | |  |  | 72,505 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

1. In accordance with the Fair Value Measurements Topic of the FASB Accounting Standards Codification, certain investments that are measured at fair value using the net asset value per share (or its equivalent) practical expedient have not been classified in the fair value hierarchy.

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

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  | **As of March 31, 2019** | | | |  |  |  |
|  |  |  | |  | |  | |  | |  |
|  |  | **Fair value** | | **Carrying value** | | **Level 1** | | **Level 2** | | **Level 3** |
|  |  |  |  |  |  |  |  |  |  |  |
| Financial assets: |  |  |  |  |  |  |  |  |  |  |
| Loans receivable | $ | 23,064,973 |  | 21,946,153 |  | — | | — | | 23,064,973 |
|  |  |  |  |  |  |  |  |  |  |  |
| Cash and cash equivalents |  | 74,881 |  | 74,881 |  | 74,881 |  | — | | — |
| Investments (at fair value) |  | 71,037 |  | 71,037 |  | 3,193 |  | 52,563 |  | — |
|  |  |  |  |  |  |  |  |  |  |  |
| Notes receivable |  | 16,183 |  | 16,183 |  | — | | 16,183 |  | — |
| Restricted cash |  | 760,273 |  | 760,273 |  | 760,273 |  | — | | — |
|  |  |  |  |  |  |  |  |  |  |  |
| Restricted cash – due to customers |  | 216,471 |  | 216,471 |  | 216,471 |  | — | | — |
| Accrued interest receivable |  | 715,838 |  | 715,838 |  | — | | 715,838 |  | — |
|  |  |  |  |  |  |  |  |  |  |  |
| Derivative instruments |  | 168 |  | 168 |  | — | | 168 |  | — |
| Financial liabilities: |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |
| Bonds and notes payable |  | 21,939,779 |  | 21,835,723 |  | — | | 21,939,779 |  | — |
| Accrued interest payable |  | 62,158 |  | 62,158 |  | — | | 62,158 |  | — |
|  |  |  |  |  |  |  |  |  |  |  |
| Due to customers |  | 216,471 |  | 216,471 |  | 216,471 |  | — | | — |
|  |  |  |  |  |  |  |  |  |  |  |

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  | **As of December 31, 2018** | | | |  |  |  |
|  |  |  | |  | |  | |  | |  |
|  |  | **Fair value** | | **Carrying value** | | **Level 1** | | **Level 2** | | **Level 3** |
|  |  |  |  |  |  |  |  |  |  |  |
| Financial assets: |  |  |  |  |  |  |  |  |  |  |
| Loans receivable | $ | 23,521,171 |  | 22,377,142 |  | — | | — | | 23,521,171 |
|  |  |  |  |  |  |  |  |  |  |  |
| Cash and cash equivalents |  | 121,347 |  | 121,347 |  | 121,347 |  | — | | — |
| Investments (at fair value) |  | 70,687 |  | 70,687 |  | 2,826 |  | 52,936 |  | — |
|  |  |  |  |  |  |  |  |  |  |  |
| Notes receivable |  | 16,373 |  | 16,373 |  | — | | 16,373 |  | — |
| Restricted cash |  | 701,366 |  | 701,366 |  | 701,366 |  | — | | — |
|  |  |  |  |  |  |  |  |  |  |  |
| Restricted cash – due to customers |  | 369,678 |  | 369,678 |  | 369,678 |  | — | | — |
| Accrued interest receivable |  | 679,197 |  | 679,197 |  | — | | 679,197 |  | — |
|  |  |  |  |  |  |  |  |  |  |  |
| Derivative instruments |  | 1,818 |  | 1,818 |  | — | | 1,818 |  | — |
| Financial liabilities: |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |
| Bonds and notes payable |  | 22,270,462 |  | 22,218,740 |  | — | | 22,270,462 |  | — |
| Accrued interest payable |  | 61,679 |  | 61,679 |  | — | | 61,679 |  | — |
|  |  |  |  |  |  |  |  |  |  |  |
| Due to customers |  | 369,678 |  | 369,678 |  | 369,678 |  | — | | — |
|  |  |  |  |  |  |  |  |  |  |  |

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 2018 Annual Report.

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**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, 2019 and 2018. 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 2018 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 “anticipate,” “assume,” “believe,” “continue,” “could,” “estimate,” “expect,” “forecast,” “future,” “intend,” “may,” “plan,” “potential,” “predict,” “scheduled,” “should,” “will,” “would,” and similar expressions, as well as statements 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 2018 Annual Report and elsewhere in this report, and include such risks and uncertainties as:

* 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 Federal Family Education Loan Program (the "FFEL Program" or "FFELP"), risks related to the use of derivatives to manage exposure to interest rate fluctuations, uncertainties regarding the expected benefits from purchased securitized and unsecuritized FFELP, private education, and consumer loans and initiatives to purchase additional FFELP, private education, and consumer loans, and risks from changes in levels of loan prepayment or default rates;
* financing and liquidity risks, including risks of changes in the general interest rate environment, including the availability of any relevant money market index rate such as LIBOR or the relationship between the relevant money market index rate and the rate at which the Company's assets and liabilities are priced, and in the securitization and other financing markets for loans, including adverse changes resulting from unanticipated repayment trends on student loans in FFELP securitization trusts that could accelerate or delay repayment of the associated bonds, 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 or legislative proposals to consolidate existing FFELP loans to the Federal Direct Loan Program or otherwise allow FFELP loans to be refinanced with Federal Direct Loan Program loans;
* the uncertain nature of the expected benefits from the acquisition of Great Lakes Educational Loan Services, Inc. ("Great Lakes") on February 7, 2018 and the ability to successfully integrate technology and other activities and successfully maintain and increase allocated volumes of student loans serviced under existing and any future servicing contracts with the U.S. Department of Education (the "Department"), which current contracts accounted for 30 percent of the Company's revenue in 2018 and may be extended from June 16, 2019 to December 15, 2019 (but any such extension is not assured), risks to the Company related to the Department's initiatives to procure new contracts for federal student loan servicing, including the risk that the Company or Company teams may not be successful in obtaining contracts, risks related to the development by the Company of a new student loan servicing platform, including risks as to whether the expected benefits from the new platform will be realized, and risks related to the Company's ability to comply with agreements with third-party customers for the servicing of Federal Direct Loan Program, FFELP, and private education and consumer loans;

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* risks related to a breach of or failure in the Company's operational or information systems or infrastructure, or those of third-party vendors, including cybersecurity risks related to the potential disclosure of confidential student loan borrower and other customer information, the potential disruption of the Company's systems or those of third-party vendors or customers, and/or the potential damage to the Company's reputation resulting from cyber-breaches;
* uncertainties inherent in forecasting future cash flows from student loan assets and related asset-backed securitizations;
* risks and uncertainties related to the ability of ALLO Communications LLC to successfully expand its fiber network and market share in existing service areas and additional communities and manage related construction risks;
* risks and uncertainties related to initiatives to pursue additional strategic investments and acquisitions, including investments and acquisitions that are intended to diversify the Company both within and outside of its historical core education-related businesses; and
* risks and uncertainties associated with litigation matters and with maintaining compliance with the extensive regulatory requirements applicable to the Company's businesses, reputational and other risks, including the risk of increased regulatory costs, resulting from the politicization of student loan servicing, 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 a diverse company with a focus on delivering education-related products and services and loan asset management. The largest operating businesses engage in student loan servicing; education technology, services, and payment processing; and communications. A significant portion of the Company's revenue is net interest income earned on a portfolio of federally insured student loans. The Company also makes investments to further diversify the Company both within and outside of its historical core education-related businesses, including, but not limited to, investments in real estate and early-stage and emerging growth companies.

***GAAP Net Income and Non-GAAP Net Income, Excluding Adjustments***

The Company prepares its financial statements and presents its financial results in accordance with U.S. GAAP. However, it also provides additional non-GAAP financial information related to specific items management believes to be important in the evaluation of its operating results and performance. A reconciliation of the Company's GAAP net income to net income, excluding derivative market value adjustments, and a discussion of why the Company believes providing this additional information is useful to investors, is provided below.

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | **Three months ended March 31,** | | | |  |  |
|  |  |  | | |  |  |
|  | **2019** | **2018** | | |  |  |
|  |  |  |  |  |  |  |
| GAAP net income attributable to Nelnet, Inc. | $ | 41,591 |  |  | 113,925 |  |
| Realized and unrealized derivative market value adjustments |  | 30,574 |  |  | (60,033) |  |
| Net tax effect (a) |  | (7,338) |  |  | 14,408 |  |
| Net income attributable to Nelnet, Inc., excluding derivative market value adjustments (b) | $ | 64,827 |  |  | 68,300 |  |
|  |  |  |  |  |  |
|  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |
| Earnings per share: |  |  |  |  |  |  |
| GAAP net income attributable to Nelnet, Inc. | $ | 1.03 |  |  | 2.78 |  |
| Realized and unrealized derivative market value adjustments |  | 0.76 |  |  | (1.46) |  |
| Net tax effect (a) |  | (0.18) |  |  | 0.35 |  |
| Net income attributable to Nelnet, Inc., excluding derivative market value adjustments (b) | $ | 1.61 |  |  | 1.67 |  |
|  |  |  |  |  |  |
|  |  |  |  |  |  |  |

1. The tax effects are calculated by multiplying the realized and unrealized derivative market value adjustments by the applicable statutory income tax rate.
2. "Derivative market value adjustments" includes both the realized portion of gains and losses (corresponding to variation margin received or paid on derivative instruments that are settled daily at a central clearinghouse) and the unrealized portion of gains and losses that are caused by changes in fair values of derivatives which do not qualify for "hedge treatment" under GAAP. "Derivative market value adjustments" does not include "derivative

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settlements" that represent the cash paid or received during the current period to settle with derivative instrument counterparties the economic effect of the Company's derivative instruments based on their contractual terms.

The accounting for derivatives requires that changes in the fair value of derivative instruments be recognized currently in earnings, with no fair value adjustment of the hedged item, unless specific hedge accounting criteria is met. Management has structured all of the Company’s derivative transactions with the intent that each is economically effective; however, the Company’s derivative instruments do not qualify for hedge accounting. As a result, the change in fair value of derivative instruments is reported in current period earnings with no consideration for the corresponding change in fair value of the hedged item. Under GAAP, the cumulative net realized and unrealized gain or loss caused by changes in fair values of derivatives in which the Company plans to hold to maturity will equal zero over the life of the contract. However, the net realized and unrealized gain or loss during any given reporting period fluctuates significantly from period to period.

The Company believes these point-in-time estimates of asset and liability values related to its derivative instruments that are subject to interest rate fluctuations are subject to volatility mostly due to timing and market factors beyond the control of management, and affect the period-to-period comparability of the results of operations. Accordingly, the Company’s management utilizes operating results excluding these items for comparability purposes when making decisions regarding the Company’s performance and in presentations with credit rating agencies, lenders, and investors. Consequently, the Company reports this non-GAAP information because the Company believes that it provides additional information regarding operational and performance indicators that are closely assessed by management. There is no comprehensive, authoritative guidance for the presentation of such non-GAAP information, which is only meant to supplement GAAP results by providing additional information that management utilizes to assess performance.

GAAP net income decreased for the three months ended March 31, 2019 compared to the same period in 2018 primarily due to the following factors:

* The recognition of a net loss during 2019, as compared to a net gain in 2018, related to changes in the fair values of derivative instruments that do not qualify for hedge accounting;
* Gains recognized in 2018 from investment activities that are included in "other income" in the consolidated statements of income, primarily attributable to one equity security for which there was an observable price increase, resulting in an upward adjustment in the investment's carrying value;
* The increase in the provision for loan losses related to the Company's portfolio of consumer loans; and
* An increase in interest expense due to higher interest rates and a larger weighted average outstanding balance under the Company's unsecured line of credit in 2019 as compared to 2018. These factors were partially offset by the following items:
* The contribution to net income from the acquisitions of Great Lakes;
* Cost reductions due to the Company's decision in October 2018 to terminate its investment in a proprietary payment processing platform;
* An increase in net interest income due to an increase in the weighted average balance of loans and an increase in core loan spread; and
* A decrease in the Company's effective tax rate due to the utilization of certain federal and state tax credits in 2019.

***Operating Results***

The Company earns net interest income on its loan portfolio, consisting primarily of FFELP loans, 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, 2019, the Company had a $21.9 billion loan portfolio that management anticipates will amortize over the next approximately 20 years and has a weighted average remaining life of 8.7 years. The Company actively works to maximize the amount and timing of cash flows generated by its FFELP portfolio and seeks to acquire additional loan assets to leverage its servicing scale and expertise to generate incremental earnings and cash flow. However, due to the continued amortization of the Company’s FFELP loan portfolio, over time, the Company's net income generated by the AGM segment will continue to decrease. The Company currently believes that in the short-term it will most likely not be able to invest the excess cash generated from the FFELP loan portfolio into assets that immediately generate the rates of return historically realized from that portfolio.

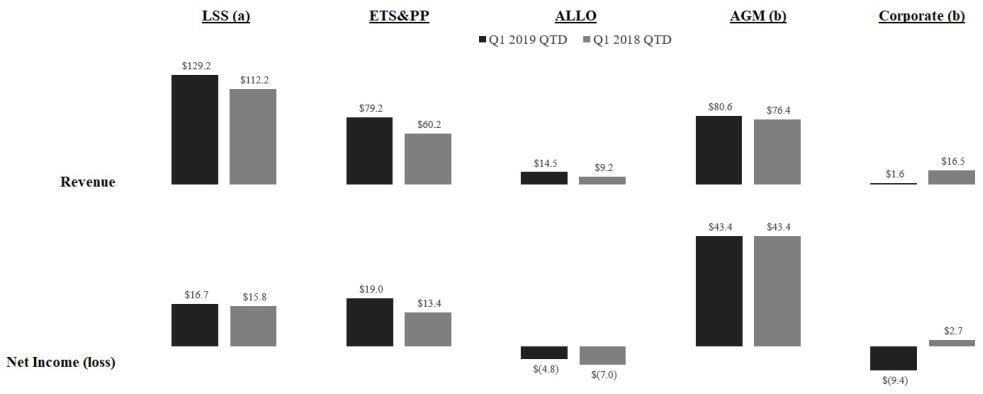
In addition, the Company earns fee-based revenue through the following reportable operating segments:

* Loan Servicing and Systems ("LSS") - referred to as Nelnet Diversified Solutions ("NDS")
* Education Technology, Services, and Payment Processing ("ETS&PP") - referred to as Nelnet Business Solutions ("NBS")
* Communications - referred to as ALLO Communications ("ALLO")

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Other business activities and operating segments that are not reportable are combined and included in Corporate and Other Activities ("Corporate"). Corporate and Other Activities also includes income earned on certain investments and interest expense incurred on unsecured debt transactions.

The information below provides the operating results for each reportable operating segment and Corporate and Other Activities for the three months ended March 31, 2019 and 2018 (dollars in millions). See "Results of Operations" for each reportable operating segment under this Item 2 for additional detail.



1. Revenue includes intersegment revenue earned by LSS as a result of servicing loans for AGM.
2. Total revenue includes "net interest income" and "total other income" from the Company's segment statements of income, excluding the impact from changes in fair values of derivatives. Net income excludes changes in fair values of derivatives, net of tax. For information regarding the exclusion of the impact from changes in fair values of derivatives, see "GAAP Net Income and Non-GAAP Net Income, Excluding Adjustments" above.

Certain events and transactions from 2018 and 2019, which have impacted or will impact the operating results of the Company and its operating segments, are discussed below. ***Loan Servicing and Systems***

* On February 7, 2018, the Company acquired Great Lakes. The operating results of Great Lakes are reported in the Company's consolidated financial statements from the date of acquisition. Thus, there are three months of Great Lakes' operations included in the three months ended March 31, 2019 as compared to approximately two months of activity in the three months ended March 31, 2018.
* Nelnet Servicing, LLC ("Nelnet Servicing") and Great Lakes have student loan servicing contracts awarded by the Department in June 2009 to provide servicing for loans owned by the Department. As of March 31, 2019, Nelnet Servicing was servicing $183.1 billion of student loans for 5.7 million borrowers under its contract, and Great Lakes was servicing $237.1 billion of student loans for 7.4 million borrowers under its contract. These contracts currently provide for expiration on June 16, 2019.

On April 24, 2019, Nelnet Servicing and Great Lakes received correspondence from the Department's Office of Federal Student Aid ("FSA") indicating the FSA's intent to exercise a six-month extension of the current servicing contracts, from June 16, 2019 to December 15, 2019. The correspondence served only as a non-binding notice of intent, and any formal extension of the contracts will occur only upon a signed modification to the contracts.

In addition, Nelnet Servicing's current Authority to Operate as a loan servicer for the Department expires on May 31, 2019, and is currently under review for renewal.

FSA is conducting a contract procurement process entitled Next Generation Financial Services Environment (“NextGen”) for a new framework for the servicing of all student loans owned by the Department. On January 15, 2019, FSA issued solicitations for three NextGen components:

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* NextGen Enhanced Processing Solution ("EPS")
* NextGen Business Process Operations ("BPO")
* NextGen Optimal Processing Solution ("OPS")

On April 1, 2019, the Company responded to the EPS component. In addition, the Company is part of teams that currently intend to respond to the BPO and OPS components. The Company cannot predict the timing, nature, or outcome of these solicitations.

* The Company has begun to incur additional costs in 2019 to be responsive to the Department's procurement and develop new private education and consumer loan origination and servicing systems, a multi-year project, which the Company currently expects will decrease future operating margins from recent historical results. For the three months ended March 31, 2019, the before tax and noncontrolling interest operating margin was 17.0 percent, as compared to 18.6 percent in the same period of 2018. The noncontrolling interest represented Great Lakes' 50 percent interest in the GreatNet joint venture, and ceased for financial reporting purposes upon the Company's acquisition of Great Lakes on February 7, 2018.

***Education Technology, Services, and Payment Processing***

* On November 20, 2018, the Company acquired Tuition Management Systems ("TMS"), a services company that offers tuition payment plans, billing services, payment technology solutions, and refund management to educational institutions. The TMS acquisition added 380 higher education schools and 170 K-12 schools to the Company’s customer base. The results of TMS’ operations are reported in the Company’s consolidated financial statements from the date of acquisition.
* In October 2018, the Company terminated its investment in a proprietary payment processing platform. These expense reductions increased before tax operating margin (income before income taxes divided by net revenue) for the three months ended March 31, 2019 to 43.0 percent, as compared to 37.8 percent in the same period of 2018.
* 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.

***Communications***

* ALLO recognized a loss of $4.8 million for the three months ended March 31, 2019, as compared to a loss of $7.0 million for the same period in 2018. The decrease in ALLO's net loss in 2019, as compared to 2018, was primarily due to a decrease in interest expense. ALLO recognized $2.5 million of interest expense to Nelnet, Inc. (parent company) during the three-month period ended March 31, 2018. Subsequent to October 1, 2018, ALLO will not report interest expense in its income statement related to amounts contributed to ALLO from Nelnet, Inc. due to a recapitalization of ALLO.
* ALLO's management uses earnings (loss) before interest, income taxes, depreciation, and amortization ("EBITDA") to eliminate certain non-cash and non-operating items in order to consistently measure performance from period to period. For the first quarter of 2019, ALLO had positive EBITDA of $1.0 million, compared with negative EBITDA of $1.8 million for the same period in 2018. EBITDA is a supplemental non-GAAP performance measure which the Company believes provides useful additional information regarding a key metric used by management to assess ALLO's performance. See "Communications Operating Segment - Results of Operations - Summary and Comparison of Operating Results" below for additional information regarding the computation and use of EBITDA for ALLO.
* ALLO has made significant investments in its communications network and currently provides fiber directly to homes and businesses in eight communities in Nebraska and one in Colorado. ALLO plans to continue to increase market share and revenue in its existing markets and is currently evaluating opportunities to expand to other communities in the Midwest. ALLO began providing services in Lincoln, Nebraska in September 2016 as part of a multi-year project to pass substantially all commercial and residential properties in the community. As of the end of the first quarter of 2019, the build-out of the Lincoln community was substantially complete. For the three months ended March 31, 2019, ALLO's capital expenditures were $12.0 million. The Company anticipates total ALLO network capital expenditures for the remainder of 2019 (April 1, 2019 - December 31, 2019) will be approximately $40 million. However, this amount could change based on customer demand for ALLO's services.

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* The Company currently anticipates ALLO's operating results will be dilutive to the Company's consolidated earnings as it continues to build and add customers to its network in Lincoln, Nebraska and other communities, due to large upfront capital expenditures and associated depreciation and upfront customer acquisition costs.

***Asset Generation and Management***

* The Company's average balance of loans increased to $22.3 billion for the first quarter of 2019, compared with $21.9 billion for the same period in 2018. Core loan spread increased to 1.30% for the quarter ended March 31, 2019, compared with 1.29% for the same period in 2018. Core loan spread, a non-GAAP measure, is computed as set forth in "Asset Generation and Management Operating Segment - Results of Operations - Loan Spread Analysis" below. Management believes core loan spread is a useful supplemental non-GAAP measure that reflects adjustments for derivative settlements related to net interest income (loan spread). However, there is no comprehensive authoritative guidance for the presentation of this measure, which is only meant to supplement GAAP results by providing additional information that management utilizes to assess performance.

Other than consumer loans funded in the Company's consumer loan warehouse facility that closed on January 11, 2019, consumer loans were and continue to be funded by the Company using operating cash, until they can be funded in a secured financing transaction. As such, these loans do not have a cost of funds (debt) associated with them. Core loan spread, excluding consumer loans, would have been 1.22% and 1.25% for the three months ended March 31, 2019 and 2018, respectively.

The Company recognized $27.1 million and $25.8 million in fixed rate floor income during the three months ended March 31, 2019 and 2018, respectively (which includes $16.7 million and $8.6 million of settlement payments received on derivatives used to hedge student loans earning fixed rate floor income). Fixed rate floor income contributed 50 basis points and 48 basis points of core loan spread for the three months ended March 31, 2019 and 2018, respectively.

* Provision for loan losses was $7.0 million and $4.0 million for the three months ended March 31, 2019 and 2018, respectively. Provision for loan losses for federally insured loans was $2.0 million for each of the three months ended March 31, 2019 and 2018.

Provision for loan losses for consumer loans was $5.0 million and $2.0 million for the three months ended March 31, 2019 and 2018, respectively. The increase in provision was a result of the increased amount of consumer loan purchases during the 2019 period.

***Corporate and Other Activities***

* The Company adopted a new lease accounting standard effective January 1, 2019. The most significant impact of the standard to the Company relates to (1) the recognition of new right-of-use ("ROU") assets and lease liabilities on its balance sheet primarily for office, data center, and dark fiber operating leases; (2) the deconsolidation of assets and liabilities for certain sale-leaseback transactions arising from build-to-suit lease arrangements for which construction was completed and the Company is leasing the constructed assets that did not qualify for sale accounting prior to the adoption of the new standard; and (3) significant new disclosures about the Company’s leasing activities.

Adoption of the new standard resulted in recognizing lease liabilities of $33.7 million based on the present value of the remaining minimum rental payments. In addition the Company recognized ROU assets of $32.8 million, which corresponds to the lease liabilities reduced by deferred rent expense as of the effective date. The Company also deconsolidated total assets of $43.8 million and total liabilities of $34.8 million for entities that had been consolidated due to sale-leaseback transactions that failed to qualify for recognition as sales under the prior guidance. Deconsolidation of these entities reduced noncontrolling interests by $6.1 million.

***Liquidity and Capital Resources***

* As of March 31, 2019, the Company had cash and cash equivalents of $74.9 million. In addition, the Company had a portfolio of available-for-sale investments, consisting primarily of student loan asset-backed securities, with a fair value of $52.7 million as of March 31, 2019.
* As of March 31, 2019, the Company's $382.5 million unsecured line of credit had $320.0 million outstanding and $62.5 million was available for future use.

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* 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 eliminated in consolidation and are not included in the Company's consolidated financial statements. However, these securities remain 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, 2019, the Company holds $15.0 million (par value) of its own asset-backed securities.
* The Company has historically generated positive cash flow from operations. However, during the three months ended March 31, 2019, the Company used $139.7 million in operating activities. Items that negatively impacted cash from operating activities for the three months ended March 31, 2019 included:
  + Net payments to the clearinghouse due to a decrease in the fair value of the Company's derivative portfolio during the period;
  + An increase in accrued interest receivable during the period due to the number of borrowers utilizing income-based repayment plans;
  + An increase in accounts receivable during the period due to the timing of collection from customers;
  + An increase in other assets during the period due to an increase in current income taxes receivable and the qualification and recognition of certain tax incentives; and
  + A decrease in “due to customers” (liability) during the period. See “Liquidity and Capital Resources – Cash Flows” below for additional information regarding the decrease in this liability account during the period.
* The majority of the Company’s portfolio of student loans is funded in asset-backed securitizations that will generate significant earnings and cash flow over the life of these transactions. As of March 31, 2019, the Company currently expects future undiscounted cash flows from its securitization portfolio to be approximately $2.16 billion, of which approximately $1.14 billion is expected to be generated over the next approximately five years (April 1, 2019 through December 31, 2023).

The estimated forecasted cash flow as of March 31, 2019 ($2.16 billion) increased $0.06 billion from the Company's estimated forecasted cash flow as of December 31, 2018 ($2.10 billion). This increase was due to additional estimated cash flows from the completion of an asset-backed securitization during the first quarter of 2019; a change in call mechanic assumptions regarding the Turbo Transactions that resulted in the estimated release of unencumbered assets from these transactions being deferred to later periods, resulting in additional estimated cash flows from assets included in these transactions; and a decrease in the forward yield curve, which increased the amount of expected fixed rate floor income to be earned on loans in the asset-backed securitizations. These amounts were partially offset by the amount of cash released from the asset-backed securitizations during the first quarter of 2019.

* During the three months ended March 31, 2019, the Company repurchased a total of 301,327 shares of Class A common stock for $16.4 million ($54.29 per share). As of March 31, 2019, 2.0 million shares remained authorized for repurchase under the Company's stock repurchase program. On May 8, 2019, the Board of Directors authorized a new 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 7, 2022. The five million shares authorized under the new program include the remaining unrepurchased shares from the prior program, which the new program replaces.
* During the three months ended March 31, 2019, the Company paid cash dividends of $7.2 million ($0.18 per share). In addition, the Company's Board of Directors has declared a second quarter 2019 cash dividend on the Company's outstanding shares of Class A and Class B common stock of $0.18 per share. The second quarter cash dividend will be paid on June 14, 2019 to shareholders of record at the close of business on May 31, 2019.
* The Company intends to use its liquidity position to capitalize on market opportunities, including FFELP, private education, and consumer loan acquisitions; strategic acquisitions and investments; expansion of ALLO’s telecommunications network; and capital management initiatives, including stock repurchases, debt repurchases, and dividend distributions. The timing and size of these opportunities will vary and will have a direct impact on the Company’s cash and investment balances.

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**CONSOLIDATED RESULTS OF OPERATIONS**

An analysis of the Company's operating results for the three months ended March 31, 2019 compared to the same period in 2018 is provided 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 distinct reportable operating segments as described above. For a reconciliation of the reportable segment operating results to the consolidated results of operations, see note 10 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 reportable segment basis.

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|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **Three months ended** | | | |  |  |  |
|  |  | **March 31,** | | |  |  | **Additional information** |  |
|  |  | **2019** |  |  | **2018** |  |  |  |
|  |  |  |  |  |  |  | Increase was due primarily to an increase in the gross yield earned on loans and an increase in the average balance of loans, |  |
| Loan interest | $ | 242,333 |  |  | 197,723 |  | partially offset by a decrease in fixed rate floor income due to higher interest rates in 2019 as compared to 2018. |  |
|  |  |  |  |  |  |  | Includes income from unrestricted interest-earning deposits and investments and funds in asset-backed securitizations. Increase |  |
| Investment interest |  | 8,253 |  |  | 5,134 |  | was due to increases in interest-earning investments and interest rates. |  |
| Total interest income |  | 250,586 |  |  | 202,857 |  |  |  |
| Interest expense |  | 191,770 |  |  | 135,550 |  | Increase was due primarily to an increase in cost of funds and an increase in the average balance of debt outstanding. |  |
| Net interest income |  | 58,816 |  |  | 67,307 |  | See table below for additional analysis. |  |
|  |  |  |  |  |  |  | Represents the periodic expense of maintaining an allowance appropriate to absorb losses inherent in the portfolio of loans. See |  |
| Less provision for loan losses |  | 7,000 |  |  | 4,000 |  | AGM operating segment - results of operations. |  |
| Net interest income after provision for loan losses |  | 51,816 |  |  | 63,307 |  |  |  |
| Other income: |  |  |  |  |  |  |  |  |
| LSS revenue |  | 114,898 |  |  | 100,141 |  | See LSS operating segment - results of operations. |  |
| ETS&PP revenue |  | 79,159 |  |  | 60,221 |  | See ETS&PP operating segment - results of operations. |  |
| Communications revenue |  | 14,543 |  |  | 9,189 |  | See Communications operating segment - results of operations. |  |
| Other income |  | 9,067 |  |  | 18,557 |  | See table below for the components of "other income." |  |
|  |  |  |  |  |  |  | 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 |  |
| Derivative settlements, net |  | 19,035 |  |  | 6,766 |  | Company's net interest income. See table below for additional analysis. |  |
|  |  |  |  |  |  |  | Includes the realized and unrealized gains and losses that are caused by changes in fair values of derivatives which do not qualify |  |
| Derivative market value adjustments, net |  | (30,574) |  |  | 60,033 |  | for "hedge treatment" under GAAP. |  |
| Total other income |  | 206,128 |  |  | 254,907 |  |  |  |
| Cost of services: |  |  |  |  |  |  |  |  |
| Cost to provide education technology, services, and payment processing services |  | 21,059 |  |  | 13,683 |  | Represents primarily direct costs to provide payment processing services in the ETS&PP operating segment. |  |
| Cost to provide communications services |  | 4,759 |  |  | 3,717 |  | Represents costs of services primarily associated with television programming costs in the Communications operating segment. |  |
| Total cost of services |  | 25,818 |  |  | 17,400 |  |  |  |
| Operating expenses: |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  | Increase was due to (i) increases in personnel to support the increase in volume of loans serviced for the government entering |  |
|  |  |  |  |  |  |  | repayment status, and the increase in private education and consumer loan servicing volume in the LSS operating segment; (ii) |  |
|  |  |  |  |  |  |  | increases in personnel to support the growth in revenue in the ETS&PP operating segment; and (iii) increases in personnel at |  |
|  |  |  |  |  |  |  | ALLO to support customer and network expansion. In addition, part of the increase in 2019 was due to an increase in personnel as |  |
| Salaries and benefits |  | 111,059 |  |  | 96,643 |  | a result of the acquisition of Great Lakes on February 7, 2018 and TMS on November 20, 2018. See each individual operating |  |
|  |  |  |  | segment results of operations discussion for additional information. |  |
|  |  |  |  |  |  |  | Increase was primarily due to (i) additional depreciation expense at ALLO, and (ii) additional amortization of intangible assets |  |
| Depreciation and amortization |  | 24,213 |  |  | 18,457 |  | related to the acquisition of Great Lakes on February 7, 2018. See each individual operating segment results of operations |  |
|  |  |  |  | discussion for additional information. |  |
|  |  |  |  |  |  |  | Decrease was due to runoff of the Company's loan portfolio on third-party platforms, the conversion of loans to the Company's |  |
|  |  |  |  |  |  |  | LSS operating segment from third-party platforms during the third quarter of 2018, and the acquisition of Great Lakes on |  |
| Loan servicing fees to third parties |  | 2,893 |  |  | 3,136 |  | February 7, 2018, which prior to the acquisition was a third-party servicer to the Company. |  |
|  |  |  |  |  |  |  | Other expenses includes expenses necessary for operations, such as postage and distribution, consulting and professional fees, |  |
|  |  |  |  |  |  |  | occupancy, communications, and certain information technology-related costs. Increase was due to (i) the acquisition of Great |  |
|  |  |  |  |  |  |  | Lakes on February 7, 2018, (ii) the acquisition of TMS on November 20, 2018, (iii) additional costs to support the increase in |  |
|  |  |  |  |  |  |  | payment plans and campus commerce activity, and (iv) an increase in operating expenses at ALLO to support customer and |  |
| Other expenses |  | 40,923 |  |  | 33,417 |  | network expansion. See each individual operating segment results of operations discussion for additional information. |  |
| Total operating expenses |  | 179,088 |  |  | 151,653 |  |  |  |
| Income before income taxes |  | 53,038 |  |  | 149,161 |  |  |  |
|  |  |  |  |  |  |  | The effective tax rate was 21.5% and 24.0% for the three months ended March 31, 2019 and 2018, respectively. Decrease was due |  |
|  |  |  |  |  |  |  | to the utilization of certain federal and state tax credits in 2019. The Company currently expects its effective tax rate for 2019 will |  |
| Income tax expense |  | 11,391 |  |  | 35,976 |  | range between 21 and 23 percent. |  |
| Net income |  | 41,647 |  |  | 113,185 |  |  |  |
|  |  |  |  |  |  |  | The 2018 amount primarily represented the net loss of the GreatNet joint venture attributable to Great Lakes, prior to the |  |
| Net (income) loss attributable to noncontrolling interests |  | (56) |  |  | 740 |  | Company's acquisition of Great Lakes on February 7, 2018. |  |
| Net income attributable to Nelnet, Inc. | $ | 41,591 |  |  | 113,925 |  |  |  |
|  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |

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|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| Additional information: |  |  |  |  |  |  |
| Net income attributable to Nelnet, Inc. | $ | 41,591 | 113,925 |  |  |  |
| Derivative market value adjustments, net |  | 30,574 | (60,033) |  | See "Overview - GAAP Net Income and Non-GAAP Net Income, Excluding Adjustments" above for additional information about |  |
| Net tax effect |  | (7,338) | 14,408 |  | non-GAAP net income, excluding derivative market value adjustments. |  |
|  |  |  |  |
| Net income attributable to Nelnet, Inc., excluding derivative market value adjustments | $ | 64,827 | 68,300 |  |  |  |
|  |  |  |  |  |  |  |

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

Derivative settlements represent the cash paid or received during the current period to settle with derivative instrument counterparties the economic effect of the Company's derivative instruments based on their contractual terms. Derivative accounting requires that net settlements with respect to derivatives that do not qualify for "hedge treatment" under GAAP be recorded in a separate income statement line item below net interest income. The Company maintains an overall risk management strategy that incorporates the use of derivative instruments to reduce the economic effect of interest rate volatility. As such, management believes derivative settlements for each applicable period should be evaluated with the Company’s net interest income as presented in the table below. Net interest income (net of settlements on derivatives) is a non-GAAP financial measure, and the Company reports this non-GAAP information because the Company believes that it provides additional information regarding operational and performance indicators that are closely assessed by management. There is no comprehensive, authoritative guidance for the presentation of such non-GAAP information, which is only meant to supplement GAAP results by providing additional information that management utilizes to assess performance. See note 4 of the notes to consolidated financial statements included under Part I, Item 1 of this report for additional information on the Company's derivative instruments, including the net settlement activity recognized by the Company for each type of derivative for the periods presented in the table under the caption "Income Statement Impact" in note 4 and in the table below.

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  |  | **Three months ended March 31,** | | |  | **Additional information** |
|  |  | **2019** |  | **2018** |  |  |
|  |  |  |  |  |  | Represents the yield the Company receives on its loan portfolio less the cost of funding these loans. Variable loan spread is also |
|  |  |  |  |  |  | impacted by the amortization/accretion of loan premiums and discounts and the 1.05% per year consolidation loan rebate fee |
| Variable loan interest margin | $ | 43,951 |  | 46,884 |  | paid to the Department. See AGM operating segment - results of operations. |
| Settlements on associated derivatives |  | 2,334 |  | (1,664) |  | Represents the net settlements received (paid) related to the Company’s 1:3 basis swaps. |
| Variable loan interest margin, net of settlements on derivatives |  | 46,285 |  | 45,220 |  |  |
|  |  |  |  |  |  | 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 |
| Fixed rate floor income |  | 10,425 |  | 17,247 |  | Market Risk - Interest Rate Risk" for additional information. |
| Settlements on associated derivatives |  | 16,701 |  | 8,590 |  | Represents the net settlements received related to the Company’s floor income interest rate swaps. |
| Fixed rate floor income, net of settlements on derivatives |  | 27,126 |  | 25,837 |  |  |
| Investment interest |  | 8,253 |  | 5,134 |  |  |
|  |  |  |  |  |  | Includes interest expense on the Junior Subordinated Hybrid Securities and unsecured line of credit. Increase due to an increase |
| Corporate debt interest expense |  | (3,813) |  | (1,958) |  | in interest rates and in the average balance outstanding on the Company's unsecured line of credit. |
| Non-portfolio related derivative settlements |  | — | | (160) |  | Represents the net settlements paid related to the Company’s hybrid debt hedges. |
| Net interest income (net of settlements on derivatives) | $ | 77,851 |  | 74,073 |  |  |
|  |  |  |  |  |  |  |

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



Borrower late fee income

Management fee revenue (a)



Investment advisory fees (b)

(Loss) gain on investments and notes receivable, net (c)



Other

Other income

**Three months ended March 31,**



|  |  |  |  |
| --- | --- | --- | --- |
|  | **2019** |  | **2018** |
|  |  |  |  |
| $ | 3,512 |  | 2,983 |
|  | 1,872 |  | 1,161 |
|  | 711 |  | 1,593 |
|  | (427) |  | 8,688 |
|  | 3,399 |  | 4,132 |
|  |  |  |  |
| $ | 9,067 |  | 18,557 |
|  |  |  |  |
|  |  |  |  |

1. Represents revenue earned from providing administrative support services to Great Lakes’ former parent company in accordance with a one-year contract that is subject to an optional annual renewal by the former parent company. The current contract expires in October 2019. Increase was due to three months of revenue under this contract in the first quarter of 2019 as compared to approximately two months (from the Great Lakes acquisition date) in the first quarter of 2018.
2. The Company provides investment advisory services through Whitetail Rock Capital Management, LLC, the Company's SEC-registered investment advisor subsidiary, under various arrangements and earns annual fees of 25 basis points on the majority of the outstanding balance of investments and up to 50 percent of the gains from the sale of securities or securities being called prior to the full contractual maturity for which it provides advisory services. As of March 31, 2019, the outstanding balance of investments subject to these arrangements was $946.9 million. The decrease in advisory fees in 2019 as compared to 2018 was the result of a decrease in performance fees earned.
3. During the first quarter of 2018, the Company recognized unrealized gains totaling $6.7 million related to the change in fair value of certain equity securities and a realized gain of $1.7 million related to the sale of a real estate investment.

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**LOAN SERVICING AND SYSTEMS OPERATING SEGMENT – RESULTS OF OPERATIONS**

The Company purchased Great Lakes on February 7, 2018. The results of Great Lakes' operations are reported in the Company's consolidated financial statements from the date of acquisition.

***Loan Servicing Volumes***

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  | **As of** | | | |  |  |  |
|  |  | **December 31,** | | **March 31,** | | **June 30,** |  |  | **September 30,** | | **December 31,** | | **March 31,** |
|  |  | **2017** |  | **2018** |  | **2018** | **2018** | | |  | **2018** |  | **2019** |
| Servicing volume (dollars in millions): |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Nelnet |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Government | $ | 172,669 |  | 176,605 |  | 176,179 | 179,283 | | |  | 179,507 |  | 183,093 |
| FFELP |  | 27,262 |  | 26,969 |  | 37,599 | 37,459 | | |  | 36,748 |  | 35,917 |
| Private and consumer |  | 11,483 |  | 12,116 |  | 15,016 | 15,466 | | |  | 15,666 |  | 16,065 |
| Great Lakes |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Government |  | — | | 242,063 |  | 241,902 | 232,741 | | |  | 232,694 |  | 237,050 |
| FFELP (a) |  | — | | 11,136 |  | — |  |  | — | | — | | — |
| Private and consumer (a) |  | — |  | 1,927 |  | 31 |  |  | — |  | — |  | — |
| Total | $ | 211,414 |  | 470,816 |  | 470,727 | 464,949 | | |  | 464,615 |  | 472,125 |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Number of servicing borrowers: |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Nelnet |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Government |  | 5,877,414 |  | 5,819,286 |  | 5,745,181 | 5,805,307 | | |  | 5,771,923 |  | 5,708,582 |
| FFELP |  | 1,420,311 |  | 1,399,280 |  | 1,787,419 | 1,754,247 | | |  | 1,709,853 |  | 1,650,785 |
| Private and consumer |  | 502,114 |  | 508,750 |  | 672,520 | 692,763 | | |  | 696,933 |  | 699,768 |
| Great Lakes |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Government |  | — | | 7,456,830 |  | 7,378,875 | 7,486,311 | | |  | 7,458,684 |  | 7,385,284 |
| FFELP (a) |  | — | | 461,553 |  | — |  |  | — | | — | | — |
| Private and consumer (a) |  | — |  | 118,609 |  | 3,987 |  |  | — |  | — |  | — |
| Total |  | 7,799,839 |  | 15,764,308 |  | 15,587,982 | 15,738,628 | | |  | 15,637,393 |  | 15,444,419 |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Number of remote hosted borrowers: |  | 2,812,713 |  | 6,207,747 |  | 6,145,981 | 6,406,923 | | |  | 6,393,151 |  | 6,332,261 |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |

(a) During the second quarter of 2018, the Company converted Great Lakes' FFELP and private education servicing volume to Nelnet Servicing's platform to leverage the efficiencies of supporting more volume on fewer systems.

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***Summary and Comparison of Operating Results***

**Three months ended March 31,** **Additional information**



**2019** **2018**



Net interest income

Loan servicing and systems revenue

Intersegment servicing revenue

Other income

Total other income

Salaries and benefits

Depreciation and amortization Other expenses

Intersegment expenses

Total operating expenses

Income before income taxes

Income tax expense

Net income

Net loss attributable to noncontrolling interest

Net income attributable to

Nelnet, Inc.

Before tax and noncontrolling interest operating margin

* 497

114,898



12,217

2,074

129,189



66,220

8,871

18,928

13,758



107,777

21,909

(5,258)

16,651

—

* 16,651

17.0 %



257



100,141

10,771

1,292

112,204



58,537

6,069

14,463

13,356



92,425

20,036

(5,003)

15,033

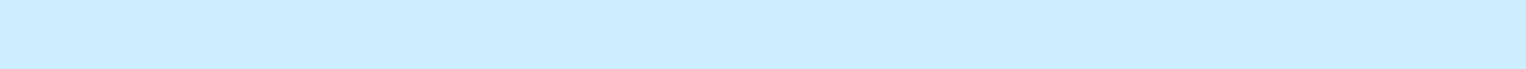
808

15,841



18.6 %

See table below for additional analysis.



Represents revenue earned by the LSS operating segment as a result of servicing loans for the AGM operating segment. Increase was due to the acquisition of Great Lakes on February 7, 2018. Prior to the acquisition, Great Lakes was a third-party servicer to the Company's AGM operating segment. Increase was also due to a significant purchase of loans by AGM in April 2018 of which LSS is the servicer.

Represents primarily revenue earned from providing administrative support services to Great Lakes’ former parent company in accordance with a one-year contract that is subject to an optional annual renewal by the former parent company. The current contract expires in October 2019. Increase was due to three months of revenue in the first quarter of 2019 as compared to approximately two months (from the Great Lakes acquisition date) in the first quarter of 2018.



Increase was due to the Great Lakes acquisition, an increase in personnel to support the increase in volume of loans serviced for the government entering repayment status, and the increase in private education and consumer loan servicing volume.



Amortization of intangible assets and depreciation of fixed assets recorded as a result of the Great Lakes acquisition on February 7, 2018 was $5.8 million and $3.8 million during the first quarter of 2019 and 2018, respectively.

Increase was due to the Great Lakes acquisition.



Intersegment expenses represent costs for certain corporate activities and services that are allocated to each operating segment based on estimated use of such activities and services.



Reflects income tax expense at an effective tax rate of 24% on income before taxes and the net loss attributable to noncontrolling interest.



Represented 50 percent of the net loss of the GreatNet joint venture that was attributable to Great Lakes prior to the Company's acquisition of Great Lakes on February 7, 2018.



The Company will incur additional costs in 2019 to integrate two core processing systems for the government-owned loans, be responsive to the Department's procurement, and develop new private education and consumer loan origination and servicing systems, a multi-year project, which the Company currently expects will decrease operating margin from recent historical results.

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*Loan servicing and systems revenue*

Government servicing - Nelnet

Government servicing - Great Lakes

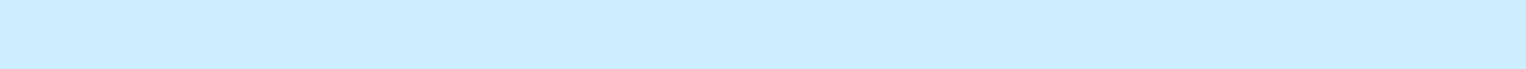
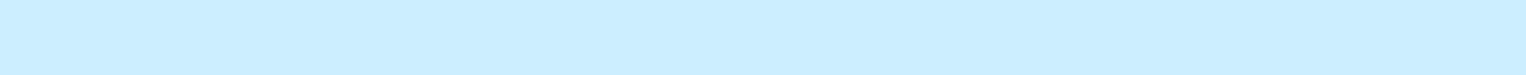
Private education and consumer loan servicing FFELP servicing

Software services

Outsourced services and other

Loan servicing and systems revenue

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | **Three months ended March 31,** | | |  | **Additional information** |  |
|  |  |  |  |  |  |  |
|  | **2019** |  | **2018** |  |  |  |
|  |  |  |  |  | Represents revenue from Nelnet Servicing's Department servicing contract. Revenue increased due to a shift in the portfolio of loans |  |
|  |  |  |  |  |  |
|  |  |  |  |  | serviced to a greater portion of loans in higher paying repayment statuses, partially offset by a decrease in the number of servicing |  |
| $ | 39,640 |  | 39,327 |  | borrowers. |  |
|  |  |  |  |  | Represents revenue from the Great Lakes' Department servicing contract from the date of acquisition, February 7, 2018. Increase was |  |
|  |  |  |  |  | due to three months of revenue in the first quarter of 2019 as compared to approximately two months (from the acquisition date) in the |  |
|  | 47,077 |  | 30,754 |  | first quarter of 2018. |  |
|  |  |  |  |  | Excluding $4.6 million in revenue earned in the first quarter of 2018 related to a private loan customer deconverting from the Great |  |
|  |  |  |  |  | Lakes servicing platform subsequent to the Company’s acquisition of Great Lakes on February 7, 2018, private education and consumer |  |
|  |  |  |  |  | loan servicing revenue was $9.5 million and $8.5 million during the first quarter of 2019 and 2018, respectively. Increase in servicing |  |
|  | 9,480 |  | 13,101 |  | revenue was due to the acquisition of Great Lakes and growth in loan servicing volume from existing and new clients. |  |
|  | 6,695 |  | 7,691 |  | Decrease was due to portfolio runoff, partially offset by the acquisition of Great Lakes. Over time, FFELP servicing revenue will |  |
|  |  |  | decrease as third-party customers' FFELP portfolios run off. |  |
|  |  |  |  |  | Historically, the majority of software services revenue related to providing hosted student loan servicing. As a result of the Great Lakes |  |
|  |  |  |  |  | acquisition, LSS added a significant unrelated third-party FFELP guaranty hosted servicing customer. Increase in 2019 was due to an |  |
|  |  |  |  |  | increase in hosted student loan servicing volume and providing hosted guaranty servicing to the new guaranty servicing customer as the |  |
|  | 9,741 |  | 7,589 |  | result of the acquisition of Great Lakes. |  |
|  |  |  |  |  | The majority of this revenue relates to providing contact center outsourcing activities. Increase in revenue was due to the addition of new |  |
|  | 2,265 |  | 1,679 |  | clients and growth of services offered to existing clients. |  |
| $ | 114,898 |  | 100,141 |  |  |  |
|  |  |  |  |  |  |  |



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**EDUCATION TECHNOLOGY, SERVICES, AND PAYMENT PROCESSING OPERATING SEGMENT – RESULTS OF OPERATIONS**

As discussed further in the Company's 2018 Annual Report, this segment of the Company’s business is subject to seasonal fluctuations which correspond, or are related to, the traditional school year.

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.

On November 20, 2018, the Company acquired TMS, a services company that offers tuition payment plans, billing services, payment technology solutions, and refund management to educational institutions. The TMS acquisition added 380 higher education schools and 170 K-12 schools to the Company’s customer base. The results of TMS’ operations are reported in the Company’s consolidated financial statements from the date of acquisition.

***Summary and Comparison of Operating Results***

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **Three months ended March 31,** | | |  | **Additional information** |  |
|  |  | **2019** |  | **2018** |  |  |  |
|  |  |  |  |  |  | Increase was due to additional interest earnings on cash deposits due to a higher balance of cash deposits and higher interest |  |
| Net interest income | $ | 2,009 |  | 665 |  | rates in 2019 as compared to 2018. |  |
| Education technology, services, and payment processing revenue |  | 79,159 |  | 60,221 |  | See table below for additional information. |  |
| Cost to provide education technology, services, and payment processing |  | 21,059 |  | 13,683 |  | See table below for additional information. |  |
| services |  |  |  |  |
|  |  |  |  |  |  | Increase was due to the acquisition of TMS along with additional personnel to support the increase in services provided to |  |
|  |  |  |  |  |  | customers, partially offset by cost reductions due to the Company's decision in October 2018 to terminate its investment in a |  |
| Salaries and benefits |  | 23,008 |  | 19,067 |  | proprietary payment processing platform. |  |
|  |  |  |  |  |  | Amortization of intangible assets related to business acquisitions was $3.3 million and $2.8 million for the three months ended |  |
| Depreciation and amortization |  | 3,510 |  | 3,341 |  | March 31, 2019 and 2018, respectively. |  |
|  |  |  |  |  |  | Increase was due to the acquisition of TMS and additional costs to support the increase in services provided to customers, |  |
|  |  |  |  |  |  | partially offset by cost reductions due to the Company's decision in October 2018 to terminate its investment in a proprietary |  |
| Other expenses |  | 5,311 |  | 4,624 |  | payment processing platform. |  |
|  |  |  |  |  |  | Intersegment expenses represent costs for certain corporate activities and services that are allocated to each operating segment |  |
| Intersegment expenses |  | 3,299 |  | 2,567 |  | based on estimated use of such activities and services. |  |
| Total operating expenses |  | 35,128 |  | 29,599 |  |  |  |
| Income before income taxes |  | 24,981 |  | 17,604 |  |  |  |
| Income tax expense |  | (5,995) |  | (4,225) |  |  |  |
| Net income | $ | 18,986 |  | 13,379 |  |  |  |
|  |  |  |  |  |  |  |  |

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*Education technology, services, and payment processing revenue*

The following table provides disaggregated revenue by service offering and before tax operating margin for each reporting period.

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **Three months ended March 31,** | | |  | **Additional information** |  |
|  |  | **2019** |  | **2018** |  |  |  |
|  |  |  |  |  |  | Increase was due to an increase in the number of managed tuition payment plans resulting from the addition of new school |  |
| Tuition payment plan services | $ | 30,173 |  | 23,043 |  | customers. |  |
| Payment processing |  | 28,979 |  | 19,926 |  | Increase was due to the acquisition of TMS and an increase in payments volume from new and existing school and non-education |  |
|  |  |  | customers. |  |
|  |  |  |  |  |  | Increase was due to an increase in the number of customers using the Company’s school administration software and services, |  |
|  |  |  |  |  |  | higher revenues from financial needs assessment services, and the acquisition of TMS. Additionally, FACTS Education Solutions |  |
| Education technology and services |  | 19,709 |  | 16,975 |  | has experienced growth in the number of students and teachers receiving its professional development and educational instruction |  |
|  |  |  | services. |  |
| Other |  | 298 |  | 277 |  |  |  |
| Education technology, services, and payment processing revenue |  | 79,159 |  | 60,221 |  |  |  |
| Cost to provide education technology, services, and payment processing |  | 21,059 |  | 13,683 |  | Costs primarily relate to payment processing revenue. Increase was due to the acquisition of TMS and an increase in payments |  |
| services |  |  |  | volume from new and existing school and non-education customers. |  |
| Net revenue | $ | 58,100 |  | 46,538 |  |  |  |
|  |  |  |  |  |  | Before tax operating margin (income before income taxes divided by net revenue) increased due to operating leverage and cost |  |
|  |  |  |  |  |  |
|  |  |  |  |  |  | reductions due to the Company's decision in October 2018 to terminate its investment in a proprietary payment processing |  |
| Before tax operating margin |  | 43.0 % |  | 37.8 % |  | platform. |  |

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**COMMUNICATIONS OPERATING SEGMENT – RESULTS OF OPERATIONS**

***Summary and Comparison of Operating Results***

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Three months ended March 31,** | | | |  | **Additional information** |  |
|  | **2019** |  |  | **2018** |  |  |  |
| Net interest income (expense) | $ | 2 |  | (2,508) |  | See note (a) below for additional information. |  |
|  |  |  |  |  |  | Communications revenue is derived primarily from the sale of pure fiber optic services to residential and business customers in Nebraska and |  |
| Communications revenue |  | 14,543 |  | 9,189 |  | Colorado, including internet, television, and telephone services. Increase was primarily due to additional residential households served. See |  |
|  |  |  | additional financial and operating data for ALLO in the tables below. |  |
| Other income |  | 125 |  | — |  |  |  |
| Total other income |  | 14,668 |  | 9,189 |  |  |  |
| Cost to provide communications services |  | 4,759 |  | 3,717 |  | Cost of services are primarily associated with television programming costs. Other costs include connectivity, franchise, and other regulatory |  |
|  |  |  | costs directly related to providing internet and voice services. |  |
|  |  |  |  |  |  | As of December 31, 2017, March 31, 2018, December 31, 2018, and March 31, 2019, ALLO had 508, 516, 550 and 554 employees, |  |
| Salaries and benefits |  | 4,737 |  | 4,063 |  | respectively, including part-time employees. ALLO also uses temporary employees in the normal course of business. Certain costs qualify for |  |
|  |  |  | capitalization as ALLO builds its network. |  |
|  |  |  |  |  |  | Depreciation reflects the allocation of the costs of ALLO's property and equipment over the period in which such assets are used. A significant |  |
|  |  |  |  |  |  | amount of property and equipment purchases have been made to support the Lincoln, Nebraska network expansion. The gross property and |  |
|  |  |  |  |  |  | equipment balances related to this segment as of December 31, 2017, March 31, 2018, December 31, 2018, and March 31, 2019 were $186.4 |  |
| Depreciation and amortization |  | 7,362 |  | 4,921 |  | million, $204.3 million, $273.9 million and $285.8 million, respectively. Amortization reflects the allocation of costs related to intangible |  |
|  |  |  | assets recorded at fair value as of the date the Company acquired ALLO over their estimated useful lives. |  |
|  |  |  |  |  |  | Other expenses includes selling, general, and administrative expenses necessary for operations, such as advertising, occupancy, professional |  |
| Other expenses |  | 3,477 |  | 2,638 |  | services, construction materials, and personal property taxes. Increase was due to expansion of the Lincoln, Nebraska network and number of |  |
|  |  |  | households served. |  |
| Intersegment expenses |  | 664 |  | 605 |  | Intersegment expenses represent costs for certain corporate activities and services that are allocated to each operating segment based on |  |
|  |  |  | estimated use of such activities and services. |  |
| Total operating expenses |  | 16,240 |  | 12,227 |  |  |  |
| Loss before income taxes |  | (6,329) |  | (9,263) |  |  |  |
| Income tax benefit |  | 1,519 |  | 2,223 |  |  |  |
|  |  |  |  |  |  | The Company anticipates this operating segment will be dilutive to consolidated earnings as it continues to build and add customers to its |  |
| Net loss | $ | (4,810) |  | (7,040) |  | network in Lincoln, Nebraska and other communities, due to large upfront capital expenditures and associated depreciation and upfront |  |
|  |  | customer acquisition costs. |  |
|  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |
| Additional information: |  |  |  |  |  |  |  |
| Net loss | $ | (4,810) |  | (7,040) |  |  |  |
| Net interest (income) expense |  | (2) |  | 2,508 |  |  |  |
| Income tax benefit |  | (1,519) |  | (2,223) |  |  |  |
| Depreciation and amortization |  | 7,362 |  | 4,921 |  |  |  |
| Earnings (loss) before interest, income taxes, depreciation, and | $ | 1,031 |  | (1,834) |  | For additional information regarding this non-GAAP measure, see the table below. |  |
| amortization (EBITDA) |  |  |  |
|  |  |  |  |  |  |  |  |

1. Nelnet, Inc. (parent company) previously provided a line of credit to ALLO for network capital expenditures and related expenses. In 2016 and 2017, the outstanding amount owed by ALLO to Nelnet, Inc. and the related interest expense incurred by ALLO and the interest income recognized by Nelnet, Inc. under the line of credit was eliminated in the Company's consolidated financial statements. On January 1, 2018, Nelnet, Inc. contributed equity to ALLO with an associated guaranteed payment and ALLO used the proceeds from this capital contribution to pay off all of the outstanding balance on the line of credit, including all accrued and unpaid interest. For financial reporting purposes, the guaranteed payment recorded by ALLO was classified as debt and such debt and the guaranteed return paid to Nelnet, Inc. (reflected as interest expense for ALLO) was eliminated in the consolidated financial statements. On October 1, 2018, the guaranteed payment was replaced with a yield-based preferred return of future earnings on the contributed equity. For financial reporting purposes, the preferred interest recorded by ALLO is classified as equity and the preferred return on the preferred interest is not treated by ALLO as interest expense. Accordingly, subsequent to October 1, 2018, ALLO will not report interest expense in its income statement related to amounts contributed to ALLO from Nelnet, Inc.

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Certain financial and operating data for ALLO is summarized in the tables below.

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |  |  |  | **Three months ended March 31,** | | | | | | | | |  |  |  |  |
|  |  |  |  |  |  |  |  | | |  |  |  |  |  |  |  | | |  |  |  |  |  |
|  |  |  |  |  |  |  | **2019** | | |  |  |  |  |  |  | **2018** | | |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | Residential revenue |  |  | $ | |  | 11,065 |  |  |  | 76.1 | % |  | $ |  | 6,747 |  |  |  | 73.4 | % |  |  |
|  | Business revenue |  |  |  |  |  | 3,414 |  |  |  | 23.5 |  |  |  |  | 2,381 |  |  |  | 25.9 |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | Other |  |  |  |  |  | 64 |  |  |  | 0.4 |  |  |  |  | 61 |  |  |  | 0.7 |  |  |  |
|  | Communications revenue |  |  |  | $ |  | 14,543 |  |  |  | 100.0 | % |  | $ |  | 9,189 |  |  |  | 100.0 | % |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | Internet |  |  | $ | |  | 8,449 |  |  |  | 58.1 | % |  | $ |  | 4,696 |  |  |  | 51.1 | % |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | Television |  |  |  |  |  | 3,898 |  |  |  | 26.8 |  |  |  |  | 2,784 |  |  |  | 30.3 |  |  |  |
|  | Telephone |  |  |  |  |  | 2,167 |  |  |  | 14.9 |  |  |  |  | 1,691 |  |  |  | 18.4 |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | Other |  |  |  |  |  | 29 |  |  |  | 0.2 |  |  |  |  | 18 |  |  |  | 0.2 |  |  |  |
|  | Communications revenue |  |  |  | $ |  | 14,543 |  |  |  | 100.0 | % |  | $ |  | 9,189 |  |  |  | 100.0 | % |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | Net loss |  |  | $ | |  | (4,810) |  |  |  |  |  |  |  |  | (7,040) |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | EBITDA (a) |  |  |  |  |  | 1,031 |  |  |  |  |  |  |  |  | (1,834) |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | Capital expenditures |  |  |  |  |  | 11,958 |  |  |  |  |  |  |  |  | 17,899 |  |  |  |  |  |  |  |
|  |  | **As of** | | **As of** | | |  |  |  |  | **As of** |  |  |  |  | **As of** | | | | **As of** |  |  |  |
|  |  | **As of September 30, 2018** | | | | **June 30,** | | |  |  |  |  |  |
|  |  | **March 31, 2019** | | **December 31, 2018** | | | **2018** |  |  |  |  | **March 31, 2018** | | | | **December 31, 2017** | | |  |
| Residential customer information: | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Households served | | 40,338 |  | 37,351 | |  | 32,529 | | |  |  | 27,643 | | |  | 23,541 | | |  |  | 20,428 | |  |
| Households passed (b) | | 127,253 |  | 122,396 | |  | 110,687 | | |  |  | 98,538 | | |  | 84,475 | | |  |  | 71,426 | |  |
| Households served/passed | | 31.7 % |  | 30.5 % | |  | 29.4 % | | |  |  | 28.1 % | | |  | 27.9 % | | |  |  | 28.6 % | |  |
| Total households in current markets (c) | | 152,840 |  | 152,840 | |  | 142,602 | | |  |  | 137,500 | | |  | 137,500 | | |  |  | 137,500 | |  |

1. Earnings (loss) before interest, income taxes, depreciation, and amortization ("EBITDA") is a supplemental non-GAAP performance measure that is frequently used in capital-intensive industries such as telecommunications. ALLO's management uses EBITDA to compare ALLO's performance to that of its competitors and to eliminate certain non-cash and non-operating items in order to consistently measure performance from period to period. EBITDA excludes interest and income taxes because these items are associated with a company's particular capitalization and tax structures. EBITDA also excludes depreciation and amortization expense because these non-cash expenses primarily reflect the impact of historical capital investments, as opposed to the cash impacts of capital expenditures made in recent periods, which may be evaluated through cash flow measures. The Company reports EBITDA for ALLO because the Company believes that it provides useful additional information for investors regarding a key metric used by management to assess ALLO's performance. There are limitations to using EBITDA as a performance measure, including the difficulty associated with comparing companies that use similar performance measures whose calculations may differ from ALLO's calculations. In addition, EBITDA should not be considered a substitute for other measures of financial performance, such as net income or any other performance measures derived in accordance with GAAP. A reconciliation of EBITDA from net income (loss) under GAAP is presented under "Summary and Comparison of Operating Results" in the table above.
2. Represents the number of single residence homes, apartments, and condominiums that ALLO already serves and those in which ALLO has the capacity to connect to its network distribution system without further material extensions to the transmission lines, but have not been connected.
3. During the third quarter of 2018, ALLO began providing service in Fort Morgan, Colorado. During the fourth quarter of 2018, ALLO began providing service in Hastings, Nebraska.

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**ASSET GENERATION AND MANAGEMENT OPERATING SEGMENT – RESULTS OF OPERATIONS *Loan Portfolio***

As of March 31, 2019, the Company had a $21.9 billion loan portfolio, consisting primarily of federally insured loans, that management anticipates will amortize over the next approximately 20 years and has a weighted average remaining life of 8.7 years. For a summary of the Company’s loan portfolio as of March 31, 2019 and December 31, 2018, 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,** | | | |  |
|  |  |  |  |  |  |
|  | **2019** | **2018** | | |  |
| Beginning balance | $ | 22,520,498 |  |  | 21,995,877 |
|  |  |  |  |  |  |
| Loan acquisitions: |  |  |  |  |  |
| Federally insured student loans |  | 270,015 |  |  | 584,586 |
|  |  |  |  |  |  |
| Consumer loans |  | 70,121 |  |  | 23,354 |
| Total loan acquisitions |  | 340,136 |  |  | 607,940 |
|  |  |  |  |  |  |
| Repayments, claims, capitalized interest, and other |  | (504,720) |  |  | (622,284) |
| Consolidation loans lost to external parties |  | (273,271) |  |  | (247,820) |
|  |  |  |  |  |  |
| Ending balance | $ | 22,082,643 |  |  | 21,733,713 |
|  |  |  |  |  |  |

***Allowance for Loan Losses and Loan Delinquencies***

The Company maintains an allowance that management believes is appropriate to absorb losses, net of recoveries, inherent in the portfolio of loans, which results in periodic provisions for loan losses. 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 for the three months ended March 31, 2019 and 2018, and a summary of the Company's loan delinquency amounts as of March 31, 2019, December 31, 2018, and March 31, 2018, see note 2 of the notes to consolidated financial statements included under Part I, Item 1 of this report.

Provision for loan losses for federally insured loans was $2.0 million for each of the three months ended March 31, 2019 and 2018.

The Company did not record a provision for private education loan losses for the three months ended March 31, 2019 and 2018.

Provision for loan losses for consumer loans was $5.0 million and $2.0 million for the three months ended March 31, 2019 and 2018, respectively. The increase in provision was a result of the increased amount of consumer loan purchases during the 2019 period as reflected in the "Loan Activity" table above.

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***Loan Spread Analysis***

The following table analyzes the loan spread on the Company’s portfolio of loans, which represents the spread between the yield earned on loan assets and the costs of the liabilities and derivative instruments used to fund the assets. The spread amounts included in the following table are calculated by using the notional dollar values found in the table under the caption "Net interest income, net of settlements on derivatives" below, divided by the average balance of loans or debt outstanding.

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Three months ended March 31,** | | | | |  |  |
|  |  |  |  | | |  |  |
|  | **2019** |  | **2018** | | |  |  |
|  |  |  |  |  |  |  |  |
| Variable loan yield, gross |  | 5.04 | % |  |  | 4.15 | % |
| Consolidation rebate fees |  | (0.84) |  |  |  | (0.85) |  |
|  |  |  |  |  |  |  |  |
| Discount accretion, net of premium and deferred origination costs amortization |  | 0.03 |  |  |  | 0.07 |  |
| Variable loan yield, net |  | 4.23 |  |  |  | 3.37 |  |
|  |  |  |  |  |  |  |  |
| Loan cost of funds - interest expense |  | (3.47) |  |  |  | (2.53) |  |
| Loan cost of funds - derivative settlements (a) (b) |  | 0.04 |  |  |  | (0.03) |  |
|  |  |  |  |  |  |  |  |
| Variable loan spread |  | 0.80 |  |  |  | 0.81 |  |
| Fixed rate floor income, gross |  | 0.19 |  |  |  | 0.32 |  |
|  |  |  |  |  |  |  |  |
| Fixed rate floor income - derivative settlements (a) (c) |  | 0.31 |  |  |  | 0.16 |  |
| Fixed rate floor income, net of settlements on derivatives |  | 0.50 |  |  |  | 0.48 |  |
|  |  |  |  |  |  |  |  |
| Core loan spread (d) |  | 1.30 | % |  |  | 1.29 | % |
|  |  |  | |  |  |  | |
| Average balance of loans | $ | 22,313,270 | |  |  | 21,871,501 | |
| Average balance of debt outstanding |  | 21,989,065 | |  |  | 21,449,449 | |

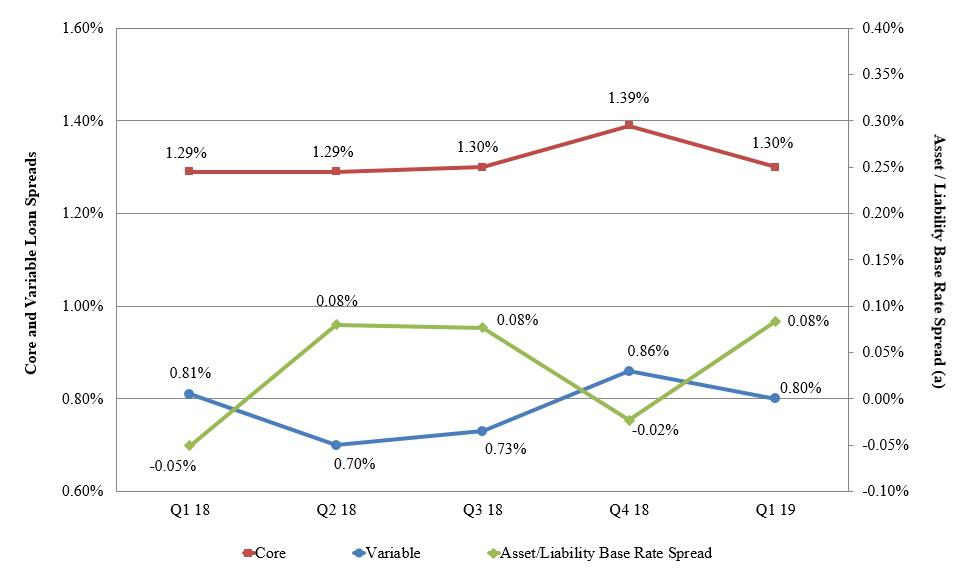
(a) Derivative settlements represent the cash paid or received during the current period to settle with derivative instrument

counterparties the economic effect of the Company's derivative instruments based on their contractual terms. Derivative accounting requires that net settlements with respect to derivatives that do not qualify for "hedge treatment" under GAAP be recorded in a separate income statement line item below net interest income. The Company maintains an overall risk management strategy that incorporates the use of derivative instruments to reduce the economic effect of interest rate volatility. As such, management believes derivative settlements for each applicable period should be evaluated with the Company’s net interest income (loan spread) as presented in this table. The Company reports this non-GAAP information because it believes that it provides additional information regarding operational and performance indicators that are closely assessed by management. There is no comprehensive, authoritative guidance for the presentation of such non-GAAP information, which is only meant to supplement GAAP results by providing additional information that management utilizes to assess performance. See note 4 of the notes to consolidated financial statements included under Part I, Item 1 of this report for additional information on the Company's derivative instruments, including the net settlement activity recognized by the Company for each type of derivative for the periods presented in the table under the caption "Income Statement Impact" in note 4 and in this table.

1. Derivative settlements include the net settlements received (paid) related to the Company’s 1:3 basis swaps.
2. Derivative settlements include the net settlements received (paid) related to the Company’s floor income interest rate swaps.
3. Other than consumer loans funded in the Company's consumer loan warehouse facility that closed on January 11, 2019, consumer loans were and continue to be funded by the Company using operating cash, until they can be funded in a secured financing transaction. As such, these loans do not have a cost of funds (debt) associated with them. The average balance of consumer loans outstanding for the three months ended March 31, 2019 and 2018 was $159.2 million and $67.1 million, respectively, and the average balance outstanding on the consumer loan warehouse facility for the three months ended March 31, 2019 was $77.2 million. Core loan spread, excluding consumer loans, would have been 1.22% and 1.25% for the three months ended March 31, 2019 and 2018, respectively.

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



(a) The interest earned on the majority of the Company's FFELP student loan assets is indexed to the one-month LIBOR

rate. The Company funds a large portion 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 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. See Item 3, “Quantitative and Qualitative Disclosures About Market Risk - Interest Rate Risk,” which provides additional detail on the Company’s FFELP student loan assets and related funding for those assets.

Variable loan spread decreased during the three months ended March 31, 2019 as compared to the same period in 2018 due to a widening in the basis between the asset and debt indices in which the Company earns interest on its loans and funds such loans (as reflected in the table above), partially offset by a net increase in 1:3 basis swap settlements received and an increase in the Company's consumer loan portfolio. Variable loan spread without consumer loans was 0.72% and 0.77% for the three months ended March 31, 2019 and 2018, respectively.

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

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | **Three months ended March 31,** | | | |  |
|  |  |  | | |  |
|  | **2019** | **2018** | | |  |
|  |  |  |  |  |  |
| Fixed rate floor income, gross | $ | 10,425 |  |  | 17,247 |
| Derivative settlements (a) |  | 16,701 |  |  | 8,590 |
|  |  |  |  |  |  |
| Fixed rate floor income, net | $ | 27,126 |  |  | 25,837 |
|  |  |  |  |  |  |
| Fixed rate floor income contribution to spread, net |  | 0.50 % |  |  | 0.48 % |

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

The decrease in gross fixed rate floor income for the three months ended March 31, 2019 compared to the same period in 2018 was due to higher interest rates in 2019 as compared to 2018. The Company has a portfolio of derivative instruments in which the Company pays a fixed rate and receives a floating rate to economically hedge loans earning fixed rate floor income. See Item 3, “Quantitative and Qualitative Disclosures About Market Risk - Interest Rate 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.

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***Summary and Comparison of Operating Results***

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **Three months ended March 31,** | | | | **Additional information** |  |
|  |  | **2019** |  | **2018** |  |  |  |
| Net interest income after provision for loan losses | $ | 51,068 |  | 62,101 |  | See table below for additional analysis. |  |
|  |  |  |  |  |  | The primary component of other income is borrower late fees. The increase in the three months ended March 31, 2019 as compared to |  |
| Other income |  | 3,525 |  | 3,351 |  | the same period in 2018 was due to an increase in federally insured loan delinquencies. |  |
|  |  |  |  |  |  | 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 |  |
| Derivative settlements, net |  | 19,035 |  | 6,926 |  | net interest income as reflected in the table below. |  |
|  |  |  |  |  |  | Includes the realized and unrealized gains and losses that are caused by changes in fair values of derivatives which do not qualify for |  |
| Derivative market value adjustments, net |  | (30,574) |  | 58,571 |  | "hedge treatment" under GAAP. |  |
| Total other income |  | (8,014) |  | 68,848 |  |  |  |
| Salaries and benefits |  | 378 |  | 382 |  |  |  |
|  |  |  |  |  |  | Third party loan servicing fees decreased due to runoff of the Company's loan portfolio on third-party platforms, significant |  |
|  |  |  |  |  |  | conversions of loans to the LSS operating segment in July 2018 and September 2018, and the acquisition of Great Lakes on February |  |
|  |  |  |  |  |  | 7, 2018, which prior to the acquisition was a third-party servicer to the Company. Servicing fees on loans serviced by Great Lakes are |  |
| Loan servicing fees to third parties |  | 2,893 |  | 3,136 |  | included in intersegment expenses effective as of the acquisition date. |  |
| Other expenses |  | 944 |  | 848 |  |  |  |
|  |  |  |  |  |  | Amounts include fees paid to the LSS operating segment for the servicing of the Company’s loan portfolio. These amounts exceed the |  |
|  |  |  |  |  |  | actual cost of servicing the loans. Increase was due to significant purchases of loans in April 2018 of which LSS is the servicer, |  |
|  |  |  |  |  |  | significant conversions of loans in July 2018 and September 2018, and the acquisition of Great Lakes on February 7, 2018, as |  |
|  |  |  |  |  |  | described above. Intersegment expenses also represent costs for certain corporate activities and services that are allocated to each |  |
| Intersegment expenses |  | 12,287 |  | 10,865 |  | operating segment based on estimated use of such activities and services. |  |
|  |  |  |  |  |  | Total operating expenses were 30 basis points and 28 basis points of the average balance of loans for the three months ended March |  |
| Total operating expenses |  | 16,502 |  | 15,231 |  | 31, 2019 and 2018, respectively. |  |
| Income before income taxes |  | 26,552 |  | 115,718 |  |  |  |
| Income tax expense |  | (6,372) |  | (27,773) |  |  |  |
| Net income | $ | 20,180 |  | 87,945 |  |  |  |
|  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |
| Additional information: |  |  |  |  |  |  |  |
| Net income | $ | 20,180 |  | 87,945 |  |  |  |
| Derivative market value adjustments, net |  | 30,574 |  | (58,571) |  | See "Overview - GAAP Net Income and Non-GAAP Net Income, Excluding Adjustments" above for additional information about |  |
| Net tax effect |  | (7,338) |  | 14,057 |  | non-GAAP net income, excluding derivative market value adjustments. |  |
|  |  |  |  |  |
| Net income, excluding derivative market value adjustments | $ | 43,416 |  | 43,431 |  |  |  |
|  |  |  |  |  |  |  |  |

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*Net interest income, net of settlements on derivatives*

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** |  |
|  |  | **2019** |  | **2018** |  |  |  |
|  |  |  |  |  |  | Increase was due to an increase in the gross yield earned on loans and an increase in the average balance of |  |
| Variable interest income, gross | $ | 277,024 |  | 223,236 |  | loans. |  |
| Consolidation rebate fees |  | (46,491) |  | (46,698) |  | Decrease was due to a decrease in the average consolidation loan balance. |  |
|  |  |  |  |  |  | Net discount accretion is due to the Company's purchases of loans at a net discount over the last several years. |  |
| Discount accretion, net of premium and deferred origination costs |  | 1,375 |  | 3,938 |  | However, due to more recent purchases in 2018 and 2019 at a net premium, the net discount accretion has |  |
| amortization |  |  |  | decreased in 2019 as compared to 2018. |  |
| Variable interest income, net |  | 231,908 |  | 180,476 |  |  |  |
| Interest on bonds and notes payable |  | (187,957) |  | (133,592) |  | Increase was due to an increase in cost of funds and an increase in the average balance of debt outstanding. |  |
| Derivative settlements, net (a) |  | 2,334 |  | (1,664) |  | Derivative settlements include the net settlements received (paid) related to the Company’s 1:3 basis swaps. |  |
| Variable loan interest margin, net of settlements on derivatives (a) |  | 46,285 |  | 45,220 |  |  |  |
| Fixed rate floor income, gross |  | 10,425 |  | 17,247 |  | Fixed rate floor income decreased due to higher interest rates in 2019 as compared to 2018. |  |
|  |  |  |  |  |  | Derivative settlements include the settlements received related to the Company's floor income interest rate |  |
| Derivative settlements, net (a) |  | 16,701 |  | 8,590 |  | swaps. Increase in settlements due to higher interest rates in 2019 as compared to 2018. |  |
| Fixed rate floor income, net of settlements on derivatives (a) |  | 27,126 |  | 25,837 |  |  |  |
| Core loan interest income (a) |  | 73,411 |  | 71,057 |  |  |  |
|  |  |  |  |  |  | Increase was due to a higher balance of interest-earning investments and higher interest rates in 2019 as |  |
| Investment interest |  | 4,534 |  | 2,610 |  | compared to 2018. |  |
| Intercompany interest |  | (842) |  | (640) |  |  |  |
|  |  |  |  |  |  | See "Allowance for Loan Losses and Loan Delinquencies" included above under "Asset Generation and |  |
| Provision for loan losses - federally insured loans |  | (2,000) |  | (2,000) |  | Management Operating Segment - Results of Operations." |  |
| Provision for loan losses - consumer loans |  | (5,000) |  | (2,000) |  |  |  |
| Net interest income after provision for loan losses (net of settlements on | $ | 70,103 |  | 69,027 |  |  |  |
| derivatives) (a) |  |  |  |  |
|  |  |  |  |  |  |  |  |

1. Derivative settlements represent the cash paid or received during the current period to settle with derivative instrument counterparties the economic effect of the Company's derivative instruments based on their contractual terms. Derivative accounting requires that net settlements on derivatives that do not qualify for "hedge treatment" under GAAP be recorded in a separate income statement line item below net interest income. The Company maintains an overall risk management strategy that incorporates the use of derivative instruments to reduce the economic effect of interest rate volatility. As such, management believes derivative settlements for each applicable period should be evaluated with the Company’s net interest income as presented in this table. Core loan interest income and net interest income after provision for loan losses (net of settlements on derivatives) are non-GAAP financial measures, and the Company reports this non-GAAP information because the Company believes that it provides additional information regarding operational and performance indicators that are closely assessed by management. There is no comprehensive, authoritative guidance for the presentation of such non-GAAP information, which is only meant to supplement GAAP results by providing additional information that management utilizes to assess performance. See note 4 of the notes to consolidated financial statements included under Part I, Item 1 of this report for additional information on the Company's derivative instruments, including the net settlement activity recognized by the Company for each type of derivative referred to in the "Additional information" column of this table, for the periods presented in the table under the caption "Income Statement Impact" in note 4 and in this table.

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**LIQUIDITY AND CAPITAL RESOURCES**

The Company’s Loan Servicing and Systems and Education Technology, Services, and Payment Processing operating segments are non-capital intensive and both produce positive operating cash flows. As such, a minimal amount of debt and equity capital is allocated to these segments and any liquidity or capital needs are satisfied using cash flow from operations. Therefore, the following 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 and capital needs to expand ALLO's communications network in the Communications operating segment.

**Sources of Liquidity**

As of March 31, 2019, the Company had cash and cash equivalents of $74.9 million. The Company also had a portfolio of available-for-sale investments, consisting primarily of student loan asset-backed securities, with a fair value of $52.7 million as of March 31, 2019.

The Company also has a $382.5 million unsecured line of credit that matures on June 22, 2023. As of March 31, 2019, there was $320.0 million outstanding on the unsecured line of credit and $62.5 million was available for future use. The line of credit provides that the Company may increase the aggregate financing commitments, through the existing lenders and/or through new lenders, up to a total of $400.0 million, subject to certain conditions.

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 eliminated in consolidation and are not included in the Company's consolidated financial statements. However, these securities remain 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, 2019, the Company holds $15.0 million (par value) of its own asset-backed securities.

The Company intends to use its liquidity position to capitalize on market opportunities, including FFELP, private education, and consumer loan acquisitions; strategic acquisitions and investments; expansion of ALLO's telecommunications network; and capital management initiatives, including stock repurchases, debt repurchases, and dividend distributions. The timing and size of these opportunities will vary and will have a direct impact on the Company's cash and investment balances.

**Cash Flows**

The Company has historically generated positive cash flow from operations. However, during the three months ended March 31, 2019, the Company used $139.7 million in operating activities, compared to generating $58.0 million from operating activities for the same period in 2018. The decrease in cash flows from operating activities for the three months ended March 31, 2019, as compared to the same period in 2018, was due to:

* The decrease in net income;
* The impact of changes to due to customers (as discussed further below);
* Adjustments to net income for the impact of deferred taxes;
* Net payments to the clearinghouse in 2019 of $14.0 million compared to net proceeds received in 2018 of $62.7 million related to the Company's derivative portfolio; and
* The impact of changes to accounts receivable and other assets during the three months ended March 31, 2019 as compared to the same period in 2018.

These factors were partially offset by:

* The adjustments to net income for derivative market value adjustments; and
* The impact of changes to accrued interest receivable and other liabilities during the three months ended March 31, 2019 as compared to the same period in 2018.

As part of the Company’s Education Technology, Services, and Payment Processing operating segment, the Company collects tuition payments and subsequently remits these payments to the appropriate schools. Cash collected for customers and the related liability are included in the Company’s consolidated balance sheet. These accounts fluctuate with the fall and spring school terms based on the timing of when the Company collects tuition payments from customers and remits such payments to schools, resulting in these balances being significantly lower as of March 31 as compared to the balances as of December 31. The acquisition of TMS in November 2018 increased the magnitude of the change in these account balances. The “due to customers” liability account decreased $153.2 million for the three months ended March 31, 2019 as compared to decreasing $58.6 million for the same period in 2018. These decreases negatively impacted cash provided by/used in operating activities in the Company’s consolidated statements of cash flows for these periods.

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The primary items included in the statement of cash flows for investing activities are the purchase and repayment of 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 loans. Cash provided by investing activities and used in financing activities for the three months ended March 31, 2019 was $386.3 million and $387.4 million, respectively. Cash provided by investing activities and used in financing activities for the three months ended March 31, 2018 was $102.3 million and $177.1 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 Loan Assets and Related Collateral** The following table shows the Company's debt obligations outstanding that are secured by loan assets and related collateral.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  |  | **As of March 31, 2019** | | |
|  |  |  |  |  |
|  |  | **Carrying amount** |  | **Final maturity** |
| Bonds and notes issued in asset-backed securitizations | $ | 20,862,951 | 11/25/24 - 4/25/67 | |
| FFELP and consumer loan warehouse facilities |  | 856,390 | 5/20/20 / 1/10/22 | |
|  |  |  |  |  |
|  | $ | 21,719,341 |  |  |
|  |  |  |  |  |

***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. Cash generated from student loans funded in asset-backed securitizations provide the sources of liquidity to satisfy all obligations related to the outstanding bonds and notes issued in such securitizations. 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, 2019, 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 $2.16 billion as detailed below.

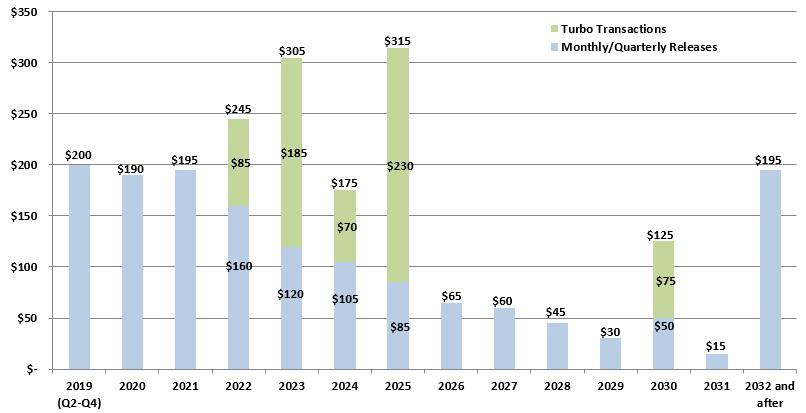
The forecasted cash flow presented below includes all loans funded in asset-backed securitizations as of March 31, 2019. As of March 31, 2019, the Company had $21.0 billion of loans included in asset-backed securitizations, which represented 95.3 percent of its total loan portfolio. The forecasted cash flow does not include cash flows that the Company expects to receive related to loans funded in its warehouse facilities as of March 31, 2019, private education and consumer loans funded with operating cash, and loans acquired subsequent to March 31, 2019.

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**Asset-backed Securitization Cash Flow Forecast**

**$2.16 billion**

**(dollars in millions)**



The forecasted future undiscounted cash flows of approximately $2.16 billion include approximately $1.32 billion (as of March 31, 2019) 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: "loans receivable," "restricted cash," and "accrued interest receivable." The difference between the total estimated future undiscounted cash flows and the overcollateralization of approximately $0.84 billion, or approximately $0.64 billion after income taxes based on the estimated effective tax rate, is expected to be accretive to the Company's March 31, 2019 balance of consolidated shareholders' equity.

Certain of the Company’s asset-backed securitizations are structured as “Turbo Transactions” which require all cash generated from the student loans (including excess spread) to be directed toward payment of interest and any outstanding principal generally until such time as all principal on the notes has been paid in full. Once the notes in such transactions are paid in full, the remaining unencumbered student loans (and other remaining assets, if any) in the securitization will be released to the Company, at which time the Company will have the option to refinance or sell these assets, or retain them on the balance sheet as unencumbered assets.

The estimated forecasted cash flow as of March 31, 2019 ($2.16 billion) increased $0.06 billion from the Company's estimated forecasted cash flow as of December 31, 2018 ($2.10 billion). This increase was due to additional estimated cash flows from the completion of an asset-backed securitization during the first quarter of 2019; a change in call mechanic assumptions regarding the Turbo Transactions that resulted in the estimated release of unencumbered assets from these transactions being deferred to later periods, resulting in additional estimated cash flows from assets included in these transactions; and a decrease in the forward yield curve, which increased the amount of expected fixed rate floor income to be earned on loans in the asset-backed securitizations. These amounts were partially offset by the amount of cash released from the asset-backed securitizations during the first quarter of 2019.

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, borrower default rates, and utilization of debt management options such as income-based repayment, deferments, and forbearance. 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

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assumption two times greater than what was used to forecast the cash flow, the cash flow forecast would be reduced by approximately $130 million to $160 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 $100 million to $120 million. As the percentage of the Company's outstanding debt financed by three-month LIBOR declines, the Company's basis risk will be reduced.

There is significant uncertainty regarding the availability of LIBOR as a benchmark rate after 2021, and any market transition away from the current LIBOR framework could result in significant changes to the forecasted cash flows from the Company's asset-backed securitizations. See Item 1A, "Risk Factors - Loan Portfolio - Interest rate risk - replacement of LIBOR as a benchmark rate" in the Company's 2018 Annual Report.

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. The forecasted cash flow does not include cash flows the Company expects to pay/receive related to derivative instruments used by the Company to manage interest rate risk. See Item 3, "Quantitative and Qualitative Disclosures About Market Risk — Interest Rate Risk."

***FFELP and Consumer Loan 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, 2019, the Company had two FFELP warehouse facilities with an aggregate maximum financing amount available of $1.00 billion, of which $0.79 billion was outstanding, and $0.21 billion was available for additional funding. One warehouse facility has a static advance rate until the expiration date of the liquidity provisions (May 20, 2019). In the event the liquidity provisions are not extended, the valuation agent has the right to perform a one-time mark to market on the underlying loans funded in this facility, subject to a floor. The loans would then be funded at this new advance rate until the final maturity date of the facility (May 20, 2020). The other warehouse facility has static advance rates that requires initial equity for loan funding and does not require increased equity based on market movements. As of March 31, 2019, the Company had $50.6 million advanced as equity support on these facilities. For further discussion of the Company's FFELP warehouse facilities outstanding at March 31, 2019, see note 3 of the notes to consolidated financial statements included under Part I, Item 1 of this report.

On January 11, 2019, the Company closed on a consumer loan warehouse facility with an aggregate maximum financing amount available of $100.0 million, an advance rate of 70 or 75 percent depending on type of collateral and subject to certain concentration limits, and a maturity date of January 10, 2022. As of March 31, 2019, $63.7 million was outstanding under this facility and $36.3 million was available for future funding. Additionally, as of March 31, 2019, the Company had $26.5 million advanced as equity support under this facility.

Upon termination or expiration of the FFELP and consumer loan 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, including opportunities to purchase private education and consumer loans.

The Company plans to fund additional loan acquisitions using current cash and investments; using its Union Bank participation agreement (as described below); using its FFELP and consumer loan warehouse facilities (as described above); increasing the capacity under existing and/or establishing new warehouse facilities; and continuing to access the asset-backed securities market.

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***Union Bank Participation Agreement***

The Company maintains an agreement with Union Bank, a related party, 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, 2019, $583.8 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 $750.0 million or an amount in excess of $750.0 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 on the Company’s consolidated balance sheets.

***Asset-Backed Securities Transactions***

On February 27, 2019, the Company completed an asset-backed securitization totaling $496.8 million (par value). See note 3 of the notes to consolidated financial statements included under Part I, Item I of this report for additional information on this securitization. In addition, on April 30, 2019, the Company completed an asset-backed securitization totaling $416.1 million (par value). The proceeds from these transactions were used primarily to refinance student loans included in the Company's FFELP warehouse facilities.

Depending on future market conditions, the Company currently anticipates continuing to access the asset-backed securitization market. Such asset-backed securitization transactions would be used to refinance loans included in its warehouse facilities, loans purchased from third parties, and/or student loans in its 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, 2019, 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 and/or variation margin payments with its third-party clearinghouse. 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 and/or pay variation margin to a third-party clearinghouse. The collateral deposits or variation margin, if significant, could negatively impact the Company's liquidity and capital resources. In addition, clearing rules require the Company to post amounts of liquid collateral when executing new derivative instruments, which could prevent or limit the Company from utilizing additional derivative instruments to manage interest rate sensitivity and risks. See note 4 of the notes to consolidated financial statements included under Part I, Item 1 of this report for additional information on the Company's derivative portfolio.

**Liquidity Impact Related to the Communications Operating Segment**

ALLO has made significant investments in its communications network and currently provides fiber directly to homes and businesses in eight communities in Nebraska and one in Colorado. ALLO plans to continue to increase market share and revenue in its existing markets and is currently evaluating opportunities to expand to other communities in the Midwest. ALLO began providing services in Lincoln, Nebraska in September 2016 as part of a multi-year project to pass substantially all commercial and residential properties in the community. As of the end of the first quarter of 2019, the build-out of the Lincoln community is substantially complete. For the three months ended March 31, 2019, ALLO's capital expenditures were $12.0 million. The Company anticipates total ALLO network capital expenditures for the remainder of 2019 (April 1, 2019 - December 31, 2019) will be approximately $40 million. However, this amount could change based on customer demand for ALLO's services. The Company currently plans to use cash from operating activities and its third-party unsecured line of credit to fund ALLO's capital expenditures, as well as potentially other third-party financing alternatives.

**Other Debt Facilities**

As discussed above, the Company has a $382.5 million unsecured line of credit with a maturity date of June 22, 2023. As of March 31, 2019, the unsecured line of credit had $320.0 million outstanding and $62.5 million was available for future use. Upon the maturity date in 2023, there can be no assurance that the Company will be able to maintain this line of credit, increase the amount outstanding under the line, or find alternative funding if necessary.

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The Company has issued Junior Subordinated Hybrid Securities (the "Hybrid Securities") that have a final maturity of September 15, 2061. The Hybrid Securities are unsecured obligations of the Company. As of March 31, 2019, the Company had $20.4 million of Hybrid Securities that remain outstanding.

The Company entered into a repurchase agreement in both 2017 and 2018, the proceeds of which are collateralized by FFELP asset-backed security investments and private education loans, respectively. As of March 31, 2019, $40.6 million and $41.4 million were subject to these repurchase agreements, respectively. Upon termination or expiration of the repurchase agreements, the Company would use cash proceeds or transfer collateral to satisfy any outstanding obligations subject to the agreements.

For further discussion of these debt facilities described above, see note 3 of the notes to consolidated financial statements included under Part I, Item 1 of this report. **Stock Repurchases**

In 2016, the Board of Directors 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 25, 2019. Shares repurchased by the Company during the three months ended March 31, 2019 are shown below. Certain of these repurchases were made pursuant to a trading plan adopted by the Company in accordance with Rule 10b5-1 under the Securities Exchange Act of 1934. For additional information on stock repurchases during the first quarter of 2019, see "Stock Repurchases" under Part II, Item 2 of this report.

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  | **Purchase price** | | **Average price of shares** |
|  | **Total shares repurchased** | |  | **(in thousands)** | | **repurchased (per share)** |
|  |  |  |  |  |  |  |
| Quarter ended March 31, 2019 | 301,327 |  | $ | 16,358 |  | 54.29 |
|  |  |  |  |  |  |  |

As of March 31, 2019, 2,028,025 shares remained authorized for repurchase under the Company's stock repurchase program. On May 8, 2019, the Board of Directors authorized a new 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 7, 2022. The five million shares authorized under the new program include the remaining unrepurchased shares from the prior program, which the new program replaces. Shares may be repurchased from time to time depending on various factors, including share prices and other potential uses of liquidity.

**Dividends**

On March 15, 2019, the Company paid a first quarter 2019 cash dividend on the Company's Class A and Class B common stock of $0.18 per share. In addition, the Company's Board of Directors has declared a second quarter 2019 cash dividend on the Company's outstanding shares of Class A and Class B common stock of $0.18 per share. The second quarter cash dividend will be paid on June 14, 2019 to shareholders of record at the close of business on May 31, 2019.

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**

***Allowance for Loan Losses***

In June 2016, the FASB issued accounting guidance regarding the measurement of credit losses on financial instruments, which will change the way entities recognize impairment of many financial assets by requiring immediate recognition of estimated credit losses expected to occur over the asset's remaining life. The Company currently uses an incurred loss model when calculating its allowance for loan losses. As a result, the Company expects the new guidance will increase the allowance for loan losses. This guidance will be effective for the Company beginning January 1, 2020. This standard represents a significant departure from existing GAAP, and may result in significant changes to the Company's accounting for the allowance for loan losses. The Company is evaluating the impact this pronouncement will have on its ongoing financial reporting.

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**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 rate characteristics:

|  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **As of March 31, 2019** | | |  |  |  |  | **As of December 31, 2018** | | |  |
|  |  |  | |  |  |  |  |  |  | |  |  |
|  |  | **Dollars** | | **Percent** |  |  |  |  | **Dollars** | | **Percent** |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |
| Fixed-rate loan assets | $ | 2,740,929 |  |  | 12.4 | % |  | $ | 2,792,734 |  | 12.4 | % |
| Variable-rate loan assets |  | 19,341,714 |  |  | 87.6 |  |  |  | 19,727,764 |  | 87.6 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |
| Total | $ | 22,082,643 |  |  | 100.0 | % |  | $ | 22,520,498 |  | 100.0 | % |
|  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |
| Fixed-rate debt instruments | $ | 59,609 |  |  | 0.3 | % |  | $ | 88,128 |  | 0.4 | % |
| Variable-rate debt instruments |  | 22,082,082 |  |  | 99.7 |  |  |  | 22,448,971 |  | 99.6 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |
| Total | $ | 22,141,691 |  |  | 100.0 | % |  | $ | 22,537,099 |  | 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 payment ("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 declining interest rate environments, when the fixed borrower rate is higher than the SAP rate, the Company’s 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 the three months ended March 31, 2019 and 2018. A summary of fixed rate floor income earned by the Company follows.

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | **Three months ended March 31,** | | | |  |
|  |  |  | | |  |
|  | **2019** | **2018** | | |  |
|  |  |  |  |  |  |
| Fixed rate floor income, gross | $ | 10,425 |  |  | 17,247 |
| Derivative settlements (a) |  | 16,701 |  |  | 8,590 |
|  |  |  |  |  |  |
| Fixed rate floor income, net | $ | 27,126 |  |  | 25,837 |
|  |  |  |  |  |  |

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

Gross fixed rate floor income decreased for the three months ended March 31, 2019 as compared to the same period in 2018 due to higher interest rates in 2019 as compared to 2018.

Absent the use of derivative instruments, a rise in interest rates will reduce the amount of floor income received and this has 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.

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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 federally insured student loan assets that were earning fixed rate floor income as of March 31, 2019.

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Fixed interest rate range** |  | **Borrower/lender weighted average** | | | **Estimated variable conversion rate** | | | | **Loan balance** |  |
| **yield** |  |  | **(a)** |  |  |  |  |
| 5.0 - 5.49% |  | 5.35 | % |  | 2.71 | % $ | | | 293,620 |  |
| 5.5 - 5.99% |  | 5.67 | % |  | 3.03 | % |  |  | 350,624 |  |
|  |  |  |  |  |  |  |  |  |  |  |
| 6.0 - 6.49% |  | 6.19 | % |  | 3.55 | % |  |  | 386,383 |  |
| 6.5 - 6.99% |  | 6.70 | % |  | 4.06 | % |  |  | 377,268 |  |
|  |  |  |  |  |  |  |  |  |  |  |
| 7.0 - 7.49% |  | 7.17 | % |  | 4.53 | % |  |  | 131,473 |  |
| 7.5 - 7.99% |  | 7.71 | % |  | 5.07 | % |  |  | 227,415 |  |
|  |  |  |  |  |  |  |  |  |  |  |
| 8.0 - 8.99% |  | 8.18 | % |  | 5.54 | % |  |  | 529,755 |  |
| > 9.0% |  | 9.05 | % |  | 6.41 | % |  |  | 198,654 |  |
|  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  | $ | | | 2,495,192 |  |
|  |  |  |  |  |  |  |  |  |  |  |

1. 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, 2019, the weighted average estimated variable conversion rate was 4.29% and the short-term interest rate was 254 basis points.

The following table summarizes the outstanding derivative instruments as of March 31, 2019 used by the Company to economically hedge loans earning fixed rate floor income.

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  | **Weighted average fixed rate paid by the** | |
| **Maturity** | |  | **Notional amount** | | **Company (a)** |  |
|  |  |  |  |  |  |  |
| 2019 |  | $ | 1,500,000 |  | 0.98 | % |
| 2020 |  |  | 1,500,000 |  | 1.01 |  |
|  |  |  |  |  |  |  |
| 2021 |  |  | 100,000 |  | 2.95 |  |
| 2023 |  |  | 400,000 |  | 2.24 |  |
|  |  |  |  |  |  |  |
| 2024 |  |  | 200,000 |  | 2.27 |  |
|  |  | $ | 3,700,000 |  | 1.25 | % |
|  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |

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

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In addition, during 2014 and 2018, the Company paid $9.1 million and $4.6 million, respectively, for interest rate swap options to economically hedge loans earning fixed rate floor income. The interest rate swap options give the Company the right, but not the obligation, to enter into interest rate swaps in which the Company would pay a fixed amount and receive discrete one-month LIBOR. The following table summarizes these derivative instruments as of March 31, 2019:

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  | **Weighted average fixed rate** | |  |  |
| **If exercised effective date** | |  | **Notional amount** | | **paid by the Company** |  |  | **If exercised maturity date** |
|  |  |  |  |  |  |  |  |  |
| August 21, 2019 | | $ | 750,000 |  | 3.28 | % |  | August 21, 2024 |
| September 25, 2019 | |  | 250,000 |  | 3.00 |  |  | September 25, 2024 |
|  |  |  |  |  |  |  |  |  |
|  |  | $ | 1,000,000 |  | 3.21 | % |  |  |
|  |  |  |  |  |  |  |  |  |

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, 2019.

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Index** | | **Frequency of variable resets** | | **Assets** |  |  | **Funding of student loan assets** |
|  |  |  |  |  |  |  |  |
| 1 month LIBOR (a) | | Daily | | $ | 20,127,858 |  | — |
| 3 month H15 financial commercial paper | | Daily | |  | 936,499 |  | — |
|  |  |  |  |  |  |  |  |
| 3 month Treasury bill | | Daily | |  | 616,256 |  | — |
| 3 month LIBOR (a) | | Quarterly | |  | — | | 9,481,048 |
|  |  |  |  |  |  |  |  |
| 1 month LIBOR | | Monthly | |  | — | | 10,488,288 |
| Auction-rate (b) | | Varies | |  | — | | 787,676 |
|  |  |  |  |  |  |  |  |
| Asset-backed commercial paper (c) | | Varies | |  | — | | 792,658 |
| Other (d) | |  |  |  | 1,436,435 |  | 1,567,378 |
|  |  |  |  |  |  |  |  |
|  |  |  |  | $ | 23,117,048 |  | 23,117,048 |
|  |  |  |  |  |  |  |  |

1. 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 the 1:3 Basis Swaps outstanding as of March 31, 2019.

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | **Maturity** |  |  | **Notional amount** |  |  |
|  |  |  |  |  | |  |
|  | 2019 | $ | | 3,250,000 | |  |
| 2020 | | (a) | | 1,000,000 | |  |
|  | |  |  |  | |  |
|  | 2021 | (a) | | 250,000 | |  |
| 2022 | | (b) | | 2,000,000 | |  |
|  | |  |  |  | |  |
|  | 2023 |  |  | 750,000 | |  |
| 2024 | |  |  | 250,000 | |  |
|  | |  |  |  | |  |
|  | 2026 |  |  | 1,150,000 | |  |
| 2027 | |  |  | 375,000 | |  |
|  | |  |  |  | |  |
|  | 2028 |  |  | 325,000 | |  |
| 2029 | |  |  | 100,000 | |  |
|  | |  |  |  | |  |
|  | 2031 |  |  | 300,000 | |  |
|  |  |  | $ | 9,750,000 | |  |
|  | | |  |  |  |  |
|  | | |  |  |  |  |
| (a) These derivatives have a forward effective start date in May 2019. | | | |  |  |  |
| (b) $250 million and $750 million of the notional amount of these derivatives have forward effective | | | | | start dates in May 2019 and May 2020, respectively. | |

The weighted average rate paid by the Company on the 1:3 Basis Swaps as of March 31, 2019 was one-month LIBOR plus 9.5 basis points.

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1. As of March 31, 2019, the Company was sponsor for $787.7 million of asset-backed securities that are set and periodically reset via a "dutch auction" (“Auction Rate Securities”). 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.
2. The interest rates on the Company's warehouse facilities are indexed to asset-backed commercial paper rates.
3. Assets include accrued interest receivable and restricted cash. Funding represents overcollateralization (equity) and other liabilities included in FFELP asset-backed securitizations and warehouse facilities.

There is significant uncertainty regarding the availability of LIBOR as a benchmark rate after 2021, and any market transition away from the current LIBOR framework could result in significant changes to the interest rate characteristics of the Company's LIBOR-indexed assets and funding for those assets. See Item 1A, "Risk Factors - Loan Portfolio - Interest rate risk - replacement of LIBOR as a benchmark rate" in the Company's 2018 Annual Report.

***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** | | | | | **Change from increase of 300** | | | | |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  | **basis points** | | | |  | **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, 2019** | | | | | | |  |  |  |  |  |  |  |  |
| Effect on earnings: |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Decrease in pre-tax net income before impact of derivative |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| settlements | $ | (3,470) |  | (6.5) % |  | $ | (5,284) | (10.0) % | |  | $ | (2,571) |  |  | (4.9) % |  | $ | (7,713) |  |  | (14.5) % |  |
| Impact of derivative settlements |  | 9,123 |  | 17.2 |  |  | 27,370 |  | 51.6 |  |  | 1,849 |  |  | 3.5 |  |  | 5,548 |  |  | 10.4 |  |
| Increase (decrease) in net income before taxes | $ | 5,653 |  | 10.7 % |  | $ | 22,086 | 41.6 % | |  | $ | (722) |  |  | (1.4) % |  | $ | (2,165) |  |  | (4.1) % |  |
| Increase (decrease) in basic and diluted earnings per share |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| $ | 0.11 |  |  |  | $ | 0.42 |  |  |  | $ | (0.01) |  |  |  |  | $ | (0.04) |  |  |  |  |
|  |  |  |  |  |  |  |  |  | | |  | |  | |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  | **Three months ended March 31, 2018** | | | | | | |  |  |  |  |  |  |  |  |
| Effect on earnings: |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Decrease in pre-tax net income before impact of derivative |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| settlements | $ | (5,120) |  | (3.4) % |  | $ | (7,990) | (5.4) % | |  | $ | (2,914) |  |  | (2.0) % |  | $ | (8,742) |  |  | (5.9) % |  |
| Impact of derivative settlements |  | 15,738 |  | 10.6 |  |  | 47,215 |  | 31.7 |  |  | 1,797 |  |  | 1.3 |  |  | 5,392 |  |  | 3.7 |  |
| Increase (decrease) in net income before taxes | $ | 10,618 |  | 7.2 % |  | $ | 39,225 | 26.3 % | |  | $ | (1,117) |  |  | (0.7) % |  | $ | (3,350) |  |  | (2.2) % |  |
| Increase (decrease) in basic and diluted earnings per share |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| $ | 0.20 |  |  |  | $ | 0.73 |  |  |  | $ | (0.02) |  |  |  |  | $ | (0.06) |  |  |  |  |

**Financial Statement Impact – Derivatives**

For a table summarizing the effect of derivative instruments in the consolidated statements of income, including the components of "derivative market value 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.

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**ITEM 4. CONTROLS AND PROCEDURES**

**Disclosure Controls and Procedures**

The Company’s management, with the participation of the Company's principal executive and principal financial officers, evaluated the effectiveness of the Company’s disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) as of March 31, 2019. Based on this evaluation, the Company’s principal executive and principal financial officers concluded that the Company's disclosure controls and procedures were effective as of March 31, 2019.

**Changes in Internal Control over Financial Reporting**

Effective January 1, 2019, the Company implemented ASC Topic 842, *Leases*. As a result, management made the following significant modifications to its internal control over financial reporting environment, including changes to accounting policies and procedures, operational processes, and documentation practices:

1. Updated policies and procedures related to accounting for lease assets and liabilities and related income and expense.
2. Modified contract review controls to consider the new criteria for determining whether a contract is or contains a lease, specifically to clarify the definition of a lease and align with the concept of control.
3. Added controls for reevaluating significant assumptions and judgments regarding leases on a quarterly basis.
4. Added controls to address related required disclosures regarding leases, including significant assumptions and judgments used in applying ASC Topic 842.

There were no other changes in the Company’s internal control over financial reporting during the fiscal quarter ended March 31, 2019 that have materially affected, or are reasonably likely to materially affect, the Company’s internal control over financial reporting.

**PART II. OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

There have been no material changes from the information set forth in the Legal Proceedings section of the Company's Annual Report on Form 10-K for the year ended December 31, 2018 under Item 3 of Part I of such Form 10-K.

**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, 2018 in response to Item 1A of Part I of such Form 10-K.

**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 2019 by the Company or any “affiliated purchaser” of the Company, as defined in Rule 10b-18(a)

1. under the Securities Exchange Act of 1934. Certain share repurchases included the table below were made pursuant to a trading plan adopted by the Company in accordance with Rule 10b5-1 under the Securities Exchange Act of 1934.

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  | **Total number of shares purchased as** |  | **Maximum number of shares that may** |
|  |  | **Total number of shares** | |  | **Average price paid per** | | **part of publicly announced plans or** |  | **yet be purchased under the plans or** |
| **Period** | | **purchased (a)** | |  | **share** | | **programs (b)** |  | **programs (b)** |
|  |  |  |  |  |  |  |  |  |  |
| January 1 - January 31, 2019 | | 57,761 |  | $ | 52.40 |  | 57,630 | 2,247,622 | |
| February 1 - February 28, 2019 | | — | |  | — | | — | 2,247,622 | |
|  |  |  |  |  |  |  |  |  |  |
| March 1 - March 31, 2019 | | 243,566 |  |  | 54.73 |  | 219,597 | 2,028,025 | |
| Total | | 301,327 |  | $ | 54.29 |  | 277,227 |  |  |
|  |  |  |  |  |  |  |  |  |  |

1. The total number of shares includes: (i) shares repurchased pursuant to the stock repurchase program discussed in footnote (b) below; and (ii) shares owned and tendered by employees to satisfy tax withholding obligations upon the vesting of restricted shares. Shares of Class A common stock tendered by employees to satisfy tax withholding obligations included 131 shares, 0 shares, and 23,969

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shares in January, February, and March 2019, respectively. Unless otherwise indicated, shares owned and tendered by employees to satisfy tax withholding obligations were purchased at the closing price of the Company's shares on the date of vesting.

1. On August 4, 2016, the Company announced that its Board of Directors had authorized a stock repurchase program in May 2016 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 25, 2019. On May 8, 2019, the Company announced that its Board of Directors authorized a new 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 7, 2022. The five million shares authorized under the new program include the remaining unrepurchased shares from the prior program, which the new program replaces.

***Working capital and dividend restrictions/limitations***

The Company's $382.5 million unsecured line of credit, which is available through June 22, 2023, imposes restrictions on the payment of dividends through covenants requiring a minimum consolidated net worth and a minimum level of unencumbered cash, cash equivalent investments, and available borrowing capacity under the line of credit. In addition, trust indentures and other financing agreements governing debt issued by the Company's education lending subsidiaries generally have limitations on the amounts of funds that can be transferred to the Company by its subsidiaries through cash dividends at certain times. Further, the payment of dividends by the Company is subject to the terms of the Company's outstanding junior subordinated hybrid securities, which generally provide that if the Company defers interest payments on those securities it cannot pay dividends on its capital stock. These provisions do not currently materially limit the Company's ability to pay dividends, and, based on the Company's current financial condition and recent results of operations, the Company does not currently anticipate that these provisions will materially limit the future payment of dividends.

**ITEM 6. EXHIBITS**

10.1

10.2

[Aircraft Joint Ownership Agreement dated as of January 1, 2019, by and between National Education Loan Network, Inc. and MSD711, LLC, filed as Exhibit 10.43 to the](http://www.sec.gov/Archives/edgar/data/1258602/000125860219000022/aircraftjointownershipag.htm) [registrant's Annual Report on Form 10-K for the year ended December 31, 2018 and incorporated herein by reference.](http://www.sec.gov/Archives/edgar/data/1258602/000125860219000022/aircraftjointownershipag.htm)

[Aircraft Management Agreement, dated as of January 1, 2019, by and between Duncan Aviation, Inc. and National Education Loan Network, Inc. and MSD711, LLC, filed](http://www.sec.gov/Archives/edgar/data/1258602/000125860219000022/flightdepartmentnelnetdu.htm) [as Exhibit 10.44 to the registrant's Annual Report on Form 10-K for the year ended December 31, 2018 and incorporated herein by reference.](http://www.sec.gov/Archives/edgar/data/1258602/000125860219000022/flightdepartmentnelnetdu.htm)

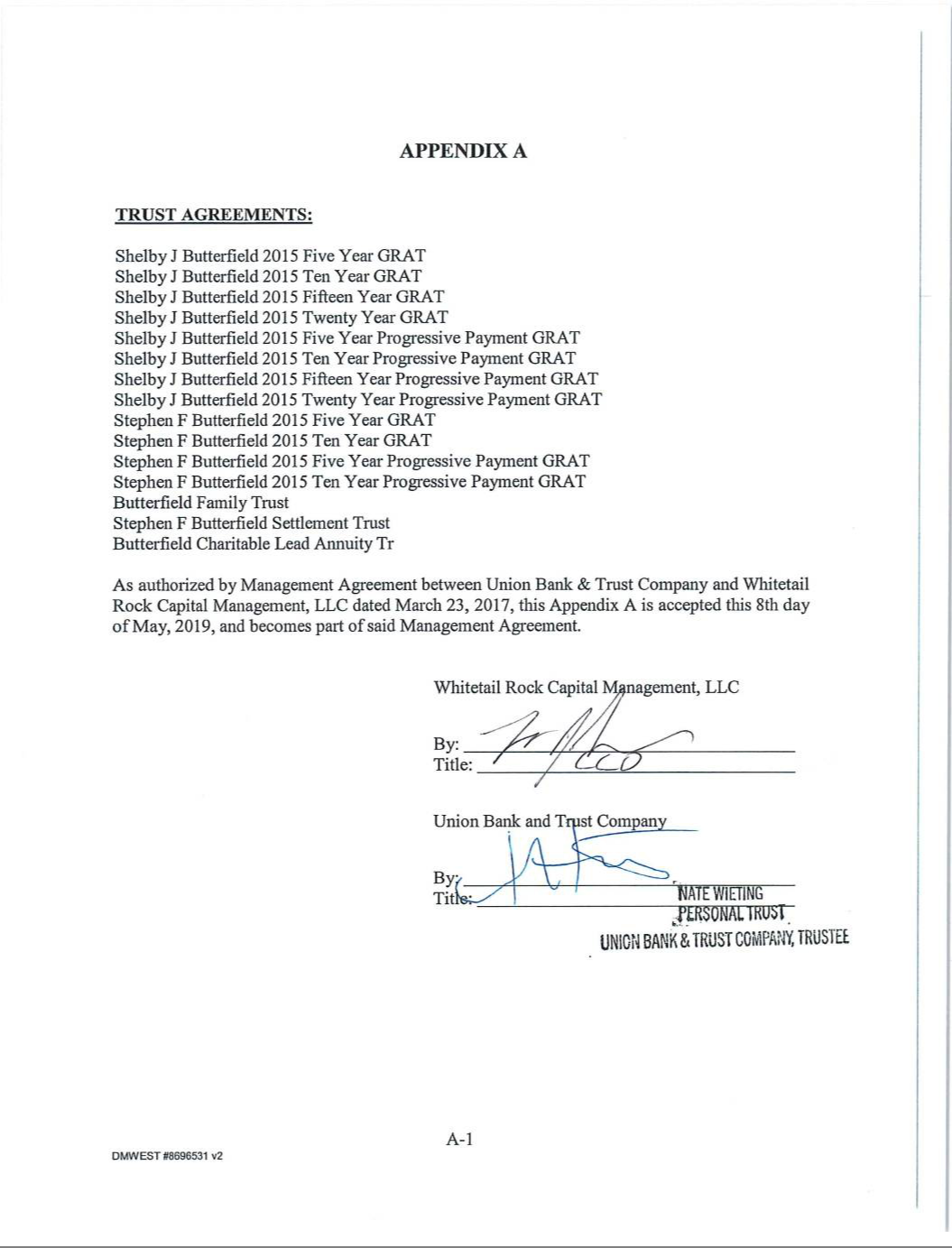
|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| 10.3\* | Amended Appendix A, dated May 8, 2019, to Management Agreement, dated effective as of March 23, 2017, by and between Union Bank and Trust Company and | | | | | |
|  | Whitetail Rock Capital Management, LLC. | | | | |  |
|  |  |  |  |  |  | |
| 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 - the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL 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 |  |  |  |  |  |  |

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**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, 2019 | By: | /s/ JEFFREY R. NOORDHOEK |
|  |  |  |  |
|  |  | Name: | Jeffrey R. Noordhoek |
|  |  | Title: | Chief Executive Officer |
|  |  |  | Principal Executive Officer |
| Date: | May 8, 2019 | By: | /s/ JAMES D. KRUGER |
|  |  |  |  |
|  |  | Name: | James D. Kruger |
|  |  | Title: | Chief Financial Officer |
|  |  |  | Principal Financial Officer and Principal Accounting Officer |
|  |  |  | 60 |



**Exhibit 31.1**

**Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002**

I, Jeffrey R. Noordhoek, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Nelnet, Inc. (the “Company”);
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and

15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

* 1. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  2. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  3. Evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  4. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

1. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
   1. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
   2. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 8, 2019 /s/ JEFFREY R. NOORDHOEK



Jeffrey R. Noordhoek Chief Executive Officer

Principal Executive Officer

**Exhibit 31.2**

**Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002**

I, James D. Kruger, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Nelnet, Inc. (the “Company”);
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and

15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

* 1. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  2. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  3. Evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  4. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

1. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
   1. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
   2. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 8, 2019 /s/ JAMES D. KRUGER

James D. Kruger

Chief Financial Officer

Principal Financial Officer and Principal Accounting Officer

**Exhibit 32**

**Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002**

In connection with the Quarterly Report of Nelnet, Inc. (the “Company”) on Form 10-Q for the quarter ended March 31, 2019 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), we certify pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

|  |  |  |  |
| --- | --- | --- | --- |
| Date: | May 8, 2019 | 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