# NELNET INC

## FORM S-1/A
(Securities Registration Statement)

## Filed 9/30/2003

| | |
|---|---|
| Address | 121 SOUTH 13TH ST STE 201 |
| | LINCONLN, Nebraska 68508 |
| CIK | 0001258602 |
| Industry | Consumer Financial Services |
| Sector | Financial |
| Fiscal Year | 12/31 |

**As filed with the Securities and Exchange Commission on September 30, 2003**
**Registration No. 333-108070**

## SECURITIES AND EXCHANGE COMMISSION
**Washington, DC 20549**

# Pre-Effective Amendment No. 2 to Form S-1
**REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933**

# Nelnet, Inc.
*(Exact name of registrant as specified in its charter)*

| **Nebraska** | **6141** | **84-0748903** |
|---|---|---|
| *(State or other jurisdiction of incorporation or organization)* | *(Primary Standard Industrial Classification Code Number)* | *(I.R.S. Employer Identification No.)* |

**121 South 13th Street, Suite 201**
**Lincoln, Nebraska 68508**
**Telephone: (402) 458-2370**
*(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)*

**Terry J. Heimes**
**Chief Financial Officer**
**Nelnet, Inc.**
**121 South 13th Street, Suite 201**
**Lincoln, Nebraska 68508**
**Telephone: (402) 458-2303**
**Facsimile: (402) 458-2294**
*(Name, address, including zip code, and telephone number, including area code, of agent for service)*

***Copies to:***

| Gerald S. Tanenbaum, Esq. | Daniel F. Kaplan, Esq. | Joseph A. Hall, Esq. |
|---|---|---|
| Cahill Gordon & Reindel LLP | Perry, Guthery, Haase & Gessford, P.C., L.L.O. | Davis Polk & Wardwell |
| 80 Pine Street | 233 South 13th Street, Suite 1400 | 450 Lexington Avenue |
| New York, New York 10005 | Lincoln, Nebraska 68508 | New York, New York 10017 |
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**Approximate date of commencement of proposed sale to the public:** As soon as practicable after the effective date of this registration statement.

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act, check the following box. ☐

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ☐

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ☐

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ☐

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box. ☐

**CALCULATION OF REGISTRATION FEE**

| Title of Each Class of Securities to be Registered | Proposed Maximum Aggregate Offering Price | Amount of Registration Fee(1) |
|---|---|---|
| Class A common stock, par value $0.01 per share | $200,000,000 | $16,180 |

(1) Previously paid.

**The registrant hereby amends this registration statement on such date or dates as may be necessary to delay its effective date until the registrant shall file a further amendment which specifically states that this registration statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act or until the registration statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.**

Subject to completion, dated September 30, 2003

**Prospectus**

# Shares

nelnet

# Class A Common Stock

Nelnet, Inc. is selling all of the shares of Class A common stock in this offering. This is the initial public offering of our Class A common stock. The estimated initial public offering price is between $ and $ per share.

Prior to this offering, there has been no public market for our Class A common stock. We intend to apply for the listing of shares of our Class A common stock on the New York Stock Exchange under the symbol “NNI.”

Each share of Class A common stock has one vote and each share of Class B common stock has ten votes. Following this offering, Michael S. Dunlap and Stephen F. Butterfield, our Co-Chief Executive Officers, and persons related to them will beneficially own Class A and Class B common stock representing % of the combined voting power of our common stock, and will control substantially all matters requiring approval by our shareholders.

**Investing in our Class A common stock involves risks. See “Risk Factors” beginning on page 8.**

| | Per share | Total |
|---|---|---|
| Initial public offering price | $ | $ |
| Underwriting discounts | $ | $ |
| Proceeds to Nelnet, before expenses | $ | $ |

We have granted the underwriters an option for a period of 30 days to purchase up to additional shares of our Class A common stock on the same terms and conditions set forth above to cover overallotments, if any.

**Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or passed upon the adequacy or accuracy of this prospectus. Any representation to the contrary is a criminal offense.**

The underwriters expect to deliver the shares of Class A common stock to investors on , 2003.

*Joint Book-Running Managers*

**JPMorgan** **Banc of America Securities LLC**

**Credit Suisse First Boston** **Morgan Stanley**

, 2003

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You should rely only on the information contained in this prospectus. We have not authorized anyone to provide you with information different from that contained in this prospectus. We are offering to sell, and seeking offers to buy, shares of our Class A common stock only in jurisdictions where offers and sales are permitted. The information contained in this prospectus is accurate only as of the date of this prospectus, regardless of the time of delivery of this prospectus or of any sale of our Class A common stock.

No action is being taken in any jurisdiction outside the United States to permit a public offering of the Class A common stock or possession or distribution of this prospectus in that jurisdiction. Persons who come into possession of this prospectus in jurisdictions outside the United States are required to inform themselves about and to observe any restrictions as to this offering and the distribution of this prospectus applicable to those jurisdictions.

The product and service names and logos used in this prospectus are service marks/trademarks or registered service marks/trademarks of Nelnet or its affiliates. Nelnet, Nconcert, Ntrust, Ngenius, Nteract, Nservice, Nelnet Notes and @theU are service marks of Nelnet, Inc. Other products, services and company names mentioned in this prospectus are the service marks/trademarks of their respective owners.

## PROSPECTUS SUMMARY

*In this prospectus, unless the context requires otherwise, "Nelnet," "we," "us" and "our" refer to Nelnet, Inc., a Nebraska corporation, and its subsidiaries, and not to the underwriters. A detailed description of the Federal Family Education Loan Program appears in Annex A to this prospectus.*

*This summary highlights selected information contained elsewhere in this prospectus. This summary does not contain all the information you should consider before investing in shares of our Class A common stock. You should read this entire prospectus carefully, including "Risk Factors" and our financial statements and the related notes, before making an investment decision.*

### Nelnet, Inc.

We are a vertically integrated education finance company, with over $10 billion in total assets, making us one of the leading education finance companies in the country. We are focused on providing quality products and services to participants in the education finance process. Headquartered in Lincoln, Nebraska, we originate, hold and service student loans, principally loans originated under the Federal Family Education Loan Program, which we refer to as the FFEL Program or FFELP. For 2002, we were the fourth largest holder and second largest servicer of FFELP loans. In addition, we, together with our branding partners, originated and acquired approximately $2.7 billion of FFELP loans in 2002, making us a leading originator and acquirer of FFELP loans.

We offer a broad range of financial services and technology-based products, including student loan origination and lending, student loan and guarantee servicing and a suite of software solutions. Our products are designed to simplify the student loan process by automating financial aid delivery, loan processing and funds disbursement. Our infrastructure, technological expertise and breadth of product and service offerings connect the key constituents of the student loan process, including lenders, financial aid officers, guaranty agencies, governmental agencies, student and parent borrowers, servicers and the capital markets, thereby streamlining the education finance process.

Our business is comprised of four primary product and service offerings:

- ***Student loan originations, acquisitions and portfolio management*** — provides student loan sales, marketing, origination, acquisition and portfolio management.
- ***Student loan servicing*** — provides student loan servicing for our portfolio and for third parties.
- ***Guarantee servicing*** — provides software systems and sub-servicing to guaranty agencies.
- ***Servicing software*** — provides student loan servicing software internally and to third-party student loan holders and servicers.

We originate and acquire student loans through a variety of methods, or channels, including:

- our direct channel, in which we originate student loans in one of our brand names directly to student and parent borrowers, which accounted for 40.7% of the student loans we originated and acquired in 2002;
- our branding partner channel, in which we acquire student loans from lenders to whom we provide marketing and origination services, which accounted for 19.5% of the student loans we originated and acquired in 2002; and
- our forward flow channel, in which we acquire student loans from lenders to whom we provide origination services, but provide no marketing services, or who have agreed to sell loans to us under forward sale commitments, which accounted for 21.7% of the student loans we originated and acquired in 2002.

In addition, we also acquire student loans through spot purchases and whole-company acquisitions, which accounted for 18.1% of the student loans we originated and acquired in 2002.

Of the $2.7 billion in FFELP loans we originated and acquired in 2002, $859 million were loans consolidated through our direct channel. As of June 30, 2003, our student loan portfolio was $9.5 billion.

We currently service $18 billion in student loans, and our software is used by third parties to service an additional $30 billion in student loans. In addition, we currently provide servicing support to guaranty agencies on a total of $18 billion of FFELP loans. Servicing support includes functions such as system software, hardware and telecommunication support, borrower and loan updates, default aversion tracking services, claim processing services and post-default collection services. We provide student loan servicing and origination functions either directly or indirectly to more than 1.7 million borrowers at hundreds of colleges and universities through our proprietary software products and outsourcing functions.

We generate the majority of our earnings from the spread between the yield we receive on our student loan portfolio and the cost of funding these loans. While the spread may vary due to fluctuations in interest rates, government special allowance payments ensure that we receive a minimum yield on our student loans, as long as certain requirements are met. For the year ended December 31, 2002, we generated net interest income of $190.9 million, total other income, including loan servicing income, of $125.8 million and net income of $48.5 million.

The cost of funding our student loan portfolio is determined by the costs of borrowings under our operating lines of credit, secured warehouse financings and asset-backed securitizations. We currently have $65 million in operating lines of credit and a $35 million commercial paper facility. We are also in the process of increasing our operating lines of credit by an additional $30 million. In addition, we have obtained financing through asset-backed commercial paper conduit warehouse programs and the issuance of variable-rate and fixed-rate, taxable and tax-exempt bonds, including asset-backed securities. For the majority of our long-term financing needs, we rely on asset-backed securitization transactions.

We have entered into a series of agreements with Union Bank and Trust Company, or Union Bank, including transactions to sell interests in student loans to Union Bank in its capacity as trustee, to purchase student loans from Union Bank, to provide student loan servicing to Union Bank, to sublease real estate from Union Bank and to provide consulting services to and receive consulting services from Union Bank. Michael S. Dunlap, our Co-Chief Executive Officer, owns an indirect interest in Union Bank and serves as its non-executive chairman. In 2000, 2001, 2002 and the first six months of 2003, approximately 68%, 15%, 14% and 24%, respectively, of the principal amount of the student loans added to our portfolio were acquired from Union Bank as part of our branding partner channel, a portion of which loans were originated by Union Bank and a portion of which were originated by third parties. To the extent Union Bank were to experience problems, it could have a material adverse effect on us.

**Student Loan Industry**

Since the creation of the federal student loan programs, hundreds of billions of dollars in federal student loans have financed the higher education of millions of students at thousands of schools across the United States. More students and families depend on federal student loans to cover the costs of post-secondary education than any other single source of financial aid, and the demand for student loans is expected to grow along with the cost of a college education. According to projections by the U.S. Department of Education, or DOE, annual gross federal student loan volume is expected to increase from $45.4 billion in federal fiscal year 2002 to $71.8 billion in federal fiscal year 2009, excluding consolidation loan volume.

**Competitive Strengths**

The following competitive strengths distinguish us in the education finance industry:

- ***We are a focused leader with a vertically integrated platform.*** We provide school financial aid offices and students with a comprehensive, full-service student lending package (Stafford, PLUS, consolidation and private loans), loan and guarantee servicing and loan servicing software. In doing so, we maintain a strong position and expertise in each of our product and service offerings and are well positioned to capitalize on industry growth.

- ***We have established a high-quality loan portfolio through our concentration on FFELP loans.*** As of June 30, 2003, more than 99% of our student loan portfolio consisted of FFELP loans, which carry at least a 98% federal guarantee on principal and accrued interest.

- ***We enjoy strong relationships with student loan market constituents.*** We have established long-term strategic relationships with school financial aid offices and with eligible lenders that direct committed portions of their originations to us. The effort and cost to establish and maintain these relationships, as well as the low turnover of selected providers, act as a barrier to entry for competitors.

- ***We have benefited from access to cost-effective financings.*** Our $2 billion loan warehousing capacity allows us to pool student loans in order to aggregate sufficient volume for cost-effective long-term financing and to time securitization market conditions effectively. As a result, our securitizations routinely price in line with our largest competitor within the student loan industry.

- ***We have built a leading, cost-competitive servicing platform with a focus on asset protection.*** Our student loan servicing platform, which facilitates interaction with borrowers, is critical to our success as a lender in the student loan marketplace. The quality of our servicing capability is also a key factor in preserving the federal guarantee on our FFELP loans. The quality of our servicing operation is best demonstrated by our low initial claim reject rate due to servicer error, which was 0.25% in 2002.

- ***Our comprehensive suite of software products enables us to carry our brand forward to the key constituents of the student loan market.*** Our products include an Internet-based financial aid delivery and management system, an Internet-based loan origination system and a centralized disbursement agent service. Our “open architecture” origination products afford schools the flexibility to work with multiple lenders.

- ***We are run by a management team with significant operating and acquisition experience.*** Our senior management employees have, on average, been with us or one of our predecessor companies for over ten years. We have a track record of successfully integrating the companies that we have acquired and retaining key employees. As a result, we have a management team with significant experience and knowledge in both student loan operations and portfolio and company acquisitions.

**Strategy**

We intend to achieve our corporate objective of furthering our leadership position in the student loan industry by executing the following strategies:

- ***Establish and maintain leadership in all our product and service offerings by utilizing our technology.*** We believe that our technology solutions position us as a leading provider for the student lending market. We believe the expanded utilization of our technology products by lenders, schools, guaranty agencies and borrowers will promote our student loan originations and acquisitions. We will continue to invest, develop and upgrade our technology to help solidify our leadership position and further penetrate our potential market.

- ***Focus on increasing our organic growth while maintaining a low-cost infrastructure.*** We believe there is continued opportunity for significant growth in light of the DOE’s projected growth rates for the student loan industry. To increase our organic growth, we have expanded our sales and marketing force to promote FFELP loan origination and consolidation efforts. We believe the infrastructure we have developed has positioned us to continue to achieve economies of scale and be a low-cost provider to our customers. In this regard, we decreased our operating expenses as a percentage of average student loans from 0.78% in 1998 to 0.54% in 2002.

- ***Strengthen existing relationships while establishing new ones.*** We have extensive customer relationships with schools and lenders throughout the United States. We will continue to focus on expanding the loan volume associated with these existing relationships, while establishing new ones through our sales force.

- ***Continue our commitment to highly focused and disciplined loan origination and acquisition practices.*** We will continue to pursue our conservative approach to asset quality by concentrating on originating, acquiring and holding federally guaranteed loans through the FFEL Program, while maintaining a disciplined underwriting approach to private loans.

- ***Opportunistically make company and portfolio acquisitions.*** Although we have reached a point in our development where we offer a comprehensive set of products and services essential to our vertically integrated business model, we will still consider acquisitions of both individual companies and loan portfolios that we believe have the potential to enhance long-term shareholder value.

**Items Which Will Affect Future Operating Results**

Our third quarter operating results will reflect compensation expense of $3.9 million related to special bonuses paid to Terry Heimes, our Chief Financial Officer, and Raymond Ciarvella, our Chief Information Officer, as described under “Management — Executive Compensation,” and to four other employees. In addition, in March 2003, we issued 331,800 shares of our Class A common stock to 35 employees for an aggregate consideration of $806,274, or $2.43 per share. In the third quarter of 2003, we will recognize a compensation charge of $ million which is equal to the difference between the initial public offering price of that number of shares and the total price paid by the employees. There will be no net effect on shareholders’ equity as a result of this transaction since additional paid-in capital will be credited by an amount equal to the compensation charge.

**Risk Factors**

You should consider the risks that we face in evaluating an investment in our Class A common stock. Among these risks are:

- potential adverse changes that may be enacted in connection with the reauthorization of the Higher Education Act of 1965, as amended, which together with the regulations thereunder we refer to as the Higher Education Act, which is scheduled to expire in September 2004, or the possibility that this Act may not be reauthorized at all;

- the fact that we operate in a highly competitive industry and compete directly against large and well-financed competitors;

- that our failure to comply with governmental regulations and guaranty agency rules could result in the loss of the federal guarantees of our FFELP loans;

- transactions with affiliates and potential conflicts of interest; and

- that our executive officers, directors and principal shareholders, and our Co-Chief Executive Officers by themselves, own a large percentage of our common stock and will be able to control substantially all corporate decisions, including the election of directors and other matters requiring shareholder approval.

For additional information regarding the risks that we face, see “Risk Factors.”

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Our principal executive offices are located at 121 South 13th Street, Suite 201, Lincoln, Nebraska 68508, and our telephone number is (402) 458-2370. Our web site is *www.nelnet.net* . Information contained on our web site is not a part of this prospectus.

## The Offering

| | |
|---|---|
| Class A common stock offered by Nelnet | shares |
| Common stock to be outstanding after this offering: | |
| Class A common stock | shares |
| Class B common stock | 14,023,454 shares |
| Total | shares |
| Use of proceeds | To originate and acquire student loans, repay $30.0 million of revolving credit indebtedness and for general corporate purposes, including capital expenditures, working capital and possible acquisitions of complementary businesses or assets. See “Use of Proceeds.” |
| Voting rights | Each share of Class A common stock has one vote and each share of Class B common stock has ten votes on all matters to be voted upon by our shareholders. In the event at any time the shares of Class B common stock outstanding constitute less than 50% of the Class B common stock outstanding on the date hereof, each remaining share of Class B common stock outstanding shall automatically be converted into one share of Class A common stock. See “Description of Capital Stock — Common Stock.” |
| Dividend policy | Nelnet does not anticipate paying any cash dividends on its common stock. |
| Proposed New York Stock Exchange symbol | “NNI.” |

Unless specifically stated otherwise, the information in this prospectus:

- assumes no exercise of the underwriters’ overallotment option of shares;
- assumes an initial public offering price of $ per share, the midpoint of the estimated initial public offering price range indicated on the front cover of this prospectus; and
- reflects our recapitalization described below under the heading “Description of Capital Stock — Recapitalization” and a subsequent reduction in the number of authorized shares of Class B common stock.

## Summary Consolidated Financial Data

You should read the summary consolidated financial data set forth below in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our financial statements and the related notes included elsewhere in this prospectus. We derived the financial data as of December 31, 2002 and 2001 and for the years ended December 31, 2002, 2001 and 2000 from our audited financial statements included elsewhere in this prospectus. We derived the financial data as of December 31, 2000 from our audited financial statements not included in this prospectus. We derived the financial data as of June 30, 2003 and for the six months ended June 30, 2003 and 2002 from our unaudited financial statements included elsewhere in this prospectus. Results for interim periods are not necessarily indicative of results to be expected during the remainder of the fiscal year or for any future periods. The as adjusted balance sheet data set forth below have been adjusted to give effect to the sale of shares of our Class A common stock in this offering and the use of $30.0 million of the net proceeds from this offering to repay revolving credit indebtedness. See "Capitalization."

| | Six months ended June 30, | | Year ended December 31, | | |
|---|---|---|---|---|---|
| | 2003 | 2002 | 2002 | 2001 | 2000 |
| | (dollars in thousands, except per share data) | | | | |
| **Income Statement Data:** | | | | | |
| Net interest income | $ 91,923 | $ 116,135 | $ 190,900 | $ 114,565 | $ 64,853 |
| Less provision for loan losses | 4,860 | 2,116 | 5,587 | 3,925 | 1,370 |
| Net interest income after provision for loan losses | 87,063 | 114,019 | 185,313 | 110,640 | 63,483 |
| Loan servicing and other fee income | 48,307 | 54,812 | 103,899 | 93,172 | 66,015 |
| Software services and other income | 9,454 | 9,392 | 21,909 | 7,713 | 8,431 |
| Operating expenses | 114,510 | 115,863 | 229,873 | 191,478 | 126,485 |
| Income before income taxes and minority interest | 30,314 | 62,360 | 81,248 | 20,047 | 11,444 |
| Net income | 17,904 | 37,788 | 48,538 | 7,147 | 4,520 |
| Earnings per share, basic and diluted | $ 0.40 | $ 0.84 | $ 1.08 | $ 0.16 | $ 0.11 |
| Weighted average shares outstanding | 45,010,490 | 44,971,290 | 44,971,290 | 44,331,490 | 41,187,230 |
| **Other Data:** | | | | | |
| Origination and acquisition volume(a) | $ 1,835,954 | $ 1,076,345 | $ 2,665,786 | $ 1,448,607 | $ 1,027,498 |
| Average student loans | $ 9,176,244 | $ 7,887,699 | $ 8,171,898 | $ 5,135,227 | $ 3,388,156 |
| Student loans serviced (at end of period) | $17,866,278 | $17,169,306 | $17,863,210 | $16,585,295 | $11,971,095 |
| **Ratios:** | | | | | |
| Net interest margin(b) | 1.86% | 2.68% | 2.15% | 2.09% | 1.76% |
| Return on average total assets | 0.35% | 0.83% | 0.52% | 0.12% | 0.12% |
| Return on average equity | 29.2% | 80.0% | 46.7% | 11.7% | 8.2% |
| Net loan charge-offs as a percentage of average student loans | 0.068% | 0.028% | 0.047% | 0.042% | 0.055% |

| | As of June 30, 2003 | | As of December 31, | | |
|---|---|---|---|---|---|
| | Actual | As adjusted | 2002 | 2001 | 2000 |
| | | | (in thousands) | | |
| **Balance Sheet Data:** | | | | | |
| Cash and cash equivalents | $ 47,776 | $ | $ 40,155 | $ 36,440 | $ 23,263 |
| Student loan receivables, net | 9,466,523 | | 8,559,420 | 7,423,872 | 3,585,943 |
| Total assets | 10,413,114 | | 9,766,583 | 8,134,560 | 4,021,948 |
| Bonds and notes payable | 10,179,726 | | 9,447,682 | 7,926,362 | 3,934,130 |
| Shareholders' equity | 127,189 | | 109,122 | 63,186 | 54,161 |

(a) Initial loans originated and acquired through various channels, including originations through our direct channel and acquisitions through our branding partner channel, our forward flow channel and the secondary market.

(b) Net interest margin is computed by dividing net interest income by the sum of average student loans and the average balance of other interest earning assets.

# RISK FACTORS

*You should carefully consider the following risk factors and all other information contained in this prospectus before investing in shares of our Class A common stock. Investing in our Class A common stock involves a high degree of risk. If any of the following risks actually occurs, our business, financial condition and results of operations could be materially and adversely affected. In that event, the trading price of our Class A common stock could decline and you may lose part or all of your investment.*

## Risks Related to Our Business and Industry

***Failure to comply with governmental regulations or guaranty agency rules could harm our business.***

Our principal business is comprised of originating, acquiring, holding and servicing student loans made and guaranteed pursuant to the FFEL Program, which was created by the Higher Education Act. Most significant aspects of our lines of business are governed by the Higher Education Act. We are also subject to rules and regulations of the agencies that act as guarantors of the student loans, known as guaranty agencies. In addition, we are subject to certain federal and state banking laws, regulations and examinations.

Our private loan portfolio is also subject to federal and state consumer protection laws and regulations, including state usury laws and related regulations and the Federal Truth in Lending Act. These laws and regulations impose substantial requirements upon lenders and servicers involved in consumer finance. Failure to comply with these laws and regulations could result in our liability to borrowers, the imposition of civil penalties and potential class action suits.

Our failure to comply with any of the regulatory regimes described above may arise from breaches of our internal control systems, technological defects or fraud by our employees or other persons. Such failure to comply, irrespective of the reason, could subject us to loss of the federal guarantee on FFELP loans, costs of curing servicing deficiencies or remedial servicing, suspension or termination of our right to participate in the FFEL Program or to participate as a servicer, negative publicity and potential legal claims or actions brought by our servicing customers and borrowers.

***We must satisfy certain requirements necessary to maintain the federal guarantees of our FFELP loans and we may incur penalties or lose our guarantees if we fail to meet these requirements.***

We must meet various requirements in order to maintain the federal guarantee on our FFELP loans. These requirements establish servicing requirements and procedural guidelines and specify school and borrower eligibility criteria. The federal guarantee on our FFELP loans is conditioned on compliance with origination, servicing and collection standards set by the DOE and guaranty agencies. FFELP loans that are not originated, disbursed or serviced in accordance with DOE regulations risk loss of their guarantee, in full or in part. If we experience a high rate of servicing deficiencies or costs associated with remedial servicing, and if we are unsuccessful in curing such deficiencies, the eventual losses on the loans that are not cured could be material.

A guaranty agency may reject a loan for claim payment due to a violation of FFEL Program due diligence collection and servicing requirements. In addition, a guaranty agency may reject claims under other circumstances, including, for example, if a claim is not timely filed or adequate documentation is not maintained. Once a loan ceases to be guaranteed, it is ineligible for federal interest subsidies and special allowance payments. If a loan is rejected for claim payment by a guaranty agency, we continue to pursue the borrower for payment and/or institute a process to reinstate the guarantee.

Rejections of claims as to portions of interest may be made by guaranty agencies for certain violations of the due diligence collection and servicing requirements, even though the remainder of a claim may be paid. Examples of errors that cause claim rejections include isolated missed collection calls or failures to send collection letters as required.

School eligibility requirements, which include default rate limits, have been implemented by the DOE. In order to maintain eligibility in the FFEL Program, schools must maintain default rates below specified levels, and both guaranty agencies and lenders are required to ensure that loans are made to students attending schools that meet default criteria.

If we fail to comply with any of the above requirements, we could incur penalties or lose the federal guarantee on some or all of our FFELP loans. Our actual loss experience on denied guarantee claims historically has not been material to our operations, but the impact on us could become material if losses were to increase substantially in future periods. During the last three fiscal years, our actual loss on denied guarantee claims did not exceed 0.004%.

***Failure to comply with restrictions on inducements under the Higher Education Act could harm our business.***

The Higher Education Act generally prohibits a lender from providing inducements to educational institutions or individuals in order to secure applicants for FFELP loans. We have entered into various agreements to acquire marketing lists of prospective FFELP loan borrowers from sources such as college alumni associations. We pay to acquire these lists and for the completed applications for loans resulting therefrom. We believe that such arrangements are permissible and do not violate restrictions on inducements, as they fit within a regulatory exception recognized by the DOE for generalized marketing and advertising activities. The DOE has provided informal guidance to us that such arrangements do not raise any improper inducement issues, since such arrangements fall within the generalized marketing exception. If the DOE were to change its position, this could hurt our reputation and could potentially result in the DOE imposing sanctions on us. These sanctions could negatively impact our business.

***Possible changes in legislation and regulations could have a negative impact upon our business.***

Pursuant to the terms of the Higher Education Act, the FFEL Program is periodically amended, and the Higher Education Act must be reauthorized by Congress every five years in order to prevent sunset of that Act. Changes in the Higher Education Act made in the two most recent reauthorizations have included reductions in student loan yields paid to lenders, increased fees paid by lenders and a decreased level of federal guarantee. Future changes could result in further negative impacts on our business. Moreover, there can be no assurance that the provisions of the Higher Education Act, which is scheduled to expire on September 30, 2004, will be reauthorized. While Congress has consistently extended the effective date of the Higher Education Act, it may elect not to reauthorize the DOE’s ability to provide interest subsidies, special allowance payments and federal guarantees for student loans. Such a failure to reauthorize would reduce the number of federally guaranteed student loans available for us to originate and/or acquire in the future and would materially adversely affect us.

In addition, funds for payment of interest subsidies and other payments under the FFEL Program are subject to annual budgetary appropriation by Congress. In recent years, federal budget legislation has contained provisions that have restricted payments made under the FFEL Program to achieve reductions in federal spending. Future legislation may adversely affect expenditures by the DOE and the financial condition of guaranty agencies.

Efforts are underway to pass legislation which would permit borrowers holding consolidation loans made under the Higher Education Act to refinance their loans under the FFEL Program multiple times, rather than only once, which would open approximately 39% of our student loan portfolio to further refinancing. Similar legislation may also abolish the so-called single holder rule, which restricts the ability of other lenders to consolidate student loans away from a lender that owns all of a particular borrower’s loans. This would put approximately one-third of our non-consolidated portfolio at risk of being consolidated away by our competitors. In addition, if legislation is enacted to allow variable-rate consolidation loans or to extend the term of Stafford loans, we may experience a decrease in our consolidation loan opportunities. Accordingly, any of these legislative changes could have a material adverse impact upon us. In addition, the DOE oversees and implements the Higher Education Act and periodically issues regulations and interpretations of that Act. Changes in such regulations and interpretations could negatively impact our business.

***Market risks to which we are subject may have an adverse impact upon our business and operations.***

Our primary market risk exposure arises from fluctuations in our borrowing and lending rates, the spread between which could be impacted by shifts in market interest rates. The borrower rates on our FFELP loans are generally reset by the DOE each July 1st based on a formula determined by the date of the origination of the loan, with the exception of rates on consolidation loans which are fixed to term. The interest rate we actually receive on our FFELP loans is the greater of the borrower rate and a rate determined by a formula based on a spread to either the 91-day Treasury Bill index or the 90-day commercial paper index, depending on when the loans were originated and the current repayment status of the loans.

We issue asset-backed securities, both fixed- and variable-rate, to fund our student loan assets. The variable-rate debt is generally indexed to 90-day LIBOR or set by auction. The income generated by our student loan assets is generally driven by different short-term indices than our liabilities, which creates interest rate risk for us. We have historically borne this risk internally through the net spread on our portfolio while continuing to monitor our interest rate risk.

***Our derivative instruments may not be successful in managing our interest rate risks.***

When we utilize derivative instruments, we utilize them to manage our interest rate sensitivity. Although we do not use derivative instruments for speculative purposes, our derivative instruments may not qualify for hedge accounting. The derivative instruments we use are typically in the form of interest rate swaps and interest rate caps. Interest rate swaps effectively change variable-rate debt obligations either to fixed-rate debt obligations or to variable-rate debt obligations based on a different index. Interest rate caps effectively limit the maximum interest on variable-rate debt obligations. Developing an effective strategy for dealing with movements in interest rates is complex, and no strategy can completely insulate us from risks associated with such fluctuations. In addition, a counterparty to a derivative instrument could default on its obligation thereby exposing us to credit risk. Further, we may have to repay certain costs, such as transaction fees or brokerage costs, if a derivative instrument is terminated by us. Finally, our interest rate risk management activities could expose us to substantial losses if interest rates move materially differently from our expectations. As a result, we cannot assure you that our economic hedging activities will effectively manage our interest rate sensitivity or have the desired beneficial impact on our results of operations or financial condition.

During 2001, we entered into an interest rate swap arrangement with a notional amount of $500 million. This swap was adjusted to fair value in our statements of income, resulting in a $3.0 million loss in 2001 and a $579,000 gain in 2002. This swap expired in June 2002. We did not enter into any derivative instruments in 2002. In the third quarter of 2003, we entered into various interest rate swap agreements, a basis swap and a cap contract with an aggregate notional amount of $3.5 billion.

***Liquidity risks inherent in our funding needs pose risks to us.***

We are subject to the risk that we may be unable to meet financial commitments to creditors, branding partners, forward flow lenders or borrowers when due. Our primary funding needs are those required to finance our student loan portfolio and satisfy our cash requirements for new student loan originations and acquisitions, operating expenses and technological development.

We rely upon conduit warehouse loan financing vehicles to support our funding needs on a short-term basis. There can be no assurance that we will be able to maintain such warehouse financing in the future. We currently have four such conduit facilities in place, with various maturity dates. Currently, the aggregate short-term commitment amount from our conduit lenders is over $2 billion. There can be no assurance that we will be able to maintain such conduit facilities, find alternative funding or increase the commitment level of such facilities, if necessary. The term of each conduit facility is less than one year, and each facility is renewable at the option of the lender and may be terminated at any time for cause. While our conduit facilities have historically been renewed for successive terms, there can be no assurance that this will continue in the future.

In addition, we rely upon securitization vehicles as our most significant source of funding for student loans on a long-term basis. The net cash flow we receive from the securitized student loans generally represents the excess amounts, if any, generated by the underlying student loans over the amounts required to be paid to the bondholders, after deducting servicing fees and any other expenses relating to the securitizations. In addition, some of the residual interests in these securitizations have been pledged to secure additional bond obligations. Our rights to cash flow from securitized student loans are subordinate to bondholder interests and these loans may fail to generate any cash flow beyond what is due to pay bondholders.

The interest rates on certain of our asset-backed securities are set and periodically reset via a “dutch auction” utilizing remarketing agents. Investors and potential investors submit orders through a broker-dealer as to the principal amount of notes they wish to buy, hold or sell at various interest rates. The broker-dealers submit their clients’ orders to the auction agent or remarketing agent, who determines the interest rate for the upcoming period. If there are insufficient potential bid orders to purchase all of the notes offered for sale or being repriced, we could be subject to interest costs substantially above the anticipated and historical rates paid on these types of securities. A failed auction or remarketing could also reduce the investor base of our other financing and debt instruments.

***Future losses due to defaults on loans held by us present credit risk which could adversely affect our earnings.***

More than 99% of our student loan portfolio as of June 30, 2003 was comprised of FFELP loans. These loans benefit from a federal guarantee of between 98% and 100% of their principal balance and accrued interest. We bear full risk of losses experienced with respect to the unguaranteed portion of the student loans.

Losses on our private loans will be borne by us, with the exception of certain privately insured loans. Privately insured loans constitute a minority of our private loan portfolio. The loan loss pattern on our private loan portfolio is not as developed as that on our FFELP loan portfolio. As of June 30, 2003, the aggregate principal balance of private loans comprised less than 1% of our entire student loan portfolio; however, it is expected to increase to between 1% and 2% over the next three years. There can be no assurance that this percentage will not further increase over the long term.

The performance of student loans in our portfolio is affected by the economy, and a prolonged economic downturn may have an adverse effect on the credit performance of these loans. While we have provided allowances estimated to cover losses that may be experienced in both our student loans that are federally guaranteed under the FFEL Program as well as our private loan portfolio, there can be no assurance that such allowances will be sufficient to cover actual losses in the future.

***We could experience cash flow problems if a guaranty agency defaults on its guarantee obligation.***

A deterioration in the financial status of a guaranty agency and its ability to honor guarantee claims on defaulted student loans could result in a failure of that guaranty agency to make its guarantee payments in a timely manner, if at all. The financial condition of a guaranty agency can be adversely affected if it submits a large number of reimbursement claims to the DOE, which results in a reduction of the amount of reimbursement that the DOE is obligated to pay the guaranty agency. The DOE may also require a guaranty agency to return its reserve funds to the DOE upon a finding that the reserves are unnecessary for the guaranty agency to pay its FFELP expenses or to serve the best interests of the FFEL Program.

If the DOE has determined that a guaranty agency is unable to meet its guarantee obligations, the loan holder may submit claims directly to the DOE, and the DOE is required to pay the full guarantee claim. However, the DOE’s obligation to pay guarantee claims directly in this fashion is contingent upon the DOE making the determination that a guaranty agency is unable to meet its guarantee obligations. The DOE may not ever make this determination with respect to a guaranty agency and, even if the DOE does make this determination, payment of the guarantee claims may not be made in a timely manner, which could result in our experiencing cash shortfalls.

***Failure of counterparties to perform under credit enhancement agreements could harm our business.***

In connection with our securitizations and issuances of debt, we periodically utilize credit enhancements or other support agreements such as letters of credit, bond insurance and interest rate swap agreements. We cannot assure performance of the counterparties to these various agreements, and failure of such counterparties to perform their obligations under these agreements could impair the viability of our underlying debt or securitization structures, which in turn could adversely impact our results of operations and financial condition.

***Competition created by the Federal Direct Loan Program and from other lenders and servicers may adversely impact our business.***

In 1992, Congress created the William D. Ford Federal Direct Loan Program, which we refer to as the FDL Program or the FDLP. Under the FDL Program, the DOE makes loans directly to student borrowers through the educational institutions they attend. The volume of student loans made under the FFEL Program and available for us to originate or acquire may be reduced to the extent loans are made to students under the FDL Program. In addition, if the FDL Program expands, to the extent the volume of loans serviced by us is reduced, we may experience reduced economies of scale, which could adversely affect our earnings. Loan volume reductions could further reduce amounts received by the guaranty agencies available to pay claims on defaulted student loans.

In the FFELP market, we face significant competition from SLM Corporation, the parent company of Sallie Mae. SLM Corporation services nearly half of all outstanding FFELP loans and is the largest holder of student loans, with a portfolio of approximately $70 billion. We also face intense competition from other existing lenders and servicers. As we expand our student loan origination and acquisition activities, that expansion may result in increased competition with some of our servicing customers. This has in the past resulted in servicing customers terminating their contractual relationships with us, and we could in the future lose more servicing customers as a result. As we seek to further expand our business, we will face numerous other competitors, many of which will be well established in the markets we seek to penetrate. Some of our competitors are much larger than we are, have better name recognition than we do and have greater financial and other resources than we do. In addition, several of our competitors have large market capitalizations or cash reserves and are better positioned to acquire companies or portfolios in order to gain market share than we are. Furthermore, many of the institutions with which we compete have significantly more equity relative to their asset bases than we do. Consequently, such competitors may have more flexibility to address the risks inherent in the student loan business. Finally, some of our competitors are tax-exempt organizations which do not pay federal or state income taxes and which generally receive floor income on certain tax-exempt obligations on a greater percentage of their student loan portfolio than we do because they have financed a greater percentage of their student loans with tax-exempt obligations issued prior to October 1, 1993 than we have. These factors could give our competitors a strategic advantage.

***Higher rates of prepayments of student loans could reduce our profits.***

Pursuant to the Higher Education Act, borrowers may prepay loans made under the FFEL Program at any time. Prepayments may result from consolidating student loans, which tends to occur more frequently in low interest rate environments, from borrower defaults, which will result in the receipt of a guarantee payment, and from voluntary full or partial prepayments, among other things. High prepayment rates will have the most impact on our asset-backed securitization transactions priced in relation to LIBOR. At December 31, 2002, we had two transactions outstanding totaling approximately $2.0 billion which had experienced cumulative prepayment rates of 14.3% and 15.9%, respectively. At June 30, 2003, we had three transactions outstanding totaling approximately $2.6 billion which had experienced cumulative prepayment rates of 18.3% to 19.1%, respectively. The rate of prepayments of student loans may be influenced by a variety of economic, social and other factors affecting borrowers, including interest rates and the availability of alternative financing. Our profits could be adversely affected by higher prepayments, which would reduce the amount of interest we receive and expose us to reinvestment risk.

***Increases in consolidation loan activity by us and our competitors present a risk to our loan portfolio and profitability.***

Our portfolio of FFELP loans is subject to refinancing through the use of consolidation loans, which are expressly permitted by the Higher Education Act. Consolidation loan activity may result in three detrimental effects on us. First, when we consolidate loans already held by us, the new consolidation loans have a lower yield than the loans being refinanced due to the statutorily mandated consolidation loan rebate fee of 1.05% per year. Although consolidation loans generally feature higher average balances, longer average lives and slightly higher special allowance payments, such attributes may not be sufficient to counterbalance the cost of the rebate fees. Second, and more significantly, we may lose student loans in our portfolio that are consolidated away by competing lenders. In prior years, our competitors consolidated away more student loans from us than we consolidated away from our competitors. Increased consolidations of student loans away from us by our competitors may result in a negative return on loans, when considering the origination costs or acquisition premiums paid with respect to these loans. Additionally, consolidation of loans away from us can result in a decrease of our servicing portfolio, thereby decreasing fee-based servicing income. Third, increased consolidations by us of our own student loans create cash flow risk because we incur upfront consolidation costs, which are in addition to the origination or acquisition costs we incurred in connection with the underlying student loans, while extending the repayment schedule of the consolidated loans.

***The volume of available student loans may decrease in the future and may adversely affect our income.***

Our student loan originations generally are limited to students attending eligible educational institutions in the United States. Volumes of originations are greater at some schools than others, and our ability to remain an active lender at a particular school with concentrated volumes is subject to a variety of risks, including the fact that each school has the option to remove us from its “preferred lender” list or to add other lenders to its “preferred lender” list, the risk that a school may enter the FDL Program or the risk that a school may begin making student loans itself. We acquire student loans through forward flow commitments with other student loan lenders, but each of these commitments has a finite term. There can be no assurance that these lenders will renew or extend their existing forward flow commitments on terms that are favorable to us, if at all, following their expiration.

In addition, as of June 30, 2003, approximately 54% of the loans we serviced were owned by third parties. To the extent that our third-party servicing clients reduce the volume of student loans that we process on their behalf, our income would be reduced, and, to the extent the related costs could not be reduced correspondingly, our net income could be materially adversely affected. Such volume reductions occur for a variety of reasons, including if our third-party servicing clients commence or increase internal servicing activities, shift volume to another service provider, perhaps because such other service provider does not compete with the client in student loan originations and acquisitions or exit the FFEL Program completely.

***Special allowance payments on student loans originated or acquired with the proceeds of certain tax-exempt obligations may limit the interest rate on certain student loans to our detriment.***

Student loans originated or acquired with the proceeds of tax-exempt obligations issued prior to October 1, 1993, as well as student loans acquired with the sale proceeds of those student loans, receive only a portion of the special allowance payment which they would otherwise be entitled to receive, but are guaranteed a minimum rate of return of 9.5% per year, less the applicable interest rate for the student loan.

A portion of our student loan portfolio is comprised of loans which have been previously financed with the proceeds of tax-exempt obligations issued prior to October 1, 1993. Based upon provisions of the

Higher Education Act and related interpretations by the DOE, we believe that, for each of these student loans, we will receive partial special allowance payments, subject to the 9.5% minimum rate of return. However, the DOE may change its regulations or its interpretations of existing regulations, or the Higher Education Act may be amended, to eliminate this special allowance payment treatment. In this event, we would receive regular special allowance payments, but with no minimum rate of return.

In the current low interest rate environment, we generally receive partial special allowance payments and the minimum 9.5% rate of return with respect to our eligible student loans originated or acquired with qualifying tax-exempt proceeds. In a higher interest rate environment, however, the regular special allowance payments on loans not originated or acquired with qualifying tax-exempt proceeds may exceed the total subsidy to holders of eligible loans originated or acquired with qualifying tax-exempt proceeds. Thus, in a higher interest rate environment, these loans could have an adverse effect upon our earnings. For further information regarding special allowance payments, see “Industry Overview — Student Loan Business Model.”

***Failures in our information technology system could materially disrupt our business.***

Our servicing and operating processes are highly dependent upon our information technology system infrastructure, and we face the risk of business disruption if failures in our information systems occur, which could have a material impact upon our business and operations. We depend heavily on our own computer-based data processing systems in servicing both our own student loans and those of third-party servicing customers. On January 1, 2002, we converted the great majority of the student loans we service to a computer hardware and software platform developed and maintained by an affiliated company. In November 2002, we converted our remaining approximately $3 billion of student loans to this same computer hardware and software platform. Problems or errors of which we are not currently aware may have occurred in connection with this conversion, and problems or errors may occur in the future in connection with the conversion of newly originated and acquired loans to our platform. If servicing errors do occur, they may result in a loss of the federal guarantee on the FFELP loans that we service or in a failure to collect amounts due on the student loans that we service. In addition, although we regularly back up our data and believe that we have taken sufficient precautions to protect our information systems, a major physical disaster or other calamity that causes significant damage to our offices or our systems would adversely affect our business.

***Transactions with affiliates and potential conflicts of interest pose risks to our shareholders.***

We have entered into certain contractual arrangements with entities controlled by Michael S. Dunlap, our Chairman and Co-Chief Executive Officer and one of our principal shareholders, and members of his family and, to a lesser extent, with entities in which other directors and members of management hold equity interests or board or management positions. Such arrangements constitute a significant portion of our business and include, among other things:

- performance of servicing duties;
- sales of student loans by such affiliates to us; and
- sales of student loan origination rights by such affiliates to us.

These arrangements may present potential conflicts of interest.

Many of these arrangements are with Union Bank and Trust Company, or Union Bank, in which Michael S. Dunlap owns an indirect interest and of which he serves as non-executive chairman. Union Bank is a significant source of student loans to us and a significant servicing customer of ours.

In 2002 and the first six months of 2003, approximately 14% and 24%, respectively, of the principal amount of the student loans added to our portfolio were acquired from Union Bank, a portion of which loans were originated by Union Bank and portion of which were originated by third parties. We believe that the acquisitions were made on terms similar to those made from unrelated entities. We intend to maintain our relationship with Union Bank, which we believe provides substantial benefits to us, although there can be no assurance that all transactions in which we engage with Union Bank are, or in the future will be, on terms that are no less favorable than we could obtain from an unrelated third party. For information on affiliated transactions, see "Related Party Transactions."

***Material problems affecting Union Bank could have a material adverse effect on us.***

The ability of Union Bank to continue to do business with us will depend on the development of Union Bank's own business, financial condition and results of operations, which will be affected by competitive and other factors beyond our control or knowledge. Because Union Bank is a privately held company, an investor in our Class A common stock might have little advance warning of problems affecting Union Bank, even though these problems could have a material adverse effect on us. For further information regarding affiliated transactions, see "Related Party Transactions."

***Imposition of personal holding company tax would decrease our net income.***

A corporation is considered to be a "personal holding company" under the U.S. Internal Revenue Code of 1986, as amended, which we refer to as the Code, if at least 60% of its adjusted ordinary gross income is "personal holding company income" (generally, passive income) and at any time during the last half of the taxable year more than half, by value, of its stock is owned by five or fewer individuals, as determined under attribution rules of the Code. A personal holding company is subject to an additional tax on its undistributed personal holding company income, currently at a 15% rate. Before this offering, more than half the value of our stock was held by five or fewer individuals, and immediately after this offering, we expect that this will continue to be the case. We believe that we can avoid current personal holding company tax through intercompany distributions, and we expect to be able to manage our exposure to this tax for the next two years in this manner. However, it is possible that thereafter more than 60% of our adjusted ordinary gross income could be classified as personal holding company income. If that were to occur, and if more than half of our value continued to be held by five or fewer individuals, we could become subject to the personal holding company tax. We have submitted a request for a private letter ruling from the Internal Revenue Service seeking a determination that our interest and fee income arising from federally guaranteed student loans does not constitute personal holding company income. If the Internal Revenue Service grants our request, we expect that we will not be subject to the personal holding company tax. If the Internal Revenue Service does not grant our request, and if there is a likelihood that we would incur personal holding company tax, then we and our controlling shareholder, Michael S. Dunlap, have agreed to take such steps as are necessary to avoid imposition of the tax by ensuring that more than half the value of our stock is not owned by five or fewer individuals. These steps could include the conversion by Mr. Dunlap of shares of Class B common stock that he owns into Class A common stock, divestitures of common stock by Mr. Dunlap and public offerings of newly issued shares of common stock. If Mr. Dunlap or we were to fail to take these steps, or fail to take them in a timely manner, then we could become subject to personal holding company tax in the future.

***"Do not call" registries may limit our ability to market our products and services.***

Our direct marketing operations are or may become subject to various federal and state "do not call" list requirements. The Federal Trade Commission has recently amended its rules to provide for a national "do not call" registry. Under these new federal regulations, which are currently being challenged in court, consumers may have their phone numbers added to the national "do not call" registry. Generally, we will be prohibited from calling anyone on that registry. In September 2003, telemarketers will have access to the registry and will be required to compare their call lists against the national "do not call" registry at least once every 90 days. We also will be required to pay a fee to access the registry on a quarterly basis. Enforcement of the "do not call" provisions will begin in the fall of 2003, and the rule provides for fines of up to $11,000 per violation and other possible penalties. This rule may restrict our ability to market effectively our products and services to new customers. Furthermore, compliance with this new rule may prove difficult, and we may incur penalties for improperly conducting our marketing activities.

***Our inability to maintain our relationships with significant branding partners and/or customers could have an adverse impact on our business.***

Our inability to maintain strong relationships with significant schools, branding partners, servicing customers, guaranty agencies and software licensees could result in loss of:

- loan origination volume with borrowers' attending certain schools;

- loan origination volume generated by some of our branding partners;

- loan and guarantee servicing volume generated by some of our loan servicing customers and guaranty agencies; and

- software licensing volume generated by some of our licensees.

Loss of a strong relationship, like those with significant branding partners such as Union Bank or with schools such as the University of Phoenix or Nova Southeastern University, could result in a material adverse effect on our business.

**Risks Related to This Offering**

***Our stock price may be volatile and your investment could decline in value.***

The market price of our Class A common stock may be volatile and subject to wide fluctuations in response to various factors, including:

- regulatory or other changes in, and public concern or opinion as to, federal student loan programs;

- actual or anticipated variations in our quarterly operating results;

- changes in our financial estimates by securities analysts;

- conditions or trends in our industry;

- additions or departures of key personnel;

- the loss of a significant student loan seller or servicing customer;

- announcements by us or our competitors of significant acquisitions, strategic partnerships, joint ventures or capital commitments; and

- economic and political factors.

In addition, the stock markets have experienced significant price and volume fluctuations that have often been unrelated or disproportionate to operating performance. These broad market fluctuations may seriously harm the market price of our Class A common stock, regardless of our operating performance. In the past, following periods of volatility in the market price of a company's securities, securities class action litigation has often been instituted. A securities class action suit brought against us could result in potential liabilities, substantial costs and diversion of our management's attention and resources, regardless of whether we win or lose.

***There may not be an active, liquid trading market for our Class A common stock.***

Prior to this offering, there has been no public market for our Class A common stock. An active, liquid trading market for our Class A common stock may not develop or be maintained following this offering. As a result, you may not be able to sell your shares of our Class A common stock quickly or at the market price. The initial public offering price of our Class A common stock is determined by negotiation between us and the representatives of the underwriters based upon a number of factors and may not be indicative of market prices that will prevail following the completion of this offering. The market price of our Class A common stock may decline below the initial public offering price, and you may not be able to resell your shares of our Class A common stock at or above the initial public offering price.

***Future sales of our Class A common stock may depress our stock price.***

The market price of our Class A common stock could decline as a result of sales of substantial amounts of our Class A common stock in the public market after this offering, or the perception that these sales could occur. In addition, these factors could make it more difficult for us to raise funds through future equity offerings. There will be shares of our Class A common stock and 14,023,454 shares of our Class B common stock, which are convertible on a one-for-one basis into shares of Class A common stock, outstanding immediately after this offering.

All of the shares of our Class A common stock sold in this offering will be freely transferable by persons other than our affiliates without restriction or further registration under the Securities Act of 1933. All or substantially all of the remaining shares of our Class A common stock, including shares of Class A common stock issued upon conversion of shares of Class B common stock, will be eligible for sale in the public market pursuant to Rule 144 under the Securities Act of 1933, subject to 180-day lock-up agreements with the underwriters and to our share retention policy. See “Description of Capital Stock — Share Retention Policy” and “Shares Eligible for Future Sale — Sales of Restricted Shares” and “— Lock-up Agreements.”

We and our executive officers and directors and all of our shareholders have entered into 180-day lock-up agreements with the underwriters. The lock-up agreements prohibit each of us from selling or otherwise disposing of shares of common stock except in limited circumstances. The lock-up agreements are only contractual agreements, and J.P. Morgan Securities Inc. and Banc of America Securities LLC, at their discretion, can waive the restrictions of any lock-up agreement at an earlier time without prior notice or announcement and allow any of us to sell shares of common stock. If the restrictions in the lock-up agreement are waived, shares of our Class A common stock will be available for sale into the public market, subject to applicable securities laws and our share retention policy, which could reduce the market price for shares of our Class A common stock. Our share retention policy prevents, subject to some exceptions, our officers or the officers of any of our direct or indirect subsidiaries at or above the level of executive director, defined for purposes of this policy as Executives, from selling or otherwise disposing of a number of shares of common stock in any calendar year in excess of one-third of the number of shares of common stock beneficially owned by such Executive on the first day of the calendar year. See “Description of Capital Stock — Share Retention Policy” and “Shares Eligible for Future Sale — Sales of Restricted Shares.”

Michael S. Dunlap, Stephen F. Butterfield and persons related to them and trusts in which they have beneficial interests have the right, subject to limitations, to make two written demands of Nelnet for registration with the Securities and Exchange Commission of all or part of their common stock. These shareholders also have piggyback registration rights for their common stock following the consummation of this offering. See “Description of Capital Stock — Registration Rights.”

***You will experience immediate and substantial dilution as a result of this offering.***

You will pay a price per share that substantially exceeds the per share value of our tangible assets after subtracting our total liabilities. As a result, if we were to distribute our net tangible assets to our shareholders immediately following this offering, you would receive less than the amount you paid for your shares of our Class A common stock. See “Dilution.”

***Our executive officers, directors and principal shareholders own a large percentage of our common stock and will be able to control substantially all corporate decisions.***

Immediately after this offering, our executive officers, directors and principal shareholders will beneficially own, in the aggregate, % of our outstanding Class A common stock, and Michael S. Dunlap and Stephen F. Butterfield, our Co-Chief Executive Officers, and persons related to them will beneficially own Class A and Class B common stock representing % of the combined voting power of our common stock. Each share of Class A common stock has one vote and each share of Class B common stock has ten votes on all matters to be voted upon by our shareholders. As a result, our executive officers, directors and principal shareholders, as a group, and Messrs. Dunlap and Butterfield, by themselves, will be able to control substantially all matters requiring approval by our shareholders, including the election of all directors, and they may do so in a manner with which you may not agree or which may not be in the best interest of other shareholders. See “Description of Capital Stock — Common Stock.”

***Our management will have broad discretion in the use of net proceeds from this offering and may not use them effectively.***

As of the date of this prospectus, we cannot specify with certainty the amounts we will spend on particular uses from the net proceeds that we will receive from this offering. Our management will have broad discretion in the application of these net proceeds, but currently intends to use them as described in “Use of Proceeds.” The failure by our management to apply these net proceeds effectively could adversely affect our ability to continue to develop our business.

***Provisions of our charter and by-laws and Nebraska law may inhibit a takeover, which could negatively affect our stock price.***

Provisions of our charter and by-laws could discourage potential acquisition proposals or make it more difficult for a third party to acquire control of us. These provisions include, among others, the authority of our board of directors to create and issue rights entitling the holders thereof to purchase our securities or the securities of any other corporation. In addition, we are subject to the provisions of the Nebraska Shareholders Protection Act, an anti-takeover law, which may also dissuade a potential acquiror of our common stock. These provisions may make it more difficult or expensive for a third party to acquire a majority of our outstanding voting stock or may delay, prevent or deter a merger, acquisition, tender offer or proxy contest, which may negatively affect our stock price. See “Description of Capital Stock — Nebraska Anti-takeover Law and Certain Charter and By-law Provisions.”

## FORWARD-LOOKING STATEMENTS

This prospectus contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. The forward-looking statements are contained principally in the sections entitled “Prospectus Summary,” “Risk Factors,” “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and “Business.” In some cases, you can identify forward-looking statements by terminology such as “may,” “will,” “should,” “could,” “would,” “expect,” “plan,” “anticipate,” “believe,” “estimate,” “project,” “predict,” “intend,” “potential” or the negative of such terms or other similar expressions.

The forward-looking statements reflect our current expectations and views about future events. The forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by the forward-looking statements. Given these risks and uncertainties, you should not place undue reliance on the forward-looking statements.

You should understand that the following factors, among other things, could cause our results to differ materially from those expressed in forward-looking statements:

- changes in terms of student loans and the educational credit marketplace arising from the implementation of applicable laws and regulations and from changes in these laws and regulations that may reduce the volume, average term, costs and yields on education loans under the FFEL Program or for non-FFELP loans or result in loans being originated or refinanced under non-FFEL programs or affect the terms upon which banks and others agree to sell FFELP loans to us;

- changes in the demand for educational financing or in financing preferences of educational institutions, students and their families, which could reduce demand for our products and services or increase our costs; and

- changes in the general interest rate environment and in the securitization markets for education loans, which could increase the costs or limit the availability of financings necessary to originate, purchase or carry education loans or expose us to losses on our derivative instruments.

We discuss many of these risks and uncertainties in greater detail under the heading “Risk Factors.”

You should read this prospectus and the documents that we reference in this prospectus and have filed as exhibits to the registration statement, of which this prospectus is part, completely and with the understanding that our actual future results may be materially different from what we expect. We may not update the forward-looking statements, even though our situation may change in the future, unless we have obligations under the federal securities laws to update and disclose material developments related to previously disclosed information. We qualify all of the forward-looking statements by these cautionary statements.

## USE OF PROCEEDS

Our net proceeds from this offering are estimated to be $ million, or $ million if the underwriters' overallotment option is exercised in full, after deducting the underwriting discounts and estimated offering expenses that we will pay.

We intend to use the net proceeds from this offering to originate and acquire student loans, to repay $30.0 million of indebtedness outstanding under our credit facility with Bank of America, N.A., an affiliate of Banc of America Securities LLC, and for general corporate purposes, including capital expenditures, working capital and possible acquisitions complementary to our business. The indebtedness to be repaid is revolving credit indebtedness that currently bears interest at an annual rate of 4.0% and matures on January 23, 2005. The proceeds of the indebtedness to be repaid were used to finance our 2001 acquisition of EFS, Inc., an Indiana student loan servicing and secondary market company. We currently have no agreements or understandings with respect to any material acquisition.

The foregoing uses of the net proceeds from this offering represent our current intentions based upon our present plans and business condition. We retain broad discretion in the allocation and use of the net proceeds of this offering and a change in our plans or business condition could result in the application of the net proceeds from this offering in a manner other than as described in this prospectus. Pending the uses described above, we intend to invest the net proceeds from this offering in our student loan portfolio and/or short-term, investment grade securities.

## DIVIDEND POLICY

We have not declared or paid dividends on our capital stock during 2001, 2002 or 2003 and do not intend to pay any cash dividends on our common stock. Any future determination to pay dividends will be at the discretion of our board of directors and will depend on our financial condition, results of operations, capital requirements and other factors that our board of directors may deem relevant.

## CAPITALIZATION

The following table sets forth our cash and cash equivalents and our capitalization as of June 30, 2003:

- on an actual basis; and
- on an as adjusted basis to give effect to (i) the sale of shares of our Class A common stock in this offering, (ii) the use of $30.0 million of the net proceeds from this offering to repay revolving credit indebtedness and (iii) a non-cash compensation charge as described below.

You should read this table in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our financial statements and the related notes included elsewhere in this prospectus.

| | As of June 30, 2003 | |
|---|---|---|
| | Actual | As adjusted |
| | (in thousands, except share data) | |
| Cash and cash equivalents | $ 47,776 | $ |
| Bonds and notes payable | $10,179,726 | $10,149,726 |
| Shareholders' equity: | | |
| Preferred stock, $0.01 par value: | | |
| 50,000,000 shares authorized; no shares issued or outstanding actual or as adjusted | — | — |
| Class A common stock, $0.01 par value: | | |
| 600,000,000 shares authorized; 31,015,034 shares issued and outstanding actual and as adjusted | 310 | |
| Class B common stock, $0.01 par value: | | |
| 15,000,000 shares authorized; 14,023,454 shares issued and outstanding actual and as adjusted | 140 | 140 |
| Additional paid-in capital | 48,832 | |
| Retained earnings | 77,907 | |
| Total shareholders' equity | 127,189 | |
| Total capitalization | $10,306,915 | $ |

In March 2003, we issued 331,800 shares of our Class A common stock to 35 employees for an aggregate consideration of $806,274. In the third quarter of 2003, we will recognize a compensation charge of $ million, which is equal to the difference between the initial public offering price of that number of shares and the total price paid by the employees. In the table above, retained earnings has been debited by the amount of such compensation charge, and additional paid-in capital has been credited by an equal amount; consequently, this transaction will result in no net effect on shareholders' equity.

## DILUTION

If you invest in our Class A common stock, your interest will be diluted to the extent of the difference between the initial public offering price per share of our Class A common stock and the pro forma net tangible book value per share of our common stock after this offering.

Our net tangible book value as of June 30, 2003 was approximately $112.9 million, or $2.51 per share of common stock. Net tangible book value per share represents total tangible assets less total liabilities, divided by the number of shares of common stock outstanding. After giving effect to the issuance and sale of shares of our Class A common stock in this offering, and after deducting the underwriting discounts and estimated offering expenses that we will pay, our pro forma net tangible book value as of June 30, 2003 would have been approximately $ million, or $ per share of common stock. This represents an immediate increase in net tangible book value of $ per share to existing shareholders and an immediate dilution of $ per share to new investors purchasing shares of Class A common stock in this offering.

The following table illustrates this dilution:

| | | |
|---|---|---|
| Assumed initial public offering price per share | | $ |
| Net tangible book value per share as of June 30, 2003 | $2.51 | |
| Increase per share attributable to this offering | $ | |
| Pro forma net tangible book value per share after this offering | | $ |
| Dilution per share to new investors | | $ |

The following table summarizes, as of June 30, 2003, on a pro forma basis, the total number of shares of common stock acquired from us for cash (in one case for cash and services) during the past five years by existing shareholders and the total consideration received by us and the average price per share paid by them and by new investors purchasing shares of Class A common stock in this offering, before deducting the underwriting discounts and estimated offering expenses that we will pay:

| | Shares purchased | | Total consideration | | Average price per share |
|---|---|---|---|---|---|
| | Number | Percent of total shares | Amount | Percent | |
| Existing shareholders purchasing shares in the past five years | | % | $ | % | $ |
| New investors | | % | | % | $ |
| Totals | | % | $ | 100.0% | $ |

## SELECTED CONSOLIDATED FINANCIAL DATA

You should read the selected consolidated financial data set forth below in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our financial statements and the related notes included elsewhere in this prospectus. We derived the financial data as of December 31, 2002 and 2001 and for the years ended December 31, 2002, 2001 and 2000 from our audited financial statements included elsewhere in this prospectus. We derived the financial data as of December 31, 2000, 1999 and 1998 and for the years ended December 31, 1999 and 1998 from our audited financial statements not included in this prospectus. We derived the financial data as of June 30, 2003 and for the six months ended June 30, 2003 and 2002 from our unaudited financial statements included elsewhere in this prospectus; and such unaudited interim financial statements reflect all material adjustments, consisting only of normal recurring accruals, which, in the opinion of management, are necessary for a fair presentation. Results for interim periods are not necessarily indicative of results to be expected during the remainder of the fiscal year or for any future periods.

| | Six months ended June 30, | | Year ended December 31, | | | | |
|---|---|---|---|---|---|---|---|
| | 2003 | 2002 | 2002 | 2001 | 2000 | 1999 | 1998 |
| | (dollars in thousands, except per share data) | | | | | | |
| **Income Statement Data:** | | | | | | | |
| Net interest income | $ 91,923 | $ 116,135 | $ 190,900 | $ 114,565 | $ 64,853 | $ 59,538 | $ 19,855 |
| Less provision for loan losses | 4,860 | 2,116 | 5,587 | 3,925 | 1,370 | 1,800 | 899 |
| Net interest income after provision for loan losses | 87,063 | 114,019 | 185,313 | 110,640 | 63,483 | 57,738 | 18,956 |
| Loan servicing and other fee income | 48,307 | 54,812 | 103,899 | 93,172 | 66,015 | — | — |
| Software services and other income | 9,454 | 9,392 | 21,909 | 7,713 | 8,431 | 5,387 | 7,506 |
| Operating expenses | 114,510 | 115,863 | 229,873 | 191,478 | 126,485 | 47,417 | 22,086 |
| Income before income taxes and minority interest | 30,314 | 62,360 | 81,248 | 20,047 | 11,444 | 15,708 | 4,376 |
| Net income | 17,904 | 37,788 | 48,538 | 7,147 | 4,520 | 9,671 | 2,879 |
| Earnings per share, basic and diluted | $ 0.40 | $ 0.84 | $ 1.08 | $ 0.16 | $ 0.11 | $ 0.42 | $ 0.14 |
| Weighted average shares outstanding | 45,010,490 | 44,971,290 | 44,971,290 | 44,331,490 | 41,187,230 | 22,863,444 | 21,000,000 |
| **Other Data:** | | | | | | | |
| Origination and acquisition volume(a) | $ 1,835,954 | $ 1,076,345 | $ 2,665,786 | $ 1,448,607 | $ 1,027,498 | $ 2,015,263 | $ 700,317 |
| Average student loans | $ 9,176,244 | $ 7,887,699 | $ 8,171,898 | $ 5,135,227 | $ 3,388,156 | $ 1,750,097 | $ 1,147,842 |
| Student loans serviced (at end of period) | $17,866,278 | $17,169,306 | $17,863,210 | $16,585,295 | $11,971,095 | $ — | $ — |
| **Ratios:** | | | | | | | |
| Net interest margin(b) | 1.86% | 2.68% | 2.15% | 2.09% | 1.76% | 2.60% | 1.24% |
| Return on average total assets | 0.35% | 0.83% | 0.52% | 0.12% | 0.12% | 0.32% | 0.21% |
| Return on average equity | 29.2% | 80.0% | 46.7% | 11.7% | 8.2% | 99.6% | 109.2% |
| Net loan charge-offs as a percentage of average student loans | 0.068% | 0.028% | 0.047% | 0.042% | 0.055% | 0.033% | 0.022% |

| | As of June 30, 2003 | As of December 31, | | | | |
|---|---|---|---|---|---|---|
| | | 2002 | 2001 | 2000 | 1999 | 1998 |
| | (in thousands) | | | | | |
| **Balance Sheet Data:** | | | | | | |
| Cash and cash equivalents | $ 47,776 | $ 40,155 | $ 36,440 | $ 23,263 | $ 26,497 | $ 11,636 |
| Student loan receivables, net | 9,466,523 | 8,559,420 | 7,423,872 | 3,585,943 | 2,989,985 | 1,814,625 |
| Total assets | 10,413,114 | 9,766,583 | 8,134,560 | 4,021,948 | 3,302,098 | 2,739,605 |
| Bonds and notes payable | 10,179,726 | 9,447,682 | 7,926,362 | 3,934,130 | 3,265,532 | 2,718,705 |
| Shareholders' equity | 127,189 | 109,122 | 63,186 | 54,161 | 15,380 | 4,038 |

(a) Initial loans originated and acquired through various channels, including originations through our direct channel and acquisitions through our branding partner channel, our forward flow channel and the secondary market.

(b) Net interest margin is computed by dividing net interest income by the sum of average student loans and the average balance of other interest earning assets.

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

*You should read the following discussion and analysis by our management of our financial condition and results of operations in conjunction with our "Selected Consolidated Financial Data" and our financial statements and the related notes included elsewhere in this prospectus.*

### Overview

We are a vertically integrated education finance company, with over $10 billion in total assets, making us one of the leading education finance companies in the country. We are focused on providing quality products and services to participants in the education finance process. Headquartered in Lincoln, Nebraska, we originate, hold and service student loans, principally loans originated under the Federal Family Education Loan Program. For 2002, we were the fourth largest holder and second largest servicer of FFELP loans. In addition, we, together with our branding partners, originated and acquired approximately $2.7 billion of FFELP loans in 2002, making us a leading originator and acquirer of FFELP loans.

Our business is comprised of four primary product and service offerings:

- ***Student loan originations, acquisitions and portfolio management.*** We provide student loan sales, marketing, originations, acquisition and portfolio management. We own a large portfolio of student loan assets through a series of education lending subsidiaries. As of June 30, 2003, our student loan portfolio was $9.5 billion, consisting of over 99% of FFELP loans and less than 1% of private loans. We generate loans owned in special purpose lending facilities through direct origination or through acquisition of loans. We generate the majority of our earnings from the spread between the yield we earn on our student loan portfolio and the cost of funding these loans. We also provide marketing and sales support and managerial and administrative support related to our asset generation activities, as well as those performed for our branding partners or other lenders who sell us loans. Revenues are primarily generated from interest earnings. While our net interest margin may vary due to fluctuations in interest rates, government special allowance payments ensure that we receive a minimum yield on our student loans, so long as certain requirements are met.

- ***Student loan servicing.*** We service our student loan portfolio and the portfolios of third parties. We currently service or provide complete outsourcing of servicing activities for $18 billion in student loans, including approximately $8.3 billion of loans in our own portfolio. The servicing activities provided include loan origination activities, application processing, borrower updates, payment processing, claim processing and due diligence procedures. These activities are performed internally for our own portfolio in addition to generating fee revenue when performed for third-party clients.

- ***Guarantee servicing.*** We provide servicing support to guaranty agencies, which includes system software, hardware and telecommunication support, borrower and loan updates, default aversion tracking services, claim processing services and post-default collection services. We currently provide servicing support to agencies that guarantee $18 billion of FFELP loans. These activities generate fee revenue in addition to expanding our relationship with other participants in the education finance sector.

- ***Servicing software.*** We provide student loan servicing software internally and to third-party student loan holders and servicers. In addition to the $18 billion in student loans which we service directly, our software products are used to service an additional $30 billion in student loans. We earn software license and maintenance fees annually from third-party clients for use of this software. We also provide computer consulting, custom software applications and customer service support.

Our student loan portfolio has grown significantly through origination and acquisition. With the development of our fully integrated platform, we are positioned for sustained organic growth. We originated and acquired $2.7 billion in student loans during 2002 through various channels, including:

- our direct channel, in which we originate student loans in one of our brand names directly to student and parent borrowers, which accounted for 40.7% of the student loans we originated and acquired in 2002;

- our branding partner channel, in which we acquire student loans from lenders to whom we provide marketing and origination services, which accounted for 19.5% of the student loans we originated and acquired in 2002; and

- our forward flow channel, in which we acquire student loans from lenders to whom we provide origination services, but provide no marketing services, or who have agreed to sell loans to us under forward sale commitments, which accounted for 21.7% of the student loans we originated and acquired in 2002.

In addition, we also acquire student loans through spot purchases and whole-company acquisitions, which accounted for 18.1% of student loans that we originated and acquired in 2002. We have increased our student loan portfolio by $5.7 billion over the last two and a half years, including $2.9 billion of loans acquired in subsidiary acquisitions.

In addition to our portfolio and asset growth, our net income has also grown significantly in recent years, increasing $41.4 million, or more than 500%, for the year ended December 31, 2002 as compared to the prior year. Our primary source of income is interest earned on our portfolio. If our portfolio continues to grow and our net interest margin remains relatively stable, we expect our net interest income and net income also to continue to increase. Interest income, and to a certain extent our net income, is also dependent upon the relative level of interest rates. While we expect our portfolio and interest earning assets to continue to grow, which should cause interest income and earnings growth, we do not expect to continue to grow at historical levels. Net income for 2002 included approximately $49.8 million of variable rate floor income. Variable rate floor income, as defined further in “Net Interest Income” below, occurs in certain declining interest rate environments, and we cannot predict whether these interest rate environments will occur in the future. We generally do not anticipate receiving or plan to receive variable rate floor income.

We have positioned ourself for growth by building a strong foundation through mergers and acquisitions of related and unrelated entities. Although our assets and loan portfolios increased through these transactions, a key aspect of each transaction was its impact on our prospective organic growth and the development of our integrated platform of services. As a result of our rapid growth, the development of our platform and changes in operations, period-to-period comparability of our results of operations may be difficult. The following are the significant acquisitions that we have made since 2000:

- We acquired the operations of UNIPAC Service Corporation, a related entity, in March 2000, which added servicing operations and growth potential.

- We added the servicing and origination operations of InTuition Holdings, Inc. in June 2000, which expanded our presence in the southeastern United States.

- We acquired MELMAC, Inc., a Maine student loan company, in January 2001, which increased our FFELP portfolio by $424 million, and increased our presence on the East Coast.

- We acquired GuaranTec, LLP in June 2001, which expanded our products and services through the addition of guarantee servicing.

- We acquired EFS, Inc. in December 2001, which increased our origination opportunities in the Midwest, increased our loan servicing operations and added $2.5 billion to our FFELP portfolio.

- We acquired Idaho Financial Associates, Inc. in January 2002 and Charter Account Systems, Inc. in May 2002, which further secured and expanded our product suite through proven and tested loan servicing software products.

Our earnings and earnings growth are directly affected by the size of our portfolio of student loans, the interest rate characteristics of our portfolio, the costs associated with financing and managing our portfolio and the costs associated with the origination and acquisition of the student loans in the portfolio. See “Liquidity and Capital Resources — Student Loan Portfolio.”

***Net Interest Income***

We generate the majority of our earnings from the spread between the yield we receive on our portfolio of student loans and the cost of funding these loans. This spread income is reported on our income statement as net interest income. The amortization and write-offs of premiums or discounts, including capitalized costs of origination, the consolidation loan rebate fee and yield adjustments from borrower benefit programs are netted against loan interest income on our income statement. The amortization and write-offs of bond issuance costs are included in interest expense on our income statement.

Our portfolio of FFELP loans generally earns interest at the higher of a variable rate based on the special allowance payment, or SAP, formula set by the DOE, and the borrower rate, which is fixed over a period of time. The SAP formula is based on an applicable index plus a fixed spread that is dependent upon when the loan was originated and the loan’s repayment status. Depending on the type of student loan and when the loan was originated, the borrower rate is either fixed to term or is reset to a market rate each July 1. Loans that reset annually on each July 1 can generate excess spread income as compared to the rate based on the SAP formula in certain declining interest rate environments. We refer to this additional income as variable rate floor income, and it is included in loan interest income. Variable rate floor income can occur when interest rates decline, generally by more than 50 basis points, for an extended period of time following the annual reset of the borrower rates on July 1 of each year. If interest rates decline sufficiently after the borrower rate is set, we earn interest at the fixed borrower rate through the next reset period. Since the rates are reset annually, we view these earnings as temporary. Our ability to earn variable rate floor income in future periods is dependent upon the interest rate environment following the annual reset of borrower rates and would generally only occur in a falling interest rate environment.

On those FFELP loans with fixed to term borrower rates, primarily consolidation loans, we earn interest at the greater of the borrower rate or a variable rate based on the SAP formula. Since we finance the majority of our student loan portfolio with variable-rate debt, we may earn excess spread on these loans for an extended period of time.

On most consolidation loans, we must pay a 1.05% per year rebate fee to the DOE. Those consolidation loans which have variable interest rates based on the SAP formula earn a yield less than that of a Stafford loan. Those consolidation loans which have fixed interest rates less than the sum of 1.05% and the variable rate based on the SAP formula also earn a yield less than that of a Stafford loan. As a result, as consolidation loans matching these criteria become a larger portion of our loan portfolio, there will be a lower yield on our loan portfolio in the short term. However, due to the extended terms of consolidation loans, we expect to earn the yield on these loans for a longer duration, making them beneficial to us in the long term.

A portion of our FFELP loan portfolio, with an outstanding balance of $925.2 million as of June 30, 2003, is comprised of loans which were previously financed with tax-exempt obligations issued prior to October 1, 1993. Based upon provisions of the Higher Education Act and related interpretations by the DOE, we believe that we may be entitled to receive special allowance payments on these loans providing us with a 9.5% minimum rate of return. To date, we have not recognized interest income generated by these loans based on the 9.5% minimum rate of return. We have asked the DOE to confirm that we are allowed to recognize the income based on the 9.5% minimum rate of return. We have deferred recognition of this excess interest income pending satisfactory resolution of this issue. As of June 30, 2003, the amount of excess interest income deferred totaled approximately $5.9 million. Since we did not refinance loans with the aforementioned tax-exempt obligations until 2003, all of this deferred income was recorded this year.

Investment interest income includes income from unrestricted interest-earning deposits and funds in our special purpose entities for our asset-backed securitizations.

***Provision for Loan Losses***

We maintain an allowance for loan losses associated with our student loan portfolio at a level that is based on the performance characteristics of the underlying loans. We analyze the allowance separately for our FFELP loans and our private loans.

The loan loss allowance attributable to FFELP loans consists of two components: a risk sharing reserve and a reserve for rejected guaranty agency claim losses, caused mainly by servicing defects. The risk sharing reserve is an estimate based on the amount of loans subject to the 2% risk sharing and on the historical experience of losses. The rejected claim loss reserve is based on the historical trend of ultimate losses on loans initially rejected for reimbursement by guaranty agencies. FFELP loans are guaranteed as to both principal and interest and, therefore, continue to accrue interest until the time they are paid by the guaranty agency. Once a FFELP loan is rejected for claim payment, our policy is to continue to pursue recovery of principal and interest, whether by curing the reject or collecting from the borrower. We attempt to cure the rejected claims through our collection efforts. As of June 30, 2003, we had an allowance for loan losses on FFELP loans aggregating approximately $10.3 million.

In determining the private loan loss allowance, we divide the portfolio into various categories, such as the type of program, loan status and months into repayment. We then estimate defaults based on the borrowers' credit profiles, net of estimated recoveries. We place a private loan on non-accrual status and charge off the loan when the collection of principal and interest is 120 days past due. We utilize this data to estimate the amount of losses in the portfolio, net of subsequent collections, that are probable of occurrence. As of June 30, 2003, we had an allowance for loan losses on private loans of approximately $3.5 million.

The evaluation of the provision for loan losses is inherently subjective, as it requires material estimates that may be subject to significant changes. The provision for loan losses reflects the activity for the applicable period and provides an allowance at a level which our management believes is adequate to cover probable losses inherent in the loan portfolio.

***Other Income***

We also earn fees and generate income from other sources, including principally loan servicing, guarantee servicing and licensing fees on our software products. Loan servicing fees are determined according to individual agreements with customers and are calculated based on the dollar value or number of loans or accounts serviced for each customer. Guarantee servicing fees are earned as a result of our providing system software, hardware and telecommunication support, borrower and loan updates, default aversion tracking services, claim processing services and post-default collection services to guaranty agencies. Guarantee servicing fees are calculated based on the number of loans serviced or amounts collected. Software services income includes software license and maintenance fees associated with student loan software products as well as certain loan marketing fees. We also charge borrowers fees on certain private loans, both at origination and when the loan enters repayment, which help to compensate for anticipated loan losses. In addition, we earn fee income on some of our securitization transactions through UFS Securities, LLC, or UFS Securities, our wholly owned broker-dealer, which effectively decreases our costs associated with accessing this market. UFS Securities sells certain tranches of our auction rate securities in a co-broker dealer arrangement with certain third-party broker-dealers. UFS Securities is paid the same amount of fees as the third-party broker-dealers for selling the auction rate securities. Since UFS Securities, which was acquired in August 2003, is our wholly owned subsidiary, these sales and the fees received for the sales by our wholly owned subsidiary will have the effect of reducing our overall costs on the sales of our auction rate securities.

As we expand our student loan origination and acquisition activities, we may face increased competition with some of our servicing customers. In the past, including in one case in 2003, servicing customers have terminated their servicing relationships with us. Furthermore, we could in the future lose more servicing customers as a result of such increased competition. However, the vast majority of our servicing agreements provide for life-of-loan servicing of the existing loans, and, as such, we do not expect this loss or the potential future loss of customers to have a material adverse effect on our results of operations for the foreseeable future.

One of our guarantee servicing customers recently notified us of its intention not to renew its servicing contract. The loss of this customer is not expected to have a material effect on our results of operations due to the relative portion of our earnings attributable to guarantee servicing revenue and the size of the individual customer.

The income and revenues provided through our servicing software operations have increased in recent years with the acquisitions of Idaho Financial Associates, Inc. and Charter Account Systems, Inc. To the extent that our servicing software license and maintenance revenues continue to increase, we believe that such increase will primarily come from our existing customer base.

***Operating Expenses***

Operating expenses include costs incurred to manage and administer our student loan portfolio and our financing transactions, costs incurred to generate and acquire student loans and general and administrative expenses, which include corporate overhead. Operating expenses also include amortization of intangible assets related to acquisitions.

***Other Significant Drivers***

In addition to the impact of growth of our student loan portfolio, our results of operations and financial condition may be materially affected by, among other things, changes in:

- applicable laws and regulations that may affect the volume or terms of education loans;
- demand for education financing and competition within the student loan industry;
- the interest rate environment, funding spreads on our financing programs and access to capital markets;
- prepayment rates on student loans, including prepayments relating to loan consolidation; and
- acquisition costs of student loan assets.

See “Risk Factors” for more information on the impact of these factors on our results of operations and financial condition.

**Results of Operations**

***Six months ended June 30, 2003 compared to six months ended June 30, 2002***

*Net interest income.* Loan interest income decreased by $37.3 million, or 16.9%, during the six months ended June 30, 2003 as compared to the comparable period in 2002. This decrease was the result of changes in the interest rate environment, in the pricing characteristics of our student loan assets and in the size of our student loan portfolio. Lower interest rates in the six months ended June 30, 2003 caused a decrease in the average net yield on our student loan portfolio to 4.01% from 5.61% for the comparable period in 2002. Variable rate floor income decreased approximately $34.4 million to approximately $12.7 million for the six months ended June 30, 2003 from approximately $47.0 million for the comparable period in 2002, due to the timing and relative change in interest rates during the periods. The weighted average interest rate on our student loan portfolio decreased during the six months ended June 30, 2003 due to the lower interest rates, together with the addition of lower yielding consolidation loans. The lower weighted average loan interest rate resulted in a reduction in loan interest income of approximately

$26.8 million. Consolidation loan activity also increased the amortization and write-offs of acquisition costs, reducing loan interest income an additional approximately $9.1 million during the six months ended June 30, 2003. The reduction in loan interest income resulting from the decline in interest rates and reduction in variable rate floor income was partially offset by an increase in our portfolio of student loans. The average student loan portfolio increased by approximately $1.3 billion, or 16.3%, for the six months ended June 30, 2003 as compared to the comparable period in 2002, which increased loan interest income by approximately $32.8 million for the six months ended June 30, 2003 as compared to the comparable period in 2002.

Interest expense on bonds and notes payable decreased $12.7 million, or 11.1%, for the six months ended June 30, 2003 as compared to the comparable period in 2002. This decrease occurred despite a increase in average total debt of approximately $1.2 billion, specifically an increase in average variable-rate debt of $1.3 billion, which increased interest expense by approximately $9.9 million. The reduction in interest rates, specifically LIBOR and auction rates, decreased our average cost of funds to 2.02% in the six months ended June 30, 2003 from 2.57% in the six months ended June 30, 2002. As a result, interest expense decreased approximately $20.8 million for the six months ended June 30, 2003 as compared to the comparable period in 2002. We reduced average fixed-rate debt by $148.8 million during the six months ended June 30, 2003, which decreased our overall interest expense by approximately $4.5 million as compared to the comparable period in 2002. Interest expense on bonds and notes payable for the six months ended June 30, 2003 includes additional amortization and write-offs of bond issuance costs of $2.6 million incurred as a result of refinancing certain debt transactions.

As a result of the foregoing, net interest income decreased by $24.2 million, or 20.8%, for the six months ended June 30, 2003 as compared to the comparable period in 2002. Our net interest margin decreased to 1.86% for the six months ended June 30, 2003 from 2.68% for the comparable period in 2002. Net interest income, excluding the effects of variable rate floor income of $12.7 million for the six months ended June 30, 2003 and $47.0 million for the comparable period in 2002, increased approximately $10.1 million to approximately $79.2 million for the six months ended June 30, 2003 from approximately $69.1 million for the comparable period in 2002.

*Provision for loan losses.* The provision for loan losses for FFELP loans increased to $1.7 million for the six months ended June 30, 2003 from $1.5 million for the comparable period in 2002. The provision for loan losses for private loans increased to $3.2 million for the six months ended June 30, 2003 from $650,000 for the comparable period in 2002. This increase was due to a specific provision of approximately $2.2 million for an identified pool of private loans based on aging, delinquency and performance. This pool of private loans is limited to loans made to borrowers attending a single school, and, in early 2002, we ceased making private loans to borrowers attending that school. The remaining combined increase of approximately $500,000 was due to the increase in the size of our FFELP and private loan portfolios. Approximately 8.1% of our private loans was delinquent as of June 30, 2003.

*Other income.* Total other income decreased $6.4 million, or 10.0%, during the six months ended June 30, 2003 as compared to the comparable period in 2002. Loan servicing and other fee income decreased $6.5 million, or 11.9%, and software services and other income increased $62,000, or 0.7%, during the six months ended June 30, 2003 as compared to the comparable period in 2002.

Loan servicing and other fee income decreased due to the reduction in the number and dollar amount of loans we serviced for third parties. See “Business — Product and Service Offerings — Student Loan Servicing.” Total third-party loan servicing volume decreased $906.3 million, or 8.6%, during the six months ended June 30, 2003 as compared to the comparable period in 2002. This resulted in a decrease in loan servicing income of approximately $7.9 million during the six months ended June 30, 2003 as compared to the comparable period in 2002. This decrease in income was offset by an increase of $2.5 million of guarantee servicing income during the six months ended June 30, 2003 due to higher guarantee volume.

Software services and other income increased due to the acquisitions of Charter Account Systems, Inc. in May 2002 and Idaho Financial Associates, Inc. in January 2002. The operation of these businesses for the six months ended June 30, 2003 resulted in an increase in income of approximately $3.0 million. In addition, late fee income on borrower payments increased $1.6 million during the six months ended June 30, 2003 as compared to the comparable period in 2002. These increases were offset by a $4.4 million decrease in income earned on a marketing contract which was terminated in the fourth quarter of 2002.

*Operating expenses.* Total operating expenses decreased $1.4 million, or 1.2%, during the six months ended June 30, 2003 as compared to the comparable period in 2002. Salaries and benefits decreased $2.3 million, or 3.9%, and total other expenses increased $988,000, or 1.7%, during the six months ended June 30, 2003 as compared to the comparable period in 2002. The decrease in salaries and benefits can be attributed to a decline in the number of employees in the six months ended June 30, 2003 compared to the comparable period in 2002.

The net increase in total other expenses can be attributed to an increase of $1.0 million in the depreciation and amortization of furniture, equipment and leasehold improvements in the six months ended June 30, 2003 as compared to the comparable period in 2002. This increase was offset by a decrease in the amortization of intangible assets of $3.2 million due to certain intangible assets having been fully amortized in 2002. Trustee and other debt related fees increased $2.3 million, or 28.2%, during the six months ended June 30, 2003 as compared to the comparable period in 2002 as a result of a $1.2 billion increase in average total debt outstanding. Occupancy and communications expense increased $1.2 million, or 21.4%, during the six months ended June 30, 2003 as compared to the comparable period in 2002 as a result of increased telemarketing activities related to consolidation loan originations. Advertising and marketing expenses decreased $2.7 million, or 36.0%, during the six months ended June 30, 2003 as compared to the comparable period in 2002 due to $2.4 million expense incurred on a large marketing contract that was terminated in the fourth quarter of 2002. Professional services increased $1.2 million, or 37.5%, during the six months ended June 30, 2003 as compared to the comparable period in 2002 as a result of outsourcing select borrower payment processing activities in the second quarter of 2002. Consulting fees and support services to related parties decreased $500,000, or 15.6%, during the six months ended June 30, 2003 as compared to the comparable period in 2002 as a result of a $1.1 million decrease in consulting fees due to the termination of a large consulting agreement in December 2002. This decrease was offset by a $600,000 increase in consulting fees to a shareholder during the six months ended June 30, 2003 as compared to the comparable period in 2002 due to the early termination of this agreement in June 2003. Postage and distribution expenses increased $1.8 million, or 35.1%, during the six months ended June 30, 2003 as compared to the comparable period in 2002 due to an increase in mass mailings to promote origination of Stafford and consolidation loans.

*Income tax expense.* Income tax expense decreased to $12.5 million for the six months ended June 30, 2003 from $24.6 million for the comparable period in 2002, due to the decrease in income before income taxes. Our effective tax rate was 41.3% for the six months ended June 30, 2003 as compared to 39.5% for the comparable period in 2002. The increase in the effective rate was a result of acquisitions that gave rise to amortization of intangible assets for financial statement purposes that was not deductible for tax purposes.

*Net income.* Net income decreased to $17.9 million for the six months ended June 30, 2003 from $37.8 million for the comparable period in 2002, for the reasons discussed above.

***Year ended December 31, 2002 compared to year ended December 31, 2001***

*Net interest income.* Loan interest income increased by $86.7 million, or 27.2%, for 2002 as compared to 2001. This increase was the result of changes in the interest rate environment, in the pricing characteristics of our student loan assets and in the size of our student loan portfolio. Lower interest rates in 2002 caused a decrease in the average net yield on our student loan portfolio to 4.96% in 2002 from 6.20% in 2001. Variable rate floor income increased approximately $19.9 million to approximately $49.8 million for

2002 from approximately $29.9 million for 2001, due to the timing and relative change in interest rates during the periods. The weighted average interest rate on our student loan portfolio decreased in 2002 due to the lower interest rates, together with the addition of lower yielding consolidation loans. The lower weighted average loan interest rate resulted in a reduction in loan interest income of approximately $65.2 million. Consolidation loan activity also increased the amortization and write-offs of acquisition costs, reducing loan interest income an additional approximately $40.4 million in 2002. The reduction in loan interest income resulting from the decline in interest rates and the reduction in variable rate floor income was partially offset by an increase in our portfolio of student loans. The average student loan portfolio increased by approximately $3.0 billion, or 59.1%, for 2002 as compared to 2001, which increased loan interest income by approximately $192.1 million for 2002 as compared to 2001, including the increase related to variable rate floor income.

Investment interest income increased $4.0 million, or 23.6%, for 2002 as compared to 2001, due to an approximately $360.1 million increase in average investment and interest-earning deposits during 2002.

Interest expense on bonds and notes payable increased $14.3 million, or 6.5%, for 2002 as compared to 2001. Average variable-rate debt increased $4.1 billion, which resulted in an increase in interest expense of $85.9 million. The reduction in short-term interest rates, specifically LIBOR, decreased our average cost of funds to 2.59% in 2002 from 3.95% in 2001. As a result, interest expense decreased approximately $83.1 million in 2002 as compared to 2001. We increased average fixed-rate debt by $199.9 million during 2002, which increased our overall interest expense by approximately $12.0 million as compared to 2001. In 2002, we first accessed the term securitization market. While the interest expense associated with term securitizations is less than that associated with our other debt instruments, the incremental benefit in 2002 was negligible. While we expect that we will continue to access the term securitization markets, we cannot predict whether the benefits of our accessing those markets will be material to our results of operations in future periods.

As a result of the foregoing, net interest income increased by $76.3 million, or 66.6%, for 2002 as compared to 2001. Our net interest margin increased to 2.15% for 2002 from 2.09% for 2001. Net interest income, excluding the effects of variable rate floor income of $49.8 million for 2002 and $29.9 million for 2001, increased $56.4 million to $141.1 million for 2002 from $84.7 million for 2001.

*Provision for loan losses.* The provision for loan losses for FFELP loans decreased to $3.2 million for 2002 from $3.3 million for 2001. The provision for loan losses for private loans increased to $2.4 million for 2002 from $700,000 for 2001. This increase was due to a specific provision of approximately $1.6 million for an identified pool of private loans based on aging, delinquency and performance. This pool of private loans is limited to loans made to borrowers attending a single school, and, in early 2002, we ceased making private loans to borrowers attending that school. The remaining combined increase of approximately $100,000 was due to the increase in the size of our FFELP and private loan portfolios. Approximately 14.4% of our private loans was delinquent as of December 31, 2002.

*Other income.* Total other income increased $24.9 million, or 24.7%, in 2002 as compared to 2001. Loan servicing and other fee income increased $10.7 million, or 11.5%, and software services and other income increased $14.2 million, or 184.1%, in 2002 as compared to 2001.

Loan servicing and other fee income increased due to growth in the loan servicing portfolio of $817.5 million in 2002 and the acquisition of EFS, Inc., which increased the servicing portfolio by an additional $1.0 billion in 2002. The change in the loan servicing volume resulted in an increase in loan servicing income of $1.3 million. In addition, we acquired GuaranTec, LLP in June 2001 resulting in an increase of $8.7 million in guarantee servicing income in 2002 as compared to 2001.

Software services and other income increased due to the acquisitions of Charter Account Systems, Inc. in May 2002 and Idaho Financial Associates, Inc. in January 2002. These acquisitions resulted in an increase in income of approximately $6.2 million in 2002 compared to 2001. Additional income of $6.6 million was earned on a marketing contract in 2002 that was not in existence in 2001. Other income also included an increase in administrative services income of $1.2 million in 2002 as compared to 2001 from the support services provided to FirstMark Services, LLC, which was not in existence in 2001.

*Operating expenses.* Total operating expenses increased $38.4 million, or 20.1%, in 2002 as compared to 2001. Salaries and benefits increased $29.5 million, or 38.1%, and total other expenses increased $8.9 million, or 7.8%, in 2002 as compared to 2001. The increase in salaries and benefits is due to the following: the acquisition of EFS, Inc. in December 2001, which increased salaries and benefits by $11.2 million, the acquisition of Idaho Financial Associates, Inc. in January 2002, which increased salaries and benefits by $7.9 million and the acquisition of Charter Account Systems, Inc. in May 2002, which increased salaries and benefits by $1.0 million. The remaining increase in salaries and benefits is due to an increase in support services personnel and the rising cost of employee benefits.

The net increase in total other expenses can be attributed to an increase in depreciation and amortization of $5.4 million, or 24.8%, in 2002 as compared to 2001, which includes an increase in the amortization of intangible assets of $5.0 million due to acquisitions of EFS, Inc., Idaho Financial Associates, Inc. and Charter Account Systems, Inc. in December 2001, January 2002 and May 2002, respectively. The remaining increase in depreciation and amortization was a result of increased depreciation and amortization of furniture, equipment and leasehold improvements in 2002 as compared to 2001, due to the acquisitions previously described. Trustee and other debt related fees increased $3.8 million, or 29.5%, in 2002 as compared to 2001, as a result of the $4.3 billion increase in average total debt outstanding. Occupancy and communications expense increased $3.9 million, or 52.6%, in 2002 as compared to 2001 due to the acquisitions previously described. Advertising and marketing expenses increased $1.4 million, or 13.7%, in 2002 as compared to 2001 due to an increase in consolidation loan origination activities. Professional services increased $5.9 million, or 175.3%, in 2002 as compared to 2001 as a result of technology-related consulting in 2002 that did not exist in 2001. Consulting fees and support services to related parties decreased $16.6 million, or 56.4%, in 2002 as compared to 2001. This decrease can be attributed to a $9.7 million decrease due to the termination of the support services contract for InTuition Holdings, Inc. and GuaranTec, LLP in December 2001, a $4.8 million decrease in contracted technology services obtained from 5280 Solutions, Inc. related to the consolidation of our servicing platform in December 2001 and a $2.1 million decrease as a result of a reduction in consulting fees for services provided by related parties.

*Income tax expense.* Income tax expense increased to $33.1 million for 2002 as compared to $12.3 million in 2001 due to the increase in income before income taxes in 2002. Our effective tax rate was 40.7% for 2002 as compared to 61.4% in 2001. The 2001 effective tax rate was high as a result of acquisitions that gave rise to amortization of intangible assets for financial statement purposes of $11.8 million that was not deductible for tax purposes. There was $6.0 million of deductible amortization of intangible assets in 2002 and $0 in 2001 which decreased the effective tax rate for 2002.

*Net income.* Net income increased to $48.5 million for 2002 from $7.1 million for 2001, for the reasons discussed above.

***Year ended December 31, 2001 compared to year ended December 31, 2000***

*Net interest income.* Loan interest income increased by $37.4 million, or 13.3%, for 2001 as compared to 2000. This increase was the result of changes in the interest rate environment, in the pricing characteristics of our student loan assets and in the size of our student loan portfolio. Lower interest rates in 2001 caused a decrease in the average net yield on our student loan portfolio to 6.20% in 2001 from 8.29% in 2000. Variable rate floor income increased approximately $29.9 million in 2001, due to the timing and relative change in interest rates during the periods. There was no variable rate floor income in 2000. The weighted average interest rate on our student loan portfolio decreased in 2001 due to the lower interest rates, together with the addition of lower yielding consolidation loans. The lower weighted average interest rate resulted in a reduction in loan interest income of approximately $75.0 million. Consolidation loan activity also increased the amortization and write-offs of acquisition costs, reducing loan interest income an additional

$3.5 million in 2001. The reduction in loan interest income resulting from a decline in interest rates and reduction in variable rate floor income was partially offset by an increase in our portfolio of student loans. The average student loan portfolio increased by approximately $1.7 billion, or 51.6%, for 2001 as compared to 2000, which increased loan interest income by approximately $117.2 million for 2001 as compared to 2000, which includes the increase related to variable rate floor income.

Investment interest income decreased by $1.1 million, or 6.4%, for 2001 as compared to 2000, due to the decrease in interest rates on invested funds.

Interest expense on bonds and notes payable decreased $13.4 million, or 5.7%, for 2001 as compared to 2000. The decline in short-term interest rates, specifically LIBOR, decreased our average cost of funds to 3.95% in 2001 from 6.04% in 2000. As a result, interest expense decreased approximately $72.8 million for 2001 as compared to 2000. Additional average debt of $1.2 million issued during 2001 increased our interest expense by approximately $57.0 million for 2001 as compared to 2000.

As a result of the foregoing, net interest income increased by $49.7 million, or 76.7%, for 2001 as compared to 2000. Our net interest margin increased to 2.09% for 2001 from 1.76% for 2000. Net interest income, excluding the effects of variable rate floor income of $29.9 million for 2001 and $0 for 2000, increased approximately $19.8 million to approximately $84.7 million for 2001 from approximately $64.9 million for 2000.

*Provision for loan losses.* The provision for loan losses for FFELP loans increased to $3.3 million for 2001 from $1.4 million for 2000. The provision for loan losses for private loans increased to $700,000 for 2001 from $0 for 2000. This increase was largely due to a specific provision of approximately $400,000 for an identified pool of private loans based on aging, delinquency and performance. This pool of private loans is limited to loans made to borrowers attending a single school, and, in early 2002, we ceased making private loans to borrowers attending that school. The remaining combined increase of approximately $2.2 million was due to the increase in the size of our FFELP and private loan portfolios. Approximately 3.1% of private loans was delinquent as of December 31, 2001.

*Other Income.* Total other income increased $26.4 million, or 35.5%, in 2001 as compared to 2000. Loan servicing and other fee income increased $27.2 million, or 41.1%, and software services and other income decreased $718,000, or 8.5%, in 2001 as compared to 2000.

Loan servicing and other fee income increased due to the acquisition of InTuition Holdings, Inc. in June 2000 and UNIPAC Service Corporation in March 2000 resulting in an increase in income of $18.4 million in 2001 as compared to 2000. In addition, we acquired GuaranTec, LLP in June 2001 which resulted in an increase in guarantee servicing of $8.7 million in 2001 as compared to 2000.

Software services and other income decreased as we recognized a cash gain on the sale of student loans to a third party of $700,000 in 2000.

*Operating expenses.* Total operating expenses increased $65.0 million, or 51.4%, in 2001 as compared to 2000. Salaries and benefits increased $25.6 million, or 49.5%, and total other expenses increased $39.4 million, or 52.7% in 2001 as compared to 2000. The increase in salaries and benefits expense was due to salaries expense of $9.6 million related to the conversion of our servicing platform in December 2001. The remaining increase was due to salary and benefit increases related to the acquisitions of UNIPAC Service Corporation in March 2000, InTuition Holdings, Inc. in June 2000 and GuaranTec, LLP in June 2001.

The net increase in total other expenses can be attributed to an increase in depreciation and amortization of $9.1 million, or 72.1%, in 2001 as compared to 2000, which included an increase in the amortization of intangible assets of $3.7 million due to acquisitions of UNIPAC Service Corporation and InTuition Holdings, Inc. in March and June 2000, respectively. The remaining increase in depreciation and amortization was the result of increased depreciation and amortization of furniture, equipment and leasehold improvements in 2001 as compared to 2000 related to the acquisitions described above. Trustee and other debt related fees increased $3.8 million, or 41.6%, in 2001 as compared to 2000 as a result of a

$1.2 billion increase in average total debt outstanding in 2001. Occupancy and communications expense increased $2.0 million, or 35.7% in 2001 as compared to 2000 due to the acquisitions previously described. Advertising and marketing expenses increased $5.6 million, or 122.8%, due to a large marketing services contract entered into in 2001. Professional services increased $1.8 million, or 113.0%, in 2001 as compared to 2000 due to an increase in revenue from payment processing services and origination activities due to a complete year's operation of InTuition Holdings, Inc., which was acquired in June 2000. Consulting fees and support services to related parties increased $14.1 million, or 91.8%, in 2001 compared to 2000. Consulting fees and support services to related parties increased due to an $11.8 million increase in technology services contract related to the acquisition of 5280 Solutions and a $5.0 million increase due to the acquisitions of the outsourced support services contract for InTuition Holdings, Inc. and GuaranTec, LLP. Postage and distribution expenses increased $1.9 million, or 33.4%, in 2001 as compared to 2000 due to the acquisitions discussed above.

*Income tax expense.* Income tax expense increased to $12.3 million for 2001 as compared to $6.9 million in 2000 due to the increase in income before income taxes in 2001. Our effective tax rate was 61.4% for 2001 as compared to 60.5% for 2000. The effective tax rates were high as a result of acquisitions that gave rise to amortization of intangible assets for financial statement purposes that was not deductible for tax purposes. Such amortization was $11.8 million in 2001 and of $8.1 million in 2000.

*Net income.* Net income increased to $7.1 million for 2001 from $4.5 million for 2000, for the reasons discussed above.

**Financial Condition**

***At June 30, 2003 compared to December 31, 2002***

Total assets increased approximately $600 million, or 6.6%, from $9.8 billion at December 31, 2002 to $10.4 billion at June 30, 2003. This was due to an increase in student loans receivable of approximately $900 million, or 10.6%, from $8.6 billion at December 31, 2002 to $9.5 billion at June 30, 2003. This increase was a result of net growth in consolidation loans of approximately $650 million and Stafford loans of approximately $250 million during the six months ended June 30, 2003. The increase in student loans receivable was partially offset by a decrease in restricted cash and investments of $164 million, or 22.1%, and a decrease in restricted cash due to loan program customers of $100 million, or 75.4%. The decrease in restricted cash and investments resulted from the release of these assets under the related bond indentures, which were a source of funding for our loan growth. The decrease in restricted cash due to loan program customers is a result of the reduction of consolidation disbursements in June 2003 in anticipation of the lower interest rates effective July 1, 2003.

Total liabilities increased approximately $600 million, or 6.5%, from $9.7 billion at December 31, 2002 to $10.3 billion at June 30, 2003. The growth in liabilities was a result of an increase in bonds and notes payable of approximately $700 million, or 7.7%, from $9.4 billion at December 31, 2002 to $10.2 billion at June 30, 2003. The increase in bonds and notes payable resulted from additional borrowings to fund our growth in student loan receivables during the six months ended June 30, 2003. The increase in bonds and notes payable was offset by a decrease of $100 million, or 75.4%, in amounts due to loan program customers due to a reduction of consolidation disbursements in June 2003 in anticipation of the lower interest rates that became effective July 1, 2003.

Shareholders' equity increased $18.1 million, or 16.6%, from $109.1 million at December 31, 2002 to $127.2 million at June 30, 2003 as a result of net income for the six months ended June 30, 2003.

***At December 31, 2002 compared to December 31, 2001***

Total assets increased approximately $1.7 billion, or 20.1%, from $8.1 billion at December 31, 2001 to $9.8 billion at December 31, 2002. The increase in assets resulted from an increase in student loans receivable of $1.2 billion, or 15.3%, from $7.4 billion at December 31, 2001 to $8.6 billion at December 31, 2002. The increase in student loans receivable resulted from an increase in consolidation loans of approximately $1.1 billion as a result of acquisitions and origination activities. Total assets also increased due to an increase in restricted cash and investments of $408.8 million, or 121.9%, resulting from bond indenture requirements that restricted cash reserves be held for the additional debt financings issued in 2002.

Total liabilities increased $1.6 billion, or 19.7%, from $8.1 billion at December 31, 2001 to $9.7 billion at December 31, 2002. The growth in liabilities was a result of an increase in bonds and notes payable of $1.5 billion, or 19.2%, from $7.9 billion at December 31, 2001 to $9.4 billion at December 31, 2002. The increase in bonds and notes payable was a result of additional debt financings issued to fund our growth in student loans receivable during 2002.

Shareholders' equity increased $45.9 million, or 72.7%, from $63.2 million at December 31, 2001 to $109.1 million at December 31, 2002 as a result of the net income for the year ended December 31, 2002 of $48.5 million, net of a $3.0 million charge in connection with a related party acquisition.

**Liquidity and Capital Resources**

We finance our operations through operating cash flow, borrowings under credit facilities and secured financing transactions. Operating activities provided net cash of $64.2 million for the six months ended June 30, 2003, an increase of approximately $3.9 million from the net cash provided by operating activities of $60.3 million during the six months ended June 30, 2002. Operating activities provided net cash of $134.2 million in 2002, an increase of approximately $52.7 million from the net cash provided by operating activities of $81.5 million during 2001. Operating cash flows are driven by net income adjusted for various non-cash items such as the provision for loan losses, depreciation and amortization.

We also use secured and unsecured operating lines of credit and financing agreements to fund operations and student loan acquisitions. Historically, a significant portion of our unsecured operating credit facilities was provided by affiliated parties. See "Related Party Transactions." As of June 30, 2003, we had secured $30 million, and are in the process of securing an additional $100 million, of operating lines of credit and commercial paper transactions under three separate facilities from a group of six large regional and national financial institutions. The cost of funds associated with our operating lines of credit is higher than that of the secured financing transactions used to fund our student loan portfolio. Our operating lines of credit are generally priced at a spread over LIBOR ranging from 60 to 250 basis points. We believe that the expansion of our operating lines and credit facilities will provide expanded access to capital in the future. In addition to our expanded operating lines and credit facilities, we believe that the growth in our cash flow from operating activities and shareholders' equity indicates a favorable trend in our available capital resources.

In the second quarter of 2003, we expanded our warehousing capacity for student loan assets with the addition of a $750 million commercial paper conduit facility. In the third quarter of 2003, we further expanded this commercial paper conduit facility to $1.05 billion. This warehouse facility will allow for expansion of our liquidity and capacity and will replace a smaller facility of approximately $350 million which expired in the third quarter of 2003. We believe that the expansion of our warehousing capacity and continued access to the asset-backed securities market will provide adequate liquidity to fund our student loan operations for the foreseeable future.

Our secured financing instruments include commercial paper lines, commercial paper conduit warehouse programs, variable-rate tax-exempt bonds, fixed-rate, tax-exempt bonds and various asset-backed securities. Of the $10.2 billion of debt outstanding as of June 30, 2003, approximately $8 billion was issued under securitization transactions. During 2002, we completed three asset-backed securities transactions totaling $2.8 billion. We anticipate continuing to access the asset-backed securities markets in 2003 and subsequent years, depending on market conditions.

Securities issued in our securitization transactions are generally priced off a spread to LIBOR or set under an auction procedure related to the bonds and notes. The student loans financed are generally priced on a spread to commercial paper or Treasury bills.

The following table summarizes our bonds and notes outstanding as of June 30, 2003:

| | As of June 30, 2003 | | | |
|---|---|---|---|---|
| | Carrying amount | Percent of total | Interest rate range | Final maturity |
| | | (dollars in thousands) | | |
| Variable-rate bonds and notes(a): | | | | |
| Bond and notes based on indices | $ 2,956,617 | 29.0% | 1.02% – 2.05% | 05/01/07 – 01/25/37 |
| Bond and notes based on auction | 4,042,135 | 39.7 | 1.00% – 1.45% | 07/01/05 – 10/01/36 |
| Total variable-rate bonds and notes | 6,998,752 | 68.7 | | |
| Commercial paper and other | 2,042,014 | 20.1 | 1.24% – 1.31% | 09/02/04 – 12/15/06 |
| Fixed-rate bonds and notes(a) | 1,049,458 | 10.3 | 5.50% – 6.68% | 05/01/05 – 06/01/28 |
| Other secured borrowings | 89,502 | 0.9 | 1.34% – 6.00% | 01/10/05 – 11/01/05 |
| Total | $10,179,726 | | | |

(a) Issued in securitization transactions.

Bonds and notes outstanding as of June 30, 2003 are due in varying amounts as follows:

| | As of June 30, 2003 |
|---|---|
| | (dollars in thousands) |
| 2004 | $ 2,282,196 |
| 2005 | 218,916 |
| 2006 | 152,822 |
| 2007 | 234,760 |
| 2008 | 92,380 |
| 2009 and thereafter | 7,198,652 |
| | $10,179,726 |

We have commitments with our branding partners, from whom we acquire student loans and to whom we provide marketing and origination services, and forward flow lenders, from whom we acquire student loans and to whom we provide origination services only, which obligate us to purchase loans originated under specific criteria, although our branding partners and forward flow lenders are not obligated to provide us with a minimum amount of loans. These commitments generally run for periods ranging from one to five years and are generally renewable. As of June 30, 2003 and December 31, 2002 and 2001, we were obligated to purchase up to $233.3 million, $266.2 million and $334.7 million, respectively, in student loans at current market rates upon the respective seller’s request under various agreements through September 30, 2004.

***Student Loan Portfolio***

The tables below describe the components of our loan portfolio:

| | As of June 30, | | | |
|---|---|---|---|---|
| | 2003 | | 2002 | |
| | Dollars | Percent of total | Dollars | Percent of total |
| | (dollars in thousands) | | | |
| FFELP: | | | | |
| Stafford | $5,246,649 | 55.4% | $5,031,331 | 62.8% |
| PLUS/ SLS (a) | 298,341 | 3.2 | 323,324 | 4.0 |
| Consolidation | 3,685,876 | 38.9 | 2,431,377 | 30.4 |
| Non-FFELP: | | | | |
| Private loans | 86,981 | 0.9 | 59,255 | 0.7 |
| Total | 9,317,847 | 98.4 | 7,845,287 | 97.9 |
| Unamortized premiums | 162,426 | 1.7 | 172,877 | 2.2 |
| Allowance for loan losses: | | | | |
| Allowance — FFELP | (10,295) | (0.1) | (9,975) | (0.1) |
| Allowance — Private | (3,455) | — | (1,263) | — |
| Net | $9,466,523 | 100.0% | $8,006,926 | 100.0% |

(a) Supplemental Loans for Students, or SLS, are the predecessor to unsubsidized Stafford loans.

| | As of December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2002 | | 2001 | | 2000 | |
| | Dollars | Percent of total | Dollars | Percent of total | Dollars | Percent of total |
| | (dollars in thousands) | | | | | |
| FFELP: | | | | | | |
| Stafford | $4,983,021 | 58.2% | $4,947,316 | 66.6% | $2,390,203 | 66.7% |
| PLUS/ SLS (a) | 313,100 | 3.7 | 335,083 | 4.5 | 115,237 | 3.2 |
| Consolidation | 3,033,607 | 35.4 | 1,923,896 | 25.9 | 1,004,548 | 28.0 |
| Non-FFELP: | | | | | | |
| Private loans | 74,660 | 0.9 | 60,760 | 0.8 | 31,843 | 0.9 |
| Total | 8,404,388 | 98.2 | 7,267,055 | 97.8 | 3,541,831 | 98.8 |
| Unamortized premiums | 167,032 | 1.9 | 167,059 | 2.3 | 47,726 | 1.3 |
| Allowance for loan losses: | | | | | | |
| Allowance — FFELP | (9,970) | (0.1) | (9,378) | (0.1) | (3,004) | (0.1) |
| Allowance — Private | (2,030) | — | (864) | — | (610) | — |
| Net | $8,559,420 | 100.0% | $7,423,872 | 100.0% | $3,585,943 | 100.0% |

(a) Supplemental Loans for Students, or SLS, are the predecessor to unsubsidized Stafford loans.

*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 student loans.

An analysis of our allowance for loan losses is presented in the following table:

| | Six months ended June 30, | | Year ended December 31, | | |
|---|---|---|---|---|---|
| | 2003 | 2002 | 2002 | 2001 | 2000 |
| | | | (dollars in thousands) | | |
| Balance at beginning of year | $ 12,000 | $ 10,242 | $ 10,242 | $ 3,614 | $ 4,122 |
| Provision for loan losses: | | | | | |
| FFELP loans | 1,660 | 1,466 | 3,162 | 3,250 | 1,370 |
| Private loans | 3,200 | 650 | 2,425 | 675 | — |
| Total provision for loan losses | 4,860 | 2,116 | 5,587 | 3,925 | 1,370 |
| Transfer from acquisitions | — | — | — | 4,866 | — |
| Charge-offs: | | | | | |
| FFELP loans | (1,335) | (869) | (2,570) | (1,742) | (1,389) |
| Private loans | (1,820) | (287) | (1,333) | (499) | (497) |
| Total charge-offs | (3,155) | (1,156) | (3,903) | (2,241) | (1,886) |
| Recoveries, private loans | 45 | 36 | 74 | 78 | 8 |
| Net charge-offs | (3,110) | (1,120) | (3,829) | (2,163) | (1,878) |
| Balance at end of year | $ 13,750 | $ 11,238 | $ 12,000 | $ 10,242 | $ 3,614 |
| Allocation of the allowance for loan losses: | | | | | |
| FFELP loans | $ 10,295 | $ 9,975 | $ 9,970 | $ 9,378 | $ 3,004 |
| Private loans | 3,455 | 1,263 | 2,030 | 864 | 610 |
| Total allowance for loan losses | $ 13,750 | $ 11,238 | $ 12,000 | $ 10,242 | $ 3,614 |
| Net charge-offs as a percentage of average student loans | 0.068% | 0.028% | 0.047% | 0.042% | 0.055% |
| Total allowance as a percentage of average student loans | 0.150% | 0.142% | 0.147% | 0.199% | 0.107% |
| Total allowance as a percentage of the ending balance of student loans | 0.148% | 0.143% | 0.143% | 0.141% | 0.102% |
| Private allowance as a percentage of the ending balance of private loans | 3.972% | 2.131% | 2.719% | 1.422% | 1.916% |
| Average student loans | $9,176,244 | $7,887,699 | $8,171,898 | $5,135,227 | $3,388,156 |
| Ending balance of student loans | $9,317,847 | $7,845,287 | $8,404,388 | $7,267,055 | $3,541,831 |
| Ending balance of private loans | $ 86,981 | $ 59,255 | $ 74,660 | $ 60,760 | $ 31,843 |

The table below shows the student loan delinquency amounts as of June 30, 2003 and 2002 and December 31, 2002, 2001 and 2000. Delinquencies have the potential to adversely impact our earnings through increased servicing and collection costs and account charge-offs.

| | June 30, | | | | December 31, | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2003 | | 2002 | | 2002 | | 2001 | | 2000 | |
| | Balance | Percent | Balance | Percent | Balance | Percent | Balance | Percent | Balance | Percent |
| | (dollars in thousands) | | | | | | | | | |
| **FFELP Student Loan Portfolio:** | | | | | | | | | | |
| Loans in school/ grace/deferment(1) | $2,841,336 | | $1,952,683 | | $2,293,763 | | $1,807,308 | | $ 954,655 | |
| Loans in forbearance(2) | 1,432,296 | | 1,156,897 | | 1,289,606 | | 854,737 | | 99,153 | |
| Loans in repayment status: | | | | | | | | | | |
| Loans current | 4,295,603 | 86.7% | 4,306,362 | 92.1% | 4,002,025 | 84.3% | 3,957,114 | 87.1% | 2,139,113 | 87.1% |
| Loans delinquent 31-60 days(3) | 222,570 | 4.5 | 142,261 | 3.0 | 307,668 | 6.5 | 247,074 | 5.4 | 131,582 | 5.4 |
| Loans delinquent 61-90 days | 125,552 | 2.5 | 78,505 | 1.7 | 146,198 | 3.1 | 110,913 | 2.4 | 64,947 | 2.6 |
| Loans delinquent 91 days or greater | 273,356 | 5.5 | 83,310 | 1.8 | 253,403 | 5.3 | 202,256 | 4.5 | 104,326 | 4.2 |
| Loans in claim status | 40,154 | 0.8 | 66,015 | 1.4 | 37,065 | 0.8 | 26,893 | 0.6 | 16,212 | 0.7 |
| Total loans in repayment | 4,957,235 | 100.0% | 4,676,453 | 100.0% | 4,746,359 | 100.0% | 4,544,250 | 100.0% | 2,456,180 | 100.0% |
| Total FFELP student loan portfolio | $9,230,867 | | $7,786,033 | | $8,329,728 | | $7,206,295 | | $3,509,988 | |
| **Private Student Loan Portfolio:** | | | | | | | | | | |
| Loans in school/ grace/deferment | $ 26,685 | | $ 24,494 | | $ 30,545 | | $ 34,597 | | $ 10,253 | |
| Loans in forbearance | 11,400 | | 3,462 | | 7,711 | | 530 | | — | |
| Loans in repayment status: | | | | | | | | | | |
| Loans current | 44,918 | 91.9% | 30,847 | 98.6% | 31,168 | 85.6% | 24,839 | 96.9% | 20,712 | 95.9% |
| Loans delinquent 31-60 days | 2,366 | 4.8 | 194 | 0.6 | 2,953 | 8.1 | 339 | 1.3 | 335 | 1.6 |
| Loans delinquent 61-90 days | 792 | 1.6 | 109 | 0.3 | 1,259 | 3.5 | 222 | 0.9 | 66 | 0.3 |
| Loans delinquent 91 days or greater | 632 | 1.3 | 115 | 0.4 | 915 | 2.5 | 205 | 0.8 | 377 | 1.7 |
| Loans in claim status | 188 | 0.4 | 34 | 0.1 | 109 | 0.3 | 28 | 0.1 | 100 | 0.5 |
| Total loans in repayment | 48,896 | 100.0% | 31,299 | 100.0% | 36,404 | 100.0% | 25,633 | 100.0% | 21,590 | 100.0% |
| Total private student loan portfolio | $ 86,981 | | $ 59,255 | | $ 74,660 | | $ 60,760 | | $ 31,843 | |

(1) Loans for borrowers who still may be attending school or engaging in other permitted educational activities and are not yet required to make payments on the loans, *e.g.* , residency periods for medical students or a grace period for bar exam preparation.

(2) Loans for borrowers who have temporarily ceased making full payments due to hardship or other factors, according to a schedule approved by the servicer consistent with the established loan program servicing procedures and policies.

(3) The period of delinquency is based on the number of days scheduled payments are contractually past due and relate to repayment loans, that is, receivables not charged off, and not in school, grace, deferment or forbearance.

*Origination and Acquisition*

Our student loan portfolio increases through various channels, including originations through our direct channel and acquisitions through our branding partner channel, our forward flow channel and the secondary market. Our portfolio increases with the addition of portfolios acquired through whole company or subsidiary acquisitions.

One of our primary objectives is to focus on originations through our direct channel and acquisitions through our branding partner channel. We have extensive and growing relationships with many large financial and educational institutions which are active in the education finance industry. Our branding relationships and forward flow relationships include Union Bank and Trust Company, an affiliate of ours, as well as many schools and national and regional financial institutions. See “Related Party Transactions.”

The table below sets forth the increase during each period presented of loans originated or acquired through each of our channels:

| | Six months ended June 30, | | Year ended December 31, | | |
|---|---|---|---|---|---|
| | 2003 | 2002 | 2002 | 2001 | 2000 |
| | | | (dollars in thousands) | | |
| Beginning balance | $8,404,388 | $7,267,055 | $ 7,267,055 | $3,541,831 | $2,940,679 |
| Direct channel: | | | | | |
| Stafford/ PLUS loan originations | 116,876 | 113,411 | 224,827 | 84,599 | — |
| Consolidation loan origination | 736,670 | 182,585 | 859,120 | 55,715 | 43,951 |
| Branding partner channel | 610,740 | 120,580 | 521,023 | 524,964 | 592,001 |
| Forward flow channel | 308,002 | 251,701 | 577,603 | 484,058 | 391,503 |
| Other channels | 63,666 | 408,068 | 483,213 | 299,271 | 43 |
| Total channel acquisitions | 1,835,954 | 1,076,345 | 2,665,786 | 1,448,607 | 1,027,498 |
| Loans acquired in subsidiary acquisitions | — | — | — | 2,919,845 | — |
| Repayments, claims, capitalized interest and other(a) | (922,495) | (498,113) | (1,528,453) | (643,228) | (426,346) |
| Ending balance | $9,317,847 | $7,845,287 | $ 8,404,388 | $7,267,055 | $3,541,831 |

(a) Includes repayments on all consolidation loans.

*Student Loan Spread Analysis*

The following table analyzes the student loan spread on our portfolio of student loans for the period indicated. This table represents the spread on assets earned in conjunction with the liabilities used to fund the assets. Maintenance of the spread on assets is a key factor in maintaining and growing our income.

| | Six months ended June 30, | | Year ended December 31, | | |
|---|---|---|---|---|---|
| | 2003 | 2002 | 2002 | 2001 | 2000 |
| | | | (dollars in thousands) | | |
| Student loan yield | 5.09% | 6.45% | 5.94% | 6.71% | 8.86% |
| Consolidation rebate fees | (0.40) | (0.28) | (0.31) | (0.23) | (0.25) |
| Premium amortization | (0.68) | (0.56) | (0.67) | (0.28) | (0.32) |
| Student loan net yield | 4.01 | 5.61 | 4.96 | 6.20 | 8.29 |
| Student loan cost of funds | (2.02) | (2.57) | (2.59) | (3.95) | (6.04) |
| Student loan spread, including variable rate floor income | 1.99 | 3.03 | 2.38 | 2.26 | 2.26 |
| Variable rate floor income | (0.14) | (0.60) | (0.61) | (0.58) | — |
| Student loan spread, excluding variable rate floor income | 1.85% | 2.44% | 1.77% | 1.67% | 2.26% |
| Average balance of student loans | $9,176,244 | $7,887,699 | $8,171,898 | $5,135,227 | $3,388,156 |

### *Interest Rate Risk*

Because we generate the majority of our earnings from the spread between the yield we receive on our portfolio of student loans and the cost of funding these loans, the interest sensitivity of our balance sheet is a key profitability driver. The majority of student loans have variable-rate characteristics in certain interest rate environments. Certain of our student loans include fixed-rate components depending upon the rate reset provisions, or, in the case of consolidation loans, are fixed at the weighted average interest rate of the underlying loans at the time of consolidation. The table below sets forth our loan assets and debt instruments by rate characteristics:

| | As of June 30, | | As of December 31, | | |
|---|---|---|---|---|---|
| | 2003 | 2002 | 2002 | 2001 | 2000 |
| | (dollars in thousands) | | | | |
| Fixed-rate loan assets(a) | $ 4,036,201 | $2,965,944 | $3,320,121 | $2,486,649 | $1,277,098 |
| Variable-rate loan assets | 5,281,646 | 4,879,343 | 5,084,267 | 4,780,406 | 2,264,733 |
| | $ 9,317,847 | $7,845,287 | $8,404,388 | $7,267,055 | $3,541,831 |
| Fixed-rate debt instruments | $ 1,049,458 | $1,207,643 | $1,122,881 | $1,232,662 | $ 583,191 |
| Variable-rate debt instruments | 9,130,268 | 7,452,492 | 8,324,801 | 6,693,700 | 3,350,939 |
| | $10,179,726 | $8,660,135 | $9,447,682 | $7,926,362 | $3,934,130 |

(a) Includes approximately $450 million, $540 million, $430 million, $570 million and $530 million of variable-rate loan assets which are classified as fixed-rate loan assets as a result of being financed by variable-rate, tax-exempt bonds subject to a 9.5% minimum yield as of June 30, 2003 and 2002 and December 31, 2002, 2001 and 2000, respectively.

Historically, we followed a policy of funding the majority of our student loan portfolio with variable-rate debt. In the current low interest rate environment, our FFELP loan portfolio is yielding excess income primarily due to the reduction in interest rates on the variable-rate liabilities funding student loans at the fixed borrower rate and due to consolidation loans earning interest at a fixed rate to the borrower. See "Risk Factors." Therefore, absent utilizing derivative instruments, in a low interest rate environment, a rise in interest rates will have an adverse effect on earnings and fair values. In higher interest rate environments, where the interest rate rises above the borrower rate and the fixed-rate loans become variable rate and are effectively matched with variable-rate debt, the impact of rate fluctuations is substantially reduced.

One objective when financing our student loan portfolio is to manage interest rate risk through:

- matching the funding of certain assets and liabilities;
- to some extent, utilizing derivative instruments to manage a portion of downside risk and interest rate fluctuations; and
- positioning our portfolio to benefit from interest rate movements and fluctuations.

We attempt to match the interest rate characteristics of pools of loan assets with debt instruments of substantially similar characteristics, particularly in rising interest rate markets. Due to the variability in duration of our assets and varying market conditions, we do not attempt to perfectly match the interest rate characteristics of the entire loan portfolio with the underlying debt instruments. We have adopted a policy of periodically reviewing the mismatch related to the interest rate characteristics of our assets and our liabilities and our opinion as to current and future market conditions. Based on those factors, we will periodically use interest rate swaps and other derivative instruments as part of overall risk management strategy to manage risk arising from our fixed-rate and variable-rate financial instruments. These strategies entail risk and may not be effective.

During the third quarter of 2003, we entered into various derivative instrument contracts to help manage our interest rate risk. The table below summarizes the derivative instruments to which we are currently a party:

| | Notional Amounts by product type | | |
|---|---|---|---|
| Maturity | Fixed/ Floating Swaps(a) | Basis Swaps(b) | Cap Contracts(c) |
| | | (dollars in millions) | |
| 2004 | $1,000 | $ 500 | $ — |
| 2005 | — | 1,000 | 500 |
| 2006 | — | 500 | — |
| Total | $1,000 | $2,000 | $500 |

(a) A fixed/floating swap is an interest rate swap in which we agree to pay a fixed rate in exchange for a floating rate. The interest rate swap effectively converts a portion of our variable rate debt to a fixed rate for a period of time fixing the relative spread between a portion of our student loan assets equal to the size of the swaps', notional amount and earning at a fixed rate and the converted fixed-rate liability.

(b) A basis swap is an interest rate swap agreement in which we agree to pay a floating rate in exchange for another floating rate, based upon different market indices. We have employed basis swaps to limit our sensitivity to dramatic fluctuations in the underlying indices used to price a portion of our variable-rate assets and variable-rate debt.

(c) A cap contract is a derivative instrument in which we agree to pay an up-front premium in exchange for a cap on the level of interest on a notional amount. We have entered into an interest rate cap contract to limit the relative rates on a portion of our variable rate debt, limiting the sensitivity to a dramatically rising interest rate market.

As a result of our interest rate management activities, we expect the change in pre-tax net income resulting from 100 basis point and 200 basis point increases in interest rates will not result in a proportional decrease in net income due to the effective switch of some variable-rate loans to fixed-rate loans. The change would also be less dramatic had the interest rate management strategies and derivative products employed in the third quarter of 2003 been in place for the six months ended June 30, 2003 or the year ended December 31, 2002.

Under Statement of Financial Accounting Standards ("SFAS") No. 133, *Accounting for Derivative Instruments and Hedging Activities* , the derivatives described above do not qualify for hedge accounting because they do not meet all criteria for effectiveness and, therefore, the change in fair value of the derivative instrument will be reflected in the statements of income. See "— Critical Accounting Policies — Accounting for Derivatives."

The following tables summarize the effect on our earnings for the six months ended June 30, 2003 and the years ended December 31, 2002 and 2001, based upon a sensitivity analysis performed by us assuming a hypothetical increase and decrease in interest rates of 100 basis points and an increase in interest rates of 200 basis points while funding costs remain constant. The effect on earnings was performed on our variable-rate assets and liabilities.

| | Six months ended June 30, 2003 | | | | | |
|---|---|---|---|---|---|---|
| | Change from decrease of 100 basis points | | Change from increase of 100 basis points | | Change from increase of 200 basis points | |
| | Dollars | Percent | Dollars | Percent | Dollars | Percent |
| | | | (dollars in thousands) | | | |
| Effect on earnings: | | | | | | |
| Increase (decrease) in pre-tax income | $24,907 | 82.2% | $(20,089) | (66.3)% | $(33,099) | (109.2)% |
| Increase (decrease) in basic and diluted earnings per share | $ 0.35 | | $ (0.29) | | $ (0.47) | |

| | Year ended December 31, 2002 | | | | | |
|---|---|---|---|---|---|---|
| | Change from decrease of 100 basis points | | Change from increase of 100 basis points | | Change from increase of 200 basis points | |
| | Dollars | Percent | Dollars | Percent | Dollars | Percent |
| | (dollars in thousands) | | | | | |
| Effect on earnings: | | | | | | |
| Increase (decrease) in pre-tax income | $15,119 | 18.6% | $(11,553) | (14.2)% | $(20,236) | (24.9)% |
| Increase (decrease) in basic and diluted earnings per share | $ 0.22 | | $ (0.16) | | $ (0.29) | |

| | Year ended December 31, 2001 | | | | | |
|---|---|---|---|---|---|---|
| | Change from decrease of 100 basis points | | Change from increase of 100 basis points | | Change from increase of 200 basis points | |
| | Dollars | Percent | Dollars | Percent | Dollars | Percent |
| | (dollars in thousands) | | | | | |
| Effect on earnings: | | | | | | |
| Increase (decrease) in pre-tax income | $2,054 | 10.3% | $ (749) | (3.7)% | $(1,975) | (9.9)% |
| Increase (decrease) in basic and diluted earnings per share | $ 0.03 | | $(0.01) | | $ (0.03) | |

The table below sets forth our variable-rate assets and liabilities categorized by the reset date of the underlying index. Fixed-rate assets and liabilities are categorized based on their maturity dates. An interest rate gap is the difference between volumes of assets and volumes of liabilities maturing or repricing during specific future time intervals. The following gap analysis reflects our interest rate-sensitive positions as of June 30, 2003 and December 31, 2002 and is not necessarily reflective of the positions that existed throughout the period.

| | As of June 30, 2003 | | | | | |
|---|---|---|---|---|---|---|
| | Interest rate sensitivity period | | | | | |
| | 3 months or less | 3 months to 6 months | 6 months to 1 year | 1 to 2 years | 2 to 5 years | Over 5 years |
| | (dollars in thousands) | | | | | |
| Interest-sensitive assets: | | | | | | |
| Student loans | $ 9,466,523 | $ — | $ — | $ — | $ — | $ — |
| Cash and investments | 659,874 | — | — | — | — | — |
| Total interest-sensitive assets | 10,126,397 | — | — | — | — | — |
| Interest-sensitive liabilities: | | | | | | |
| Short-term borrowings | 9,130,268 | — | — | — | — | — |
| Long-term notes | 63,773 | 63,773 | 111,880 | 215,122 | 333,375 | 261,535 |
| Total interest-sensitive liabilities | 9,194,041 | 63,773 | 111,880 | 215,122 | 333,375 | 261,535 |
| Period gap | 932,356 | (63,773) | (111,880) | (215,122) | (333,375) | (261,535) |
| Cumulative gap | 932,356 | 868,583 | 756,703 | 541,581 | 208,206 | (53,329) |
| Ratio of interest-sensitive assets to interest-sensitive liabilities | 110.1% | —% | —% | —% | —% | —% |
| Ratio of cumulative gap to total interest-sensitive assets | 9.2% | 8.6% | 7.5% | 5.3% | 2.1% | (0.5)% |

| | As of December 31, 2002 | | | | | |
|---|---|---|---|---|---|---|
| | Interest rate sensitivity period | | | | | |
| | 3 months or less | 3 months to 6 months | 6 months to 1 year | 1 to 2 years | 2 to 5 years | Over 5 years |
| | (dollars in thousands) | | | | | |
| Interest-sensitive assets: | | | | | | |
| Student loans | $8,559,420 | $ — | $ — | $ — | $ — | $ — |
| Cash and investments | 916,572 | — | — | — | — | — |
| Total interest-sensitive assets | 9,475,992 | — | — | — | — | — |
| Interest-sensitive liabilities: | | | | | | |
| Short-term borrowings | 8,324,801 | — | — | — | — | — |
| Long-term notes | 48,645 | 48,645 | 97,289 | 223,759 | 436,617 | 267,926 |
| Total interest-sensitive liabilities | 8,373,446 | 48,645 | 97,289 | 223,759 | 436,617 | 267,926 |
| Period gap | 1,102,546 | (48,645) | (97,289) | (223,759) | (436,617) | (267,926) |
| Cumulative gap | 1,102,546 | 1,053,901 | 956,612 | 732,853 | 296,236 | 28,310 |
| Ratio of interest-sensitive assets to interest-sensitive liabilities | 113.2% | —% | —% | —% | —% | —% |
| Ratio of cumulative gap to total interest-sensitive assets | 11.6% | 11.1% | 10.1% | 7.7% | 3.1% | 0.3% |

## Critical Accounting Policies

This Management’s Discussion and Analysis of Financial Condition and Results of Operations discusses our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America, or GAAP. The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the reported amounts of income and expenses during the reporting periods. We base our estimates and judgments on historical experience and on various other factors that we believe are reasonable under the circumstances. Actual results may differ from these estimates under varying assumptions or conditions. Note 3 of the notes to consolidated financial statements includes a summary of the significant accounting policies and methods used in the preparation of our consolidated financial statements.

On an on-going basis, management evaluates its estimates and judgments, particularly as they relate to accounting policies that management believes are most “critical” — that is, they are most important to the portrayal of our financial condition and results of operations and they require management’s most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. These accounting policies include securitization accounting, accounting for derivatives, determining the level of the allowance for loan losses and the program reimbursement reserve.

### *Securitization Accounting*

We use the issuance of asset-backed securities, commonly called securitization transactions, as a key component of our financing strategy. In conjunction with these transactions, we transfer student loans to a trust which issues bonds backed by the student loans. Our securitization transactions do not qualify for sale treatment under SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities-a Replacement of SFAS No. 125* , as the trusts continue to be under our effective control and as such we do not record or recognize gain on sale in conjunction with the transaction, but rather treat the transfers as secured borrowings. All of the financial activities and related assets and liabilities, including debt, of the securitizations are reflected and consolidated in our financial statements. Servicing, administrative support services and other intercompany activities have been eliminated in accordance with generally accepted accounting principles.

***Accounting for Derivatives***

We account for derivative and certain financial instruments in accordance with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities,* which requires that every derivative instrument, including certain derivative instruments embedded in other contracts, be recorded at fair value on the balance sheet as either an asset or liability. We determine fair value for our derivative contracts from bid pricing obtained from independent market sources.

For some of our derivatives, mainly certain interest rate swaps, we document the relationship between the hedging instrument and the hedged items, as well as the risk management objective and strategy for undertaking various hedge transactions at the inception of the hedging relationship. To the extent possible, we link each derivative to either a specific asset or liability on the balance sheet or expected future cash flows, and designate them as either fair value or cash flow hedges. Fair value hedges are designed to hedge our exposure to changes in fair value of a fixed-rate asset or liability, or a “fair value” hedge, while cash flow hedges are designed to hedge our exposure to variability of either a variable-rate asset’s or liability’s cash flows or expected fixed-rate debt issuance, or a “cash flow” hedge. For effective fair value hedges, we adjust the derivative instruments to fair value with any difference recorded immediately in the income statement. For effective cash flow hedges, changes in the fair value of the cash flow hedge are deferred in other comprehensive income, net of tax, and recognized in earnings in the same period as the earnings effects of the hedged item. SFAS No. 133 requires that changes in the fair value of derivative instruments be recognized currently in earnings unless specific hedge accounting criteria as specified by SFAS No. 133 are met. We believe that our derivatives are effective economic hedges and they are a critical element of our interest rate risk management strategy. However, under SFAS No. 133, our derivative instruments, are considered ineffective hedges because they hedge only a portion of the term of the underlying risk.

Basis swaps are used to convert variable-rate debt from one interest rate index to another to match the interest rate characteristics of the assets. We will periodically use basis swaps to change the index of our LIBOR-based debt, to better match the cash flows of our student loan assets. SFAS No. 133 requires that the change in the cash flows of the derivative effectively offset both the change in the cash flows of the asset and the change in the cash flows of the liability. As a result, these swaps are recorded at fair value with subsequent changes in value reflected in the income statement.

***Allowance for Loan Losses***

The allowance for loan losses represents management’s estimate of probable losses on student loans. This evaluation process is subject to numerous estimates and judgments. In making such estimates and judgments, management considers such things as the value and character of loans outstanding, past loan loss experience and general economic conditions. We evaluate the adequacy of the allowance for losses on our FFELP loan portfolio separately from our private loan portfolio. Historical delinquencies and credit loss experience are also considered when reviewing the current aging of the portfolio, together with analyses that reflect current trends and conditions.

In contrast to the determination of our allowance for loan losses for our private loan portfolio, when we determine the allowance for our FFELP loan portfolio, we consider trends in student loan claims rejected for payment by guaranty agencies and the amount of FFELP loans subject to the 2% risk sharing. The allowance is based on periodic evaluations of our loan portfolio considering past experience, changes to federal student loan programs, current economic conditions and other relevant factors. The allowance is maintained at a level management believes is adequate to provide for estimated probable credit losses inherent in the loan portfolio. This evaluation is inherently subjective, as it requires estimates that may be susceptible to significant changes.

In determining the adequacy of the allowance for loan losses on private loans, we consider several factors including:

- loans in repayment versus those in non-paying status;
- months in repayment;
- delinquency status;
- type of program; and
- trends in defaults in the portfolio based on our experience and industry data.

***Program Reimbursement Reserve***

The program reimbursement reserve represents the amount that management estimates we will be required to repay to lenders due to our failure to follow prescribed due diligence procedures and servicing activities prescribed by the Higher Education Act. Failure to meet certain due diligence requirements that must be followed to maintain the DOE guarantee on the loans will cause a loss of the guarantee on the loans and potential loss to us if we are unable to cure the deficiency under procedures prescribed by the federal government.

This evaluation process is subject to numerous estimates and judgments. In making these estimates and judgments, management considers such factors as the outstanding loan volume that we service, servicing loss experience, cure experience, portfolio default rates and general economic conditions. The program reimbursement reserve is determined based on a process that begins with an estimate of the probable losses on serviced student loans. This estimate is based on the weighted average historical loss rates for the past ten years, current portfolio delinquency rates and other economic conditions that provide information on the expected servicing losses. The estimated loss rate is applied to the student loans currently serviced to derive a gross estimated servicing loss. The estimated servicing loss is then reduced by the estimated cure rate on such claims. The estimated cure rate is based on the weighted average historical cure rates for the past ten years to derive a reasonable estimate of the expected cure rate. The gross servicing losses net of the estimated cures will provide the estimated servicing reimbursement reserve that we recognize.

The program reimbursement reserve reflects assumptions and estimates we believe are reasonable in light of historical servicing errors and known trends with respect to student loans serviced. However, these estimates and assumptions are inherently subjective and may be susceptible to significant changes. Management continually measures expected losses against actual losses and assumptions are revised accordingly. Management believes that the program reimbursement reserve is adequate to cover probable losses in the portfolio of student loans serviced.

**Recent Accounting Pronouncements**

***Early Extinguishment of Debt***

In April 2002, the Financial Accounting Standard Board, or FASB, issued SFAS No. 145, *Rescission of FASB Statements Nos. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections* . This statement rescinds FASB Statement No. 4, *Reporting Gains and Losses from Extinguishment of Debt* and an amendment of that statement, FASB Statement No. 64, *Extinguishments of Debt Made to Satisfy Sinking-Fund Requirements* . The statement also rescinds FASB Statement No. 44, *Accounting for Intangible Assets of Motor Carriers* and amends FASB Statement No. 13, *Accounting for Leases* to eliminate an inconsistency between the required accounting for sale-leaseback transactions and the required accounting for certain lease modifications that have economic effects that are similar to sale-leaseback transactions. This statement also amends other existing authoritative pronouncements to make various technical corrections, clarify meanings or describe their applicability under changed conditions. The provisions of SFAS No. 145 related to the rescission of FASB No. 4 are effective for fiscal years beginning after May 15, 2002. The provisions of SFAS No. 145 related to FASB No. 13 are effective for transactions occurring after May 15, 2002. All other provisions of SFAS No. 145 are effective for financial statements issued on or after May 15, 2002. We do not expect to have any material changes to our financial statements as a result of SFAS No. 145.

***Accounting for Costs Associated with Exit or Disposal Activities***

In June 2002, FASB issued SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities* . SFAS No. 146 requires that a liability for costs associated with exit or disposal activities be recognized when the liability is incurred. Existing generally accepted accounting principles provide for the recognition of such costs at the date of management's commitment to an exit plan. In addition, SFAS No. 146 requires that the liability be measured at fair value and be adjusted for changes in estimated cash flows. The provisions of the new standard are effective for exit or disposal activities initiated after December 31, 2002. It is not expected that SFAS No. 146 will materially affect our financial statements.

***Accounting for Stock-Based Compensation***

In December 2002, the FASB issued SFAS No. 148, *Accounting for Stock-Based Compensation — Transition and Disclosure, an amendment to FASB Statement No. 123* . SFAS No. 148 requires annual disclosures about the method of accounting for stock-based compensation and tabular information about the effect of the method accounting for stock-based compensation on net income and earnings per share, including pro forma amounts, in the "Summary of Significant Accounting Policies." On a quarterly basis, SFAS No. 148 requires prominent disclosure in tabular form of the effect of the method of stock-based compensation on net income and earnings per share for all periods presented as accounted for under APB Opinion No. 25. The disclosures required by SFAS 148 will be included in the financial statements when required for shares issued under our recently adopted Employee Share Purchase Plan.

***Accounting for Guarantees***

In November 2002, the FASB issued FASB Interpretation (FIN) No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* . FIN No. 45 identifies characteristics of certain guarantee contracts and requires that a liability be recognized at fair value at the inception of such guarantees for the obligations undertaken by the guarantor. Additional disclosures also are prescribed for certain guarantee contracts. The initial recognition and initial measurement provisions of FIN No. 45 are effective for those guarantees issued or modified after December 31, 2002. The disclosure requirements of FIN No. 45 were effective for us as of December 31, 2002. Disclosures required by FIN No. 45 relating to our guarantees are included in note 17 of the notes to consolidated financial statements related to the guarantee of an affiliate's liabilities to an unrelated third party. We do not believe such guarantee requires a liability to be recognized. The adoption of FIN No. 45 did not have a material effect on our financial statements.

***Consolidation of Variable Interest Entities***

In January 2003, the FASB issued FIN No. 46, *Consolidation of Variable Interest Entities* . FIN No. 46 clarifies the application of Accounting Research Bulletin No. 51, *Consolidated Financial Statements,* to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties, which are referred to as variable interest entities. Variable interest entities are required to be consolidated by their primary beneficiaries if they do not effectively disperse risks among parties involved. The primary beneficiary of a variable interest entity is the party that absorbs a majority of the entity's expected losses, receives a majority of its expected residual returns, or both, as a result of holding variable interests. FIN No. 46 also requires new disclosures about variable interest entities. We do not believe that FIN No. 46 will have a material effect on our financial statements.

***Statement of Financial Accounting Standards No. 149 — Amendment of Statement 133 on Derivative Instruments and Hedging Activities***

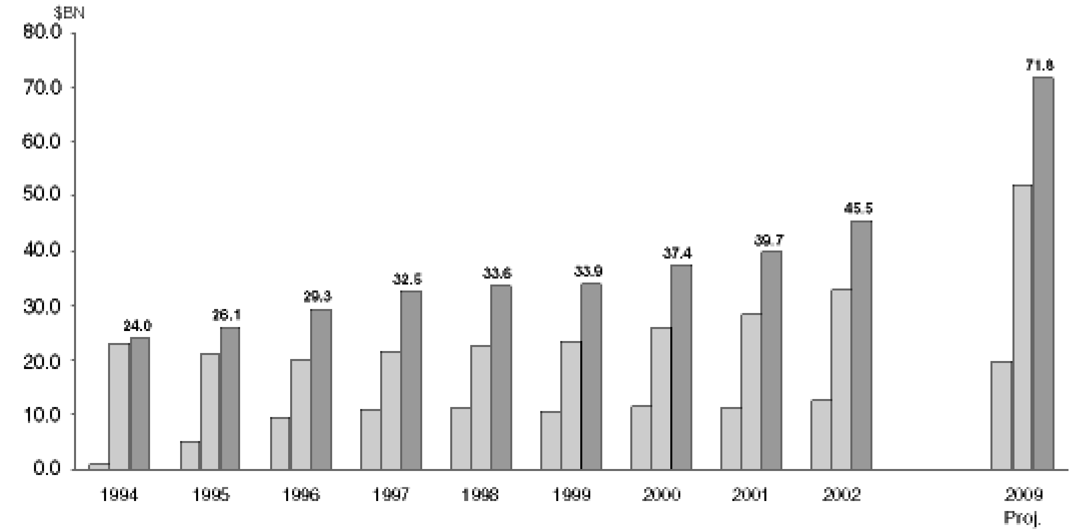
This Statement amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives) and for hedging activities under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* . This Statement is effective for contracts entered into or modified after June 30, 2003, except as stated below and for hedging relationships designated after June 30, 2003. In addition, except as stated below, all provisions of this Statement should be applied prospectively. The provisions of this Statement that relate to SFAS No. 133 implementation issues that have been effective for fiscal quarters that began prior to June 15, 2003, should continue to be applied in accordance with their respective effective dates. In addition, paragraphs 7(a) and 23(a) of SFAS No. 133, which relate to forward purchases or sales of when-issued securities or other securities that do not yet exist, should be applied to both existing contracts and new contracts entered into after June 30, 2003. We do not believe SFAS No. 149 will have a significant impact on our financial statements.

***Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity***

In May 2003, the FASB issued SFAS No 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*. SFAS No. 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability, or an asset in some circumstances. SFAS No. 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. We have adopted the standard effective July 1, 2003. We do not believe SFAS No. 150 will have a significant impact, if any, on our financial statements.

## INDUSTRY OVERVIEW

Since the creation of federal student loan programs, hundreds of billions of dollars in federal student loans have financed the higher education of millions of students at thousands of schools across the United States. College costs have risen at both public and private institutions. According to the DOE, in the decade 1990-1991 to 2000-2001, prices at public and private colleges rose by approximately 23% and 27%, respectively, after adjustment for inflation. Students and families depend more on federal student loans to cover the costs of post-secondary education than any other single source of financial aid. The demand for student loans is expected to grow. According to a projection by the DOE, gross federal student loan volume, comprised of FFELP loans and FDLP loans, is expected to grow to $71.8 billion in federal fiscal year 2009, excluding consolidation loan volume. This projection is an increase from the $45.4 billion in loans that were originated in federal fiscal year 2002, and this projection does not include the potential for higher loan limits that are currently being contemplated by Congress.




| | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2009 Proj. |
|---|---|---|---|---|---|---|---|---|---|---|
| FDLP | 0.9 | 5.1 | 9.4 | 10.9 | 11.1 | 10.6 | 11.5 | 11.3 | 12.7 | 19.7 |
| FFELP | 23.1 | 21.0 | 19.9 | 21.6 | 22.5 | 23.3 | 25.9 | 28.4 | 32.8 | 52.1 |
| Total | 24.0 | 26.1 | 29.3 | 32.5 | 33.6 | 33.9 | 37.4 | 39.7 | 45.5 | 71.8 |

Source: Department of Education estimates proposed for the President’s 2004 fiscal year budget.

The large majority of student loans are made to finance post-secondary education under federally guaranteed student loan programs, although many students and parents also obtain education funding through private student loan programs. Federally guaranteed student loan programs are highly regulated by the DOE. Under programs guaranteed by the federal government, banks and other lenders that satisfy statutory eligibility requirements can make student loans at below-market rates due to subsidies and guarantees. The largest student loan program, formerly called the Guaranteed Student Loan Program, or GSLP, and currently known as the Federal Family Education Loan Program, was created in 1965 to ensure affordable access by families to a full range of post-secondary educational institutions. In 1972, to encourage further bank participation in the GSLP, Congress established the Student Loan Marketing Association, known as Sallie Mae, a government-sponsored enterprise as a for-profit, public stockholder-owned, national secondary market for student loans. Currently, Sallie Mae is a wholly owned subsidiary of SLM Corporation. SLM Corporation was formed in 1997 as a Delaware corporation, marking the beginning of the privatization of Sallie Mae as a government-sponsored enterprise, to be completed by September 2006.

The FFEL Program currently includes a network of thousands of originators and educational institutions and 36 state-sponsored or non-profit guaranty agencies which guarantee and administer loans under contract with the DOE. A number of non-profit entities, banks and other financial intermediaries operate as secondary markets for student loans. Lender participation in the FFEL Program is relatively concentrated, with approximately 70% of outstanding loans held by the top ten participants, including nearly 40% owned or managed by Sallie Mae.

**Student Loan Business Model**

In general, a student applies for a loan from a financial institution through a school's financial aid office or directly from the financial institution. Typically, financial institutions acting as lenders or entities that service student loans are the source of student loan originations. A financial institution may hold the student loan it originates or sell its student loan portfolio to the secondary market. The characteristics of student loans typically result in those loans trading at a premium. This creates a situation that allows for selling the portfolio to the secondary market at a premium which frees up capital enabling the institution to originate new student loans. The secondary market is made up of a variety of non-profit entities, banks and for-profit companies. Typically, a participant in the secondary market funds loans purchased from the financial institution through the use of a warehouse financing line. Once a loan holder, such as Nelnet, has garnered enough loans, it may choose to finance the loans through an asset securitization vehicle. The student loans are generally transferred to a special purpose entity that pays for the loans through the issuance of debt. As a result of the federal guarantee of student loans, the senior tranches of notes in these securitizations are generally rated AAA, and the subordinated tranches are generally rated A or better.

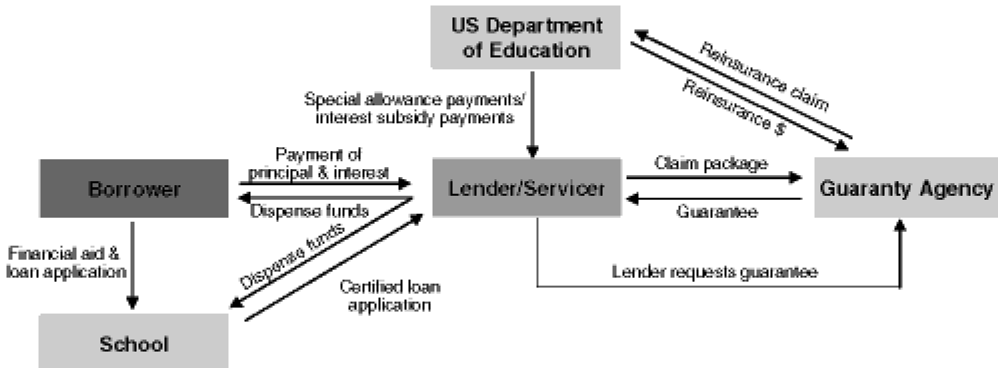
To induce lenders to enter the student loan market, the government assures that a lender receives a minimum yield on FFELP loans, regardless of whether rates change over the course of a year or whether rates exceed the cap on a borrower's loans. Depending on the type of student loan and when it was originated, the borrower rate is either fixed to term or is reset to a market rate each July 1. FFELP student loans generally earn interest at the greater of the borrower rate or a variable rate determined by reference to the average of the applicable index (91-day Treasury bill rate or 90-day commercial paper rate) in a calendar quarter plus a fixed spread that is dependent upon when the loan was originated and the loan's repayment status. If the resulting variable rate plus the applicable spread exceeds the borrower rate, the DOE pays the difference. This payment is referred to as the special allowance payment, or SAP. We refer to the fixed spread to the underlying index as the special allowance margin. In some declining interest rate environments, lenders earn additional spread income through the next reset date on those FFELP loans earning at the annually reset borrower rate. We refer to this additional income as variable rate floor income. On those FFELP loans with fixed to term borrower rates, primarily consolidation loans, lenders earn interest at the greater of the borrower rate or a variable rate based on the SAP formula.

Guaranty agencies expedite government reimbursement for defaulted student loans to eligible lenders. These guaranty agencies are non-profit institutions and state agencies that have entered into federal reimbursement contracts with the DOE pursuant to the Higher Education Act. Guaranty agencies collect revenue in the form of fees based upon new guarantees, the outstanding principal amount of loans guaranteed and default prevention activities. Reimbursement from a guaranty agency to the lender is contingent upon servicing in accordance with certain regulatory requirements. The guaranty agencies provide for 100% reimbursement of principal and accrued interest for loans disbursed before October 1, 1993 and 98% reimbursement of principal and accrued interest for loans disbursed on or after October 1, 1993, if the loans are serviced according to DOE guidelines. In addition, the lender is entitled to receive the full 100% of principal and accrued interest in the event of a borrower's death, disability or bankruptcy. Guaranty agencies reimburse eligible lenders from reserve accounts established for this purpose. The guaranty agency, in turn, receives reimbursement from the DOE. In the event a guaranty agency fails to pay, the lender can claim reimbursement directly from the DOE.

Servicing student loan assets is important because losses on defaults are largely mitigated by the servicer's ability to service the student loans according to DOE guidelines. Proper servicing of a student loan is required in order to maintain eligibility for interest subsidy payments and guarantee reimbursement for principal and accrued interest losses. As a result of the strict requirements and expense associated with properly servicing accounts, servicing is often outsourced by financial institutions and secondary market participants to specialized student loan servicers. This allows servicers to obtain economies of scale in their operations by aggregating student loans from a variety of market participants.

Claims rejected by the DOE or a guaranty agency may be "cured," which involves reinstatement of the guarantee. When the lender obtains a payment or a new signed repayment agreement from the borrower in the case of certain collection due diligence violations, the lender may receive reinstated interest subsidies and special allowance payments. Interest subsidies are interest payments made by the DOE on eligible loans while the borrower is in school and during grace and deferment periods.

The following chart illustrates the student loan process.




**Federal Student Loan Programs**

Federal student loans are made up of two primary programs:

- The Federal Family Education Loan Program, which is known as the FFEL Program or the FFELP.

- The William D. Ford Federal Direct Loan Program, which is known as the FDL Program or the FDLP.

The federal government guarantees the repayment of at least 98% of the principal balance and the accrued interest of all FFELP loans. In addition, the federal government subsidizes the interest cost of some of these loans. As described below, the amount of the subsidy a borrower receives and the repayment terms vary depending upon the type of loan and borrower.

***The Federal Family Education Loan Program***

The FFEL Program is a public-private partnership in which lenders make federally guaranteed student loans to students and their parents in coordination with school financial aid offices. During the 2002 federal fiscal year, which ended September 30, 2002, almost eight million new FFELP loans, which excludes consolidation loans, with a principal amount of $32.8 billion, were made to eligible borrowers, according to the DOE's fiscal year 2004 budget presentation.

Loans made under the FFEL Program include:

- ***Subsidized Federal Stafford Loans*** for students who pass a financial needs test. This loan type is the largest component of the FFEL Program, with aggregate borrowing limited to $23,000 for undergraduate students and $65,500 for graduate students. The federal government pays all interest costs for subsidized Stafford borrowers while borrowers are in school and during grace and deferment periods. The interest rate on these loans currently changes annually, but is capped at a maximum annual rate of 8.25%. During the 2002 federal fiscal year, $15.3 billion in subsidized Stafford loans were made, according to the DOE's fiscal year 2004 budget presentation.

- ***Unsubsidized Federal Stafford Loans*** for students who do not meet a financial needs test or who need to supplement their subsidized loans. Although borrowers may defer payment of interest while they are in school, they are responsible for all interest that accrues. The interest rate on these loans also changes annually and is capped at a maximum annual rate of 8.25%. During the 2002 federal fiscal year, $13.9 billion in unsubsidized Stafford loans were made, according to the DOE's fiscal year 2004 budget presentation.

- ***Federal PLUS Loans*** for parents of dependent undergraduate students. Although borrowers may defer payment of interest while their children are in school, they are responsible for all interest that accrues. Borrowers may borrow up to the cost of attendance per child, minus financial aid from other sources. The interest rate on PLUS loans is variable, but is capped at a maximum annual rate of 9.00%. During the 2002 federal fiscal year, $3.6 billion in PLUS loans were made, according to the DOE's fiscal year 2004 budget presentation.

- ***Federal Consolidation Loans*** designed to help borrowers manage repayment of multiple loans by combining all eligible loans into a single, new guaranteed FFELP loan with a longer repayment term, a fixed interest rate and a smaller total monthly payment. As a result of extended repayment periods associated with consolidation loans, total payments made by consolidation borrowers over the life of their consolidation loan are generally greater than those made by borrowers with standard repayment periods. According to the DOE, during the 2002 federal fiscal year $23.0 billion in federal consolidation loans were made in addition to the $32.8 billion in new loans made under the FFEL Program during the same year, due in part to record-low interest rates.

Participants in the FFEL Program include:

- ***Eligible Lenders.*** Eligible lenders, which are registered with the DOE, originate and hold FFELP loans and receive interest subsidy payments, special allowance payments and default reimbursement. Eligible lenders include banks, savings and loan associations, credit unions, pension funds, insurance companies and, under certain conditions, schools and guaranty agencies. Eligible lenders may also serve as a trustee on behalf of entities not otherwise eligible to hold FFELP loans, such as Nelnet, allowing such other entities to participate in the FFEL Program as a beneficial owner of the loan assets.

- ***Servicers.*** Servicing of student loan assets is critical for FFELP lenders because losses on defaults are mainly dependent on the servicer's ability to service the loans according to DOE guidelines. Proper servicing of a student loan is required in order to maintain eligibility for special allowance payments, interest subsidy payments and guarantee reimbursement.

- ***Guaranty Agencies.*** Guaranty agencies expedite reimbursement for defaulted student loans to eligible lenders. These guaranty agencies are non-profit institutions or state agencies that have entered into federal reimbursement contracts with the DOE pursuant to the Higher Education Act. Reimbursement from the guaranty agency to the lender is contingent upon servicing in accordance with certain regulatory requirements. There will be 100% reimbursement of principal and accrued interest for defaulted loans disbursed before October 1, 1993 and 98% reimbursement of principal and accrued interest for defaulted loans disbursed on or after October 1, 1993, if such loans are serviced according to DOE guidelines. Guaranty agencies reimburse eligible lenders from reserve accounts established for this purpose. The guaranty agency, in turn, receives reimbursement from the DOE. The level of reimbursement to the guaranty agency depends on a number of factors. Typically, guaranty agencies guarantee loans to students attending eligible institutions in the state or region serviced by the guaranty agency. They may also guarantee loans to students who reside in their own state or region, but who attend eligible institutions in another state or region. After a claim has been paid, the guaranty agency assumes ownership of the loan and is obligated to pursue post-disposition recoveries. The guaranty agency retains a percentage of post-disposition recoveries and reimburses the DOE with the remaining percentage.

- ***Department of Education.*** The DOE's regulations provide a number of incentives to student loan market participants. The DOE provides eligible private lenders with an incentive to lend to students by guaranteeing default reimbursement. When applicable, it also pays special allowance payments. The DOE provides eligible borrowers with an incentive to borrow by providing interest subsidies and capped interest rates. In the event of a guaranty agency bankruptcy or a determination by the DOE that the guaranty agency is unable to reimburse claims, an eligible lender has the right to submit claims directly to the DOE for payment. Under such circumstances, the DOE is obligated to pay the holder of the loan the full insurance obligation of the guaranty agency, subject to its servicing guidelines.

### *The Federal Direct Loan Program*

Under the FDL Program, loans are made directly by the federal government to borrowers. Most terms of FDLP loans are the same as FFELP loans. According to the DOE's fiscal year 2004 budget presentation, the $12.7 billion of FDLP loans in 2002 consisted of approximately $6.2 billion in subsidized Stafford loans, $4.9 billion in unsubsidized Stafford loans and $1.6 billion in PLUS loans. During the 2002 federal fiscal year, newly originated FDLP loans constituted 28% of total newly originated FFELP and FDLP loans, down from 33% during the 1998 federal fiscal year.

### *Reauthorization of the Higher Education Act*

The Higher Education Act, and thereby the federal student loan program, needs to be reauthorized every five years. The next reauthorization is set for September 2004. Some of the key issues being debated are:

- ***Single holder rule on consolidation loans.*** Currently, if only one lender holds all of a student's loans, then a competitor cannot consolidate the loans away from the current holder unless the current holder refuses to consolidate the loans for the borrower. There is a high probability that the single holder rule will be eliminated during reauthorization. In the industry as a whole, a large portion of all non-consolidated loans are currently held by only one lender. Elimination of the single holder rule would open up a portion of the market to increased competition.

- ***The ability to refinance consolidation loans.*** Currently, once a loan is consolidated, it cannot be refinanced by another government guaranteed student loan unless subsequent FFELP loans are made to the borrower. If this rule changes, the amount of consolidation loans that are refinanced could be significant.

- ***Variable-rate consolidation loans and extended repayment of Stafford loans.*** Reauthorization proposals have been made to Congress that would continue variable borrower rates for Stafford and PLUS loans beyond July 1, 2006. In addition, language has been suggested that would permit new consolidation loans to have variable rates. Language has also been proposed that would allow Stafford/PLUS borrowers to have extended repayment terms, similar to those terms provided for under the loan consolidation program. Both of these initiatives would offset two of the most appealing aspects of consolidation loans, *i.e.* , long-term fixed rates and extended repayment. Adoption of these initiatives could decrease consolidation opportunities in the market.

- ***9.5% floor income.*** Student loans originated or acquired with the proceeds of tax-exempt obligations issued prior to October 1, 1993 are subject to a minimum, or floor, rate of return of 9.5% per year based upon provisions of the Higher Education Act and related interpretations by the DOE. Reauthorization proposals have been made to Congress that would limit the minimum return to those loans which are funded directly with tax-exempt obligations and potentially eliminate excess earnings on loans subsequently funded with taxable obligations. Adoption of this initiative could decrease loan interest income to lenders receiving 9.5% floor income.

- ***Variable rate floor income.*** Language has been proposed that would eliminate the potential of excess earnings on student loans that are reset annually in a declining interest rate environment. Adoption of this initiative could decrease loan interest income to lenders receiving variable rate floor income.

- ***Borrower limits.*** For the last 20 years, the maximum amount that a freshman or sophomore can borrow has remained around $2,500. Educational tuition has increased at approximately two times the rate of inflation over this same time frame. There is a possibility that these borrower limits could be increased, thereby potentially increasing the average size of future loan originations in the market.

## BUSINESS

### Overview

We are a vertically integrated education finance company, with over $10 billion in total assets, making us one of the leading education finance companies in the country. We are focused on providing quality products and services to participants in the education finance process. Headquartered in Lincoln, Nebraska, we originate, hold and service student loans, principally loans originated under the FFEL Program. For 2002, we were the fourth largest holder and second largest servicer of FFELP loans. In addition, we, together with our branding partners, originated and acquired approximately $2.7 billion of FFELP loans in 2002, making us a leading originator and acquirer of FFELP loans.

We offer a broad range of financial services and technology-based products, including student loan origination and lending, student loan and guarantee servicing and a suite of software solutions. Our products are designed to simplify the student loan process by automating financial aid delivery, loan processing and funds disbursement. Our infrastructure, technological expertise and breadth of product and service offerings connect the key constituents of the student loan process, including lenders, financial aid officers, guaranty agencies, governmental agencies, student and parent borrowers, servicers and the capital markets, thereby streamlining the education finance process.

Our business is comprised of four primary product and service offerings:

- ***Student loan originations, acquisitions and portfolio management.*** We provide student loan sales, marketing, originations, acquisition and portfolio management. We own a large portfolio of student loan assets through a series of education lending subsidiaries. As of June 30, 2003, our student loan portfolio was $9.5 billion, consisting of over 99% of FFELP loans and less than 1% of private loans. We generate loans owned in special purpose lending facilities through direct origination or through acquisition of loans. We generate the majority of our earnings from the spread between the yield we earn on our student loan portfolio and the cost of funding these loans. We also provide marketing and sales support and managerial and administrative support related to our asset generation activities, as well as those performed for our branding partners or other lenders who sell such loans. Revenues are primarily generated from interest earnings. While our net interest margin may vary due to fluctuations in interest rates, government special allowance payments ensure that we receive a minimum yield on our student loans, so long as certain requirements are met.

- ***Student loan servicing.*** We service our student loan portfolio and the portfolios of third parties. We currently service or provide complete outsourcing of servicing activities for $18 billion in student loans, including approximately $8.3 billion of loans in our own portfolio. The servicing activities include loan origination activities, application processing, borrower updates, payment processing, claim processing and due diligence procedures. These activities are performed internally for our own portfolio and generate fee revenue when performed for third-party clients.

- ***Guarantee servicing.*** We provide servicing support to guaranty agencies, which includes system software, hardware and telecommunication support, borrower and loan updates, default aversion tracking services, claim processing services and post-default collection services. We currently provide servicing support to agencies that guarantee $18 billion of FFELP loans. These activities generate fee revenue in addition to expanding our relationship with other participants in the education finance sector.

- ***Servicing software.*** We provide student loan servicing software internally and to third-party student loan holders and servicers. In addition to the $18 billion in student loans which we service directly, our software products are used to service an additional $30 billion in student loans. We earn software license and maintenance fees annually from third-party clients for use of this software. We also provide computer consulting, custom software applications and customer service support.

We generate the majority of our earnings from the spread between the yield we receive on our student loan portfolio and the cost of funding these loans. While the spread may vary due to fluctuations in interest rates, government special allowance payments ensure that we receive a minimum yield on our student loans, so long as certain requirements are met. We also earn fees from student loan and guarantee servicing and licensing fees from our servicing software. Earnings growth is primarily driven by the growth in the student loan portfolio and growth in our fee-based product and service offerings, coupled with cost-effective financing and expense management. For the year ended December 31, 2002, we generated net interest income of $190.9 million, total other income, including loan servicing income, of $125.8 million and net income of $48.5 million.

We originate and acquire student loans through a variety of methods, or channels, including:

- our direct channel, in which we originate student loans in one of our brand names directly to student and parent borrowers, which accounted for 40.7% of the student loans we originated and acquired in 2002;

- our branding partner channel, in which we acquire student loans from lenders to whom we provide marketing and origination services, which accounted for 19.5% of the student loans we originated and acquired in 2002; and

- our forward flow channel, in which we acquire student loans from lenders to whom we provide origination services, but provide no marketing services, or who have agreed to sell loans to us under forward sale commitments, which accounted for 21.7% of the student loans we originated and acquired in 2002.

In addition, we also acquire student loans through spot purchases and whole-company acquisitions, which accounted for 18.1% of the student loans that we originated and acquired in 2002.

Of the $2.7 billion in FFELP loans we originated and acquired in 2002, $859 million were loans consolidated through our direct channel. As of June 30, 2003, our student loan portfolio was $9.5 billion.

We currently service $18 billion in student loans, and our software is used by third parties to service an additional $30 billion in student loans. In addition, we currently provide servicing support to guaranty agencies on a total of $18 billion of FFELP loans. Servicing support includes functions such as system software, hardware and telecommunication support, borrower and loan updates, default aversion tracking services, claim processing services and post-default collection services. We provide student loan servicing and origination functions either directly or indirectly to more than 1.7 million borrowers at hundreds of colleges and universities through our proprietary software products and outsourcing functions.

Over 99% of the student loans in our portfolio as of June 30, 2003 were FFELP loans, as opposed to the less than 1% of private loans in our portfolio that did not carry federal guarantees. At least 98% of the principal and accrued interest of FFELP loans is guaranteed by the federal government, provided that we meet certain procedures and standards specified in the Higher Education Act. We believe we are in material compliance with the procedures and standards as required in the Higher Education Act. FFELP loans originated prior to October 1, 1993 carry a 100% guarantee on the principal amount and accrued interest, and FFELP loans originated after that date are guaranteed for 98% of the principal amount and accrued interest. As a result, holders of FFELP loan portfolios historically have experienced minimal losses net of the guarantee. Our net loan losses on FFELP loans in 2002 were approximately $2.7 million, or less than 0.04% of our average FFELP loan portfolio.

***Our History***

We have a 25-year history dating back to the formation of UNIPAC Service Corporation in 1978. UNIPAC was formed to service loans for Union Bank and Trust Company of Lincoln, Nebraska and Packers Service Corporation of Omaha, Nebraska. It grew its third-party student loan servicing business to approximately $9.7 billion in loans in 2000, when it was merged with Nelnet. Our immediate predecessor was formed in 1996 as a student loan acquisition company, and, prior to the merger, it had built its student loan portfolio through a series of spot portfolio acquisitions and later through student loan company acquisitions.

In 2000, we decided to create a vertically integrated platform that would be able to compete in each sector of the student loan industry. Over the past three years we have acquired several education finance services companies, including a student loan secondary market company. In addition, in August 2003, we acquired the securities company that provides us with broker-dealer services in connection with our asset-backed securitizations.

We executed these acquisitions to complete our effort to vertically integrate and add geographic diversity and operational expertise to our education finance platform. We have successfully integrated these companies into the Nelnet platform, and they have increased our profitability as a result. We now believe that we have all of the key components of our vertical integration strategy. Going forward, we intend to focus principally on organic growth while opportunistically making company and portfolio acquisitions.

**Competitive Strengths**

We believe that the following competitive strengths are important to maintaining our growth, profitability and standing in our industry:

- Focused leader with vertically integrated platform.

- High-quality loan portfolio established through our concentration on FFELP loans.

- Strong relationships with student loan market constituents.

- Access to cost-effective financings.

- Leading, cost-competitive servicing platform with a focus on asset protection.

- Comprehensive suite of software products.

- Management team with significant operating and acquisition experience.

***Focused leader with vertically integrated platform.*** We maintain a strong position and deep expertise in each of our product and service offerings and are well positioned to capitalize on industry growth. We were among the largest holders of federally guaranteed student loans with $9.5 billion of loans outstanding as of June 30, 2003. In 2002, we originated and acquired $2.7 billion in student loans, including $859 million in consolidation loans. We currently service $18 billion in student loans, and our software is used by third parties to service an additional $30 billion in student loans. In addition, we currently provide servicing support to guaranty agencies that guarantee $18 billion in student loans. We have relationships with hundreds of colleges and universities and provide loan servicing either directly or through our proprietary software to approximately 1.7 million borrowers. We provide school financial aid offices and students a comprehensive, full-service student lending package (Stafford, PLUS, consolidation and private loans), loan and guarantee servicing and loan servicing software. By offering the full range of services required for student lending, we facilitate and streamline the student lending process. Our established servicing capability allows us to service our student loan portfolio rather than outsourcing this task to a third party. In addition, our technology product suite often enables us to gain access to schools, creating new lending opportunities, as well as deepening our existing relationships by increasing our share of a school’s loan volume. We use the technology to enhance our relationships, offer more services to each customer, reduce operating expenses and increase our revenues and profitability. Our vertically integrated platform allows us to take advantage of economies of scale and run a cost-efficient operation.

***High-quality loan portfolio established through our concentration on FFELP loans.*** We have focused our lending operations on FFELP loans, which carry at least a 98% federal guarantee on principal and accrued interest. As of June 30, 2003, more than 99%, or $9.4 billion, of our student loan portfolio consisted of FFELP loans and less than 1%, or $87 million, consisted of private loans, which do not carry a federal guarantee. We maintain strict underwriting criteria for our private loan portfolio.

***Strong relationships with student loan market constituents.*** We use a network of student loan channels to offer services to students, schools, lenders and secondary markets throughout the United States. As part of our loan origination activities, we have established long-term strategic relationships either directly with school financial aid offices or with eligible banks and schools that function as “branding” partners, who direct committed portions of their originations to us through forward flow commitments. Financial aid offices can have considerable influence on students’ selections of lenders. The effort and expense to create and maintain these relationships, as well as the low turnover of selected providers, acts as a barrier to entry for competitors. Our branding partners act as alternative channels for origination and have strong brand recognition in the areas on which they focus. By utilizing the appropriate and effective brand, we can cost-effectively leverage our penetration at different schools and throughout certain regions of the United States.

***Access to cost-effective financings.*** We currently have a loan warehousing capacity of over $2 billion through 364-day commercial paper conduit programs maturing at different times and participation funding arrangements committed on a short-term basis by various financial institutions. Our large warehousing capacity allows us to pool student loans in order to aggregate sufficient volume for cost-effective, long-term financing and to time securitization market conditions properly. Generally, loans that best fit long-term financing vehicles are selected to be transferred into one of our long-term securitizations. Because transferring those loans to a long-term securitization includes certain fixed administrative costs, we maximize the economies of scale by executing large transactions that routinely price in line with our largest competitor within the student loan industry.

***Leading, cost-competitive servicing platform with a focus on asset protection.*** We have built a leading, nationally recognized student loan servicing platform. We believe that a servicing operation is critical to success as a lender in the student loan marketplace. The servicing platform is the mechanism that facilitates interaction with borrowers. Our servicing portfolio includes both loans from our lending portfolio as well as from third parties. Nelnet-originated and third-party serviced loans utilize the same servicing platform, technology and employee base and are all serviced in exactly the same manner. The quality of our servicing operation is best demonstrated by our low initial claim reject rate due to servicer error. The quality of our servicing capability is also a key factor in preserving the federal guarantee on our FFELP loans. In 2002, our initial claim reject rate was only approximately 0.25%. The technological focus of our servicing platform, coupled with economies of scale, has enabled us to create a competitive cost structure.

***Comprehensive suite of software products.*** Our products include an Internet-based financial aid delivery and management system, an Internet-based loan origination system and a centralized disbursement agent service. Our “open architecture” origination products afford schools the flexibility to work with multiple lenders of their choice. These products are directly integrated into our servicing platform, which provides various features such as loan approval, disbursement of funds, customer service, account maintenance, federal reporting and billing collections, payment processing, default aversion, claim filing and uninsured loan recovery. Our software products include:

- ***Nteract*** — our Internet-based student loan origination system.
- ***Nconcert*** — our Internet-based financial aid delivery and management system.
- ***Ntrust*** — our centralized disbursement agent service.
- ***Ngenius*** — our origination and disbursement engine that supports Nconcert, Ntrust and Nteract.
- ***Nservice*** — our servicing system for FFELP and private loans.

These programs are designed to reduce paperwork, streamline the approval process and improve communication between a school’s financial aid office and its students. The software unites financial aid offices, lenders, students, secondary markets and servicing companies, reducing turnaround time, simplifying the process for students and providing better service with fewer errors.

***Management team with significant operating and acquisition experience.*** Our management is led by Co-Chief Executive Officers Michael S. Dunlap and Stephen F. Butterfield. Mr. Dunlap has worked in the financial services industry for 20 years, having served previously as chief executive officer of Union Bank of Nebraska. Mr. Butterfield has worked in the student loan industry for 14 years and the broader financial services industry for 29 years. Mr. Dunlap focuses on our day-to-day operating activities, and Mr. Butterfield focuses on capital markets and investor relations. Our senior employees with management responsibilities have been with us or one of our predecessor companies for an average of over ten years. Furthermore, we have successfully integrated the companies that we have acquired and have retained their key employees. As a result, we have a management team with significant experience and knowledge in both student loan operations and portfolio and company acquisitions.

**Strategy**

Our corporate objective is to further our leadership position in the student loan industry. We intend to achieve this objective by executing the following strategies:

- Establish and maintain leadership in all our product and service offerings by utilizing our technology.
- Focus on increasing our organic growth while maintaining a low-cost infrastructure.
- Strengthen existing relationships while establishing new ones.
- Continue our commitment to highly focused and disciplined loan origination and acquisition practices.
- Opportunistically make company and portfolio acquisitions.

***Establish and maintain leadership in all our product and service offerings by utilizing our technology.*** We believe that our technology solutions position us as a leading provider for the student lending market. We believe the expanded utilization of our technology products by lenders, schools, guaranty agencies and borrowers will promote our student loan originations and acquisitions. Our user-friendly software not only allows us to service loans both internally and for third parties, but also continues to facilitate our growing position as a preferred originator and holder of loans for schools and borrowers. We will continue to invest, develop and upgrade our technology to help solidify our leadership position and further penetrate our potential market.

***Focus on increasing our organic growth while maintaining a low-cost infrastructure.*** We will continue to grow our student loan portfolio and maintain and capitalize on our low-cost infrastructure to realize increased profitability as the industry expands. We believe there is continued opportunity for significant growth in light of the DOE’s projected growth rates for the student loan industry. To increase our organic growth, we have expanded our sales and marketing force to promote FFELP loan origination and consolidation efforts. We believe the infrastructure we have developed has positioned us to continue to achieve economies of scale and be a low-cost provider to our customers. In this regard, we decreased our operating expenses as a percentage of average student loans from 0.78% in 1998 to 0.54% in 2002.

***Strengthen existing relationships while establishing new ones.*** We have extensive customer relationships with schools and lenders throughout the United States. We will continue to focus on expanding the loan volume associated with these existing relationships, while establishing new ones through our sales force. We have a sales force of over 300 people, of whom approximately 80 are calling directly on colleges and universities, while the remaining approximately 220 focus on marketing directly to borrowers. We will continue to take advantage of the sales force’s experience as well as our management’s industry knowledge and relationships.

***Continue our commitment to highly focused and disciplined loan origination and acquisition practices.*** We will continue to pursue our conservative approach to asset quality by concentrating on originating, acquiring and holding federally guaranteed loans through the FFEL Program, while maintaining a disciplined underwriting approach to private loans. As of June 30, 2003, our student loan portfolio was comprised of over 99% FFELP loans and less than 1% private loans. Due to existing commitments, we expect the percentage of private loans in our student portfolio to increase to between 1% and 2% over the next three years. Future circumstances may dictate or warrant incremental increases. In any event, we will maintain our strict underwriting standards for the limited amount of private loans in our portfolio.

***Opportunistically make company and portfolio acquisitions.*** Although we have reached a point in our development where we offer a comprehensive set of products and services essential to our vertically integrated business model and benefit from economies of scale and organic growth, we will still consider acquisitions in the future. These may include either individual companies or loan portfolios that we believe have the potential to enhance long-term shareholder value. Since our inception, we have a successful track record of acquisitions. We have acquired and successfully integrated more than ten education finance related companies and have retained their key employees. As a result, we have the experience and skill sets necessary to acquire and integrate additional targets that add long-term value to our franchise and are accretive to earnings.

## Product and Service Offerings

### *Student Loan Origination, Acquisition and Portfolio Management*

Our student loan origination, acquisition and portfolio management business is our largest product and service offering and drives the majority of our earnings. When we originate FFELP loans on our own behalf or when we acquire FFELP loans from others, we engage one or more "eligible lenders," as defined in the Higher Education Act, to act as our trustees to hold title to all such originated and acquired FFELP loans. These eligible lender trustees hold the legal title to our FFELP loans, and we hold 100% of the beneficial interests in those loans. We have originated and acquired approximately $7.0 billion in student loans since January 1, 2000, excluding subsidiary acquisitions. We often originate loans using the Nelnet brand name but, in many cases, we use well-known, geographically strategic brand names of our branding partners, such as Education Solutions, Inc. and Union Bank and Trust Company. This strategy gives us the flexibility to market the brand with the best recognition in a given region or at a given college or university. We originated 9.7%, 40.7% and 46.5% of the loans added to our student loan portfolio in 2001, 2002 and the first six months of 2003, respectively.

The branding partner channel for FFELP loan acquisitions is established by our various contracts with FFELP lenders. In 2001, 2002 and the first six months of 2003, 36.2%, 19.5% and 33.3% of our loan acquisitions were attributable to this channel. We frequently act as exclusive marketing agent for some branding partners in specified geographic areas. We ordinarily purchase loans originated by those branding partners pursuant to a commitment to purchase loans at a premium above par, shortly following full disbursement of the loans. We ordinarily retain rights to acquire loans subsequently made to the same borrowers, or serial loans. Some branding partners, however, retain rights to portions of their loan originations. Origination and servicing of loans made by branding partners is performed by us during the lives of loan origination and servicing agreements so that loans do not need to be changed to a different servicer upon purchase by us. The marketing agreements and commitments to purchase loans are ordinarily for the same term, which is commonly three to five years in duration. These agreements ordinarily contain provisions for automatic renewal for successive terms, subject to termination by notice at the end of a term or early termination for breach. We are generally obligated to purchase all of the loans originated by our branding partners under these commitments, although our branding partners are not obligated to provide us with a minimum amount of loans.

In addition to the branding partner channel, we have established a forward flow channel for acquiring FFELP loans from third parties. In 2001, 2002 and the first six months of 2003, 33.4%, 21.7% and 16.8% of our loan acquisitions were attributable to this channel. The forward flow channel is established by entering into various agreements pursuant to which FFELP lenders retain responsibilities for marketing, but commit to sell all or a portion of their future originations to us at a premium. These forward flow commitments frequently obligate the lender to sell all loans made by the applicable lender, but in other instances are limited to sales of loans originated in certain specific geographic regions or exclude loans that are otherwise committed for sale to third parties. We are generally obligated to purchase loans subject to forward flow commitments shortly following full disbursement, although our forward flow lenders are not obligated to provide us with a minimum amount of loans. We typically retain rights to purchase serial loans. The loans subject to purchase are generally subject to a servicing agreement with us for the life of each such loan. Such forward flow commitments ordinarily are for terms of three to five years in duration.

As of June 30, 2003, the characteristics of our student loan portfolio, exclusive of the unamortized cost of acquisition, were as described below.

**Composition of Student Loan Portfolio**
**(As of June 30, 2003)**
**(dollars in thousands, except average outstanding balances)**

| | |
|---|---|
| Loans outstanding | $9,317,847 |
| FFELP loans: | |
| Stafford loans | $5,246,649 |
| PLUS/ SLS loans(a) | $298,341 |
| Consolidation loans | $3,685,876 |
| Private loans | $86,981 |
| Number of borrowers | 771,079 |
| Average outstanding principal balance per borrower | $12,084 |
| Number of loans | 2,110,278 |
| Average outstanding principal balance per loan | $4,415 |
| Weighted average annual interest rate | 5.03% |
| Weighted average remaining term (months) | 167.2 |

(a) Supplemental Loans for Students, or SLS, are the predecessor to unsubsidized Stafford loans.

Once a student’s loans have entered the repayment or grace period, they are eligible to be consolidated if they meet certain requirements. Loan consolidation allows borrowers to make one payment per month and extend the loan repayment period. In addition to these attributes, in recent years, historically low interest rates have contributed to demand for consolidation loans. To meet this demand, we have developed an extensive loan consolidation department to serve borrowers with loans in our portfolio as well as borrowers whose loans are held by other lenders.

Our capital markets and portfolio administration departments provide financing options to fund our loan portfolio. We have a warehousing capacity of over $2 billion through 364-day commercial paper conduit programs and participation funding arrangements. These transactions provide short-term asset financing for the purchase of student loan portfolios. The financings are constructed to offer short-term capital and are annually renewable.

Short-term warehousing allows us to buy and manage student loans prior to transferring them into more permanent financing arrangements. Our large warehousing capacity allows us to pool student loans in order to maximize loan portfolio characteristics for efficient financing and to properly time market conditions. Generally, loans that best fit long-term financing vehicles are selected to be transferred into one of our long-term securitizations. Because transferring those loans to a long-term securitization includes certain fixed administrative costs, we maximize our economies of scale by executing large transactions that routinely price in line with our largest competitor. We are a frequent issuer and benefit from a high level of name recognition by the asset-backed investment community.

We currently have approximately $8 billion in asset-backed securities issued, including auction-rate notes whose interest rates are reset periodically. These asset-backed securities allow us to finance student loan assets over multiple years, thereby eliminating the renewal risk associated with warehouse vehicles.

We rely upon securitization vehicles as our most significant source of funding for student loans on a long-term basis. The net cash flow we receive from the securitized student loans generally represents the excess amounts, if any, generated by the underlying student loans over the amounts required to be paid to the bondholders, after deducting servicing fees and any other expenses relating to the securitizations. In addition, some of the residual interests in these securitizations may have been pledged to secure additional bond obligations. Our rights to cash flow from securitized student loans are subordinate to bondholder interests and may fail to generate any cash flow beyond what is due to pay bondholders.

Our original securitization transactions began in 1996, utilizing a master trust structure, and were privately placed auction-rate note securitizations. As the size and volume of our securitizations increased, we began publicly offering asset-backed securities under shelf registration statements, using special purpose entities. When we deemed long-term interest rates attractive, we issued fixed-rate debt backed by cash flows from FFELP loans with fixed-rate floors which effectively match the funding of our assets and liabilities. In 2002, we began accessing the term asset-backed securities market by issuing amortizing multi-tranche LIBOR-indexed variable-rate debt securities. Almost all of the securitization debt that we have issued since 1996 is still outstanding today, including the taxable and tax-exempt securitization debt issued by companies we have acquired. We have utilized financial guarantees from monoline insurers and senior/ subordinate structures to assist in obtaining “AAA” ratings on our senior securitized debt in addition to cash reserves and excess spread to assist in obtaining “A” and “AA” ratings on our subordinated debt. We intend to continue to issue auction rate notes, variable-rate and fixed-rate term asset-backed securities and debt securities through other asset funding vehicles in order to minimize our cost of funds and give us the most flexibility to optimize the return on our student loan assets.

Our student loan origination and lending activities could be significantly impacted by the reauthorization of the Higher Education Act. For example, if the single holder rule, which generally restricts a competitor from consolidating loans away from a holder that owns all of a student’s loans, is abolished, a substantial portion of our non-consolidated portfolio would be at risk of being consolidated away by a competitor. On the other hand, abolition of the rule would also open up a portion of the rest of the market and provide us with the potential to gain market share. The portion of the rest of the market that would be opened up to us, as measured in aggregate principal amount of student loans, would be greater than the portion of our non-consolidated portfolio that would be at risk of being consolidated by a competitor. Other potential changes which could impact us include:

- allowing refinancing of consolidation loans, which would open approximately 39% of our portfolio to such refinancing;

- allowing for variable-rate consolidation loans and extended repayment terms of Stafford loans, which would lead to less loans lost through consolidation of our portfolio, but would also decrease our consolidation opportunities; and

- allowing for increased borrower limits, which may provide opportunities for increasing the average size of our future loan originations.

A further description of the issues in connection with the reauthorization of the Higher Education Act appears under “Industry Overview — Federal Student Loan Programs — Reauthorization of the Higher Education Act.”

In addition, our efforts to expand into the consolidation market are expected to be affected by recently amended Federal Trade Commission rules and similar state regulations providing for so-called “do not call” registries. Under these rules, consumers may have their phone numbers added to a “do not call” registry, and we would generally be prohibited from calling any such consumers to market our products and services. This rule may restrict our ability to market effectively our products and services to new customers. Furthermore, compliance with this new rule may prove difficult, and we may incur penalties for improperly conducting our marketing activities.

***Student Loan Servicing***

We specialize in the servicing of federally guaranteed and private student loans. Our servicing division offers lenders across the country a complete line of education loan services, including recovery of non-guaranteed loans, application processing, disbursement of funds, customer service, account maintenance, federal reporting and billing collections, payment processing, default aversion and claim filing.

Our quality and experience in student loan servicing is evident in the historical performance of our entire pool of loan assets, which enjoys a very low initial claim rejection rate due to servicer error, which is the percent of claims submitted by us or our servicing customers rejected by a guaranty agency due to servicer error. In 2002, the initial claim rejection rate due to servicer error was approximately 0.25% of all claims filed by us or servicing customers. The substantial majority of these initial claim rejections are cured, meaning a payment or the borrower's promise to pay has been received. Historically, the aggregate of our losses and those of our servicing customers from rejected loans and interest denials has been less than $1 million per year, or less than 0.01% of our average servicing portfolio.

As we expand our student loan origination and acquisition activities, we may face increased competition with some of our servicing customers. In the past, including in one case recently, servicing customers have terminated their servicing relationships with us, and we could in the future lose more servicing customers as a result. However, due to our life-of-loan servicing agreements, we do not expect this loss and potential loss of customers to have a material adverse effect on our results of operations for the foreseeable future.

***Guarantee Servicing***

We provide servicing support for $18 billion in guaranteed student loans. This servicing support is provided to guaranty agencies, which are the organizations that serve as the intermediary between the federal government and the lender and who are responsible for paying the claims made on defaulted loans. One of our guarantee servicing customers recently notified us of its intention not to renew its servicing contract. The loss of this customer is not expected to have a material effect on our results of operations.

***Servicing Software***

Our servicing software is focused on providing technology solutions to education finance issues. Our subsidiaries, Idaho Financial Associates, Inc. and Charter Account Systems, Inc. provide student loan software and support for entities involved in the asset management aspects of the student loan arena. In addition, 5280 Solutions, Inc., of which we own a 50% interest, provides customized software solutions to help in the administration and management of the student loan process. Staffed with more than 100 programmers, support staff and administrative support personnel, we provide software and maintenance to more than 25 different clients servicing $30 billion in student loan assets.

**Software Products**

Our software products are designed to provide us loan origination access to colleges and universities, while simplifying the financial aid process. We also license our servicing software products to third-party student loan holders and servicers. Our software products include the following:

- *Nteract* – an Internet-based, open-architecture student loan origination and disbursement management system. Nteract provides a complete solution for processing FFELP and private student loan certifications, initiating change transactions and comprehensive application through disbursement reporting. Nteract operates in a real-time environment and can be accessed for online inquiry at any time 24 hours a day, seven days a week. Nteract is used by our student loan origination, acquisition and portfolio management unit and our student loan servicing unit.

- *Nconcert* – our Internet-based, open-architecture financial aid delivery and management system. Nconcert is used by our student loan origination, acquisition and portfolio management unit and our student loan servicing unit.

- *Ntrust* – a centralized disbursement service. It is a comprehensive, open-architecture solution for receiving FFELP and private student loan funds, reports and the student loan industry's standardized data files. Ntrust provides a single point of contact for the college or university's entire electronic loan processing needs and provides real-time loan disbursement adjustment processing. Ntrust is used by our student loan origination, acquisition and portfolio management unit and our student loan servicing unit.

- *Ngenius* – the origination engine that supports the Nconcert, Ntrust and Nteract products. Used internally for our loan origination initiatives and those of our customers, it is a table-driven origination platform which provides flexibility and scalability. The system interacts with multiple guaranty agencies and can support an "instant" guarantee. Ngenius is used by our student loan origination, acquisition and portfolio management unit and our student loan servicing unit.

- *Nservice* – our servicing engine for FFELP and private loans. The Nservice system is a profile driven system, allowing for easy implementation of most regulatory changes and rapid development of custom loan programs. Software development is aided by the use of high-level application development tools to speed delivery of enhancements. The Nservice system provides for automated compliance with most Higher Education Act regulations. Nservice also facilitates the servicing of FFELP and private loans into a single, integrated servicing environment, improving service to schools, borrowers and lenders. Nservice is used by our student loan servicing unit, and the software is also licensed to third-party student loan holders and servicers by our servicing software unit.

In addition to the products described above, we offer a variety of borrower services to assist students and parents in navigating the financial aid process. These services include our unique @theU higher education resource, which provides free information on college planning and financial aid, paired with a loyalty program to allow members to earn credit toward reducing the balance of a student loan regardless of lender or servicer. Another product, Nelnet Notes, provides online assistance to help borrowers better understand the financial aid process, as well as broader money management issues.

Generally, our non-servicing related software products are operated for the benefit of our school and borrower customers on our hardware without specific charges to the school or borrowers. Our servicing software can be licensed to third parties for use on their hardware for which they pay annual license and maintenance fees.

Our software products, including website content and functionality, have been developed and maintained using internal business and technical resources. External software consultants are utilized on selected occasions when circumstances require specific technical knowledge or experience. Costs associated with research and development related to the development of computer software are expensed when incurred in accordance with SFAS No. 86, *Accounting for the Cost of Computer Software to be Sold, Leased or Otherwise Marketed.* Research and development machinery and equipment that have alternative future uses either in research and development activities or otherwise are capitalized and depreciated over their useful lives.

All costs associated with website development or the maintenance of existing software products are expensed when incurred. We also capitalize software costs under the provisions of Statement of Position 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use* . Material software developments or enhancements that are considered to have useful lives of greater than one year are capitalized and amortized over their useful lives. Costs related to maintaining our purchased software including the costs of programming are expensed as incurred. Purchased software is capitalized and amortized over the estimated useful life.

**Intellectual Property**

We own numerous trademarks and service marks to identify our various products and services, both by words and logos, or by "design" marks. We currently have approximately 15 pending and ten registered marks for such products and services, and we actively assert our rights to those marks when we believe potential infringement may be occurring. We believe our marks and logos have developed and continue to develop strong brand-name recognition in our industry and the consumer marketplace. Each of these marks has, upon registration, an indefinite duration so long as we continue to use the mark on or in connection with such goods or services as the mark identifies. In order to protect the indefinite duration, we make filings to continue registration of these marks. We own one patent application that has been published with respect to a customer-loyalty program and have also actively asserted our rights thereunder in situations where we believe our claims may be infringed upon. If such patent is granted, it will have a duration and effect of 20 years from the date of application. We own many copyright-protected works, including our various computer system codes and displays, websites, publications and marketing collateral. We also have trade secret rights to many of our processes and strategies, and our software product designs.

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

**Seasonality**

Origination of student loans is generally subject to seasonal trends, which correspond to the beginning of each semester of the school year. Student loans are disbursed as directed by the school and are usually divided into two or three equal disbursements released at specified times during the school year. The two periods of August through October and December through February account for approximately 73% of our total annual disbursements. While applications and disbursements are seasonal, our earnings are generally not tied to this cycle. Due to our portfolio size, new disbursements or run-off for any given month will not materially change the net interest earnings of the portfolio. Consolidation loans are generally made prior to or immediately after the July 1 reset in a rising or falling interest rate environment.

**Customers**

We provide student loan servicing either directly or through our proprietary software to approximately 1.7 million borrowers. We have direct and indirect relationships with hundreds of colleges and universities across the nation. We have servicing agreements with 239 customers and software license agreements with 34 licensees. Notwithstanding the depth of our customer base, our business is subject to some vulnerability arising from concentrations of: loan origination volume with borrowers attending certain schools; loan origination volume generated by certain branding partners; loan and guarantee servicing volume generated by certain loan servicing customers and guaranty agencies; and software licensing volume generated by certain licensees. Our ability to maintain strong relationships with significant schools, branding partners, servicing customers, guaranty agencies and software licensees is subject to a variety of risks. Termination of such a strong relationship could result in a material adverse effect on our business. Losses of relationships with a significant branding partner such as Union Bank and Trust Company or with schools such as University of Phoenix or Nova Southeastern University could have a material adverse effect on us.

**Competition**

We face competition from many lenders in the highly competitive student loan industry. Using our size, we have leveraged economies of scale to gain market share and compete by offering a full array of FFELP and private loan products and services. In addition, we differentiate ourselves from other lenders through our vertical integration, technology and strong relationships with colleges and universities.

We view SLM Corporation, the parent company of Sallie Mae, as our largest competitor in loan origination, holding and servicing. SLM Corporation services nearly half of all outstanding FFELP loans and is the largest holder of student loans, with a portfolio of nearly $70 billion. Large national and regional banks are also strong competition, although many are involved only in origination. In different geographic locations across the country, we run into strong competition from the local tax-exempt student loan secondary markets. The FDL Program has also reduced the origination volume available for FFEL Program participants, which in 2002 accounted for 28% of total volume, although this portion of total volume has decreased from approximately 33% in 1998. In addition, in the last few years, low interest rates have attracted many new competitors to the student loan consolidation business.

**Employees**

As of June 30, 2003, we had approximately 1,890 employees. Approximately 670 of these employees hold professional and management positions while 1,220 are in support and operational positions. None of our employees is covered by collective bargaining agreements. We are not involved in any material disputes with any of our employees, and we believe that relations with our employees are good.

**Properties**

We maintain 14 principal offices in cities across the United States. We do not own any of our principal facilities. The following table lists the principal facilities leased by us.

| Location | Function | Square footage | Lease expiration date |
|---|---|---|---|
| Albany, NY | Charter Software Licensing | 3,550 | September 2004 |
| Boise, ID | IFA Software Licensing | 9,993 | August 2005 |
| Denver, CO | Loan Servicing, Executive Management, Technology | 106,185 | February 2008 |
| Fredericksburg, VA | Loan Consolidation | 18,000 | May 2007 |
| Honolulu, HI | Sales | 611 | October 2004 |
| Indianapolis, IN | Loan Servicing, Loan Generation | 58,770 | February 2008 |
| Jacksonville, FL | Loan Servicing, Loan Generation, Technology | 116,828 | January 2007 |
| Lincoln, NE | Corporate Headquarters, Loan Servicing, Loan Generation | 94,909 | December 2010 |
| Phoenix, AZ | Capital Markets | 3,500 | N/A |
| Portland, ME | Loan Generation, Sales | 5,211 | January 2010 |
| Tempe, AZ | Loan Generation | 3,431 | March 2004 |
| Tucson, AZ | Loan Generation | 426 | June 2004 |
| Tulsa, OK | Loan Generation, Sales | 2,500 | July 2005 |
| Washington, DC | Government Relations, Sales | 1,806 | May 2005 |

**Litigation**

We are subject to various claims, lawsuits and proceedings that arise in the normal course of business. These matters principally consist of claims by borrowers disputing the manner in which their loans have been processed. On the basis of present information, anticipated insurance coverage and advice received from counsel, it is the opinion of our management that the disposition or ultimate determination of these claims, lawsuits and proceedings will not have a material adverse effect on our business, financial position or results of operations.

# MANAGEMENT

## Executive Officers and Directors

The following table sets forth our executive officers and directors, and their ages and positions, as of August 8, 2003. Except as otherwise indicated, each of the Executive Directors specified below was appointed to that position as one of our Executive Directors on August 8, 2003.

| Name | Age | Position |
|---|---|---|
| Michael S. Dunlap | 39 | Chairman and Co-Chief Executive Officer |
| Stephen F. Butterfield | 51 | Vice Chairman and Co-Chief Executive Officer |
| Don R. Bouc | 56 | President and Director |
| Terry J. Heimes | 39 | Chief Financial Officer and Executive Director |
| Hilario J. Arguinchona | 59 | Executive Director |
| David A. Bottegal | 46 | Executive Director and Chief Marketing Officer |
| Raymond J. Ciarvella | 46 | Executive Director and Chief Information Officer |
| Todd M. Eicher | 33 | Executive Director |
| Matthew D. Hall | 43 | Executive Director |
| Charles Hosea | 43 | Executive Director |
| Dennis Leach | 49 | Executive Director |
| Edward P. Martinez | 49 | Executive Director and Secretary |
| Jeffrey R. Noordhoek | 37 | Executive Director |
| Richard H. Pierce | 60 | Executive Director |
| Dominic Rotondi | 49 | Executive Director |
| Cheryl Watson | 42 | Executive Director |
| James P. Abel | 52 | Director |
| Thomas E. Henning | 50 | Director |
| Lee E. Mikles | 47 | Director |
| Arturo Moreno | 56 | Director |
| Brian J. O’Connor | 47 | Director |
| James H. VanHorn | 51 | Director |

### *Michael S. Dunlap*

Michael S. Dunlap has served as our Chairman and Co-Chief Executive Officer since August 2003. Mr. Dunlap previously served as our President and sole Chief Executive Officer from December 2001 until August 2003. He has been a member of our Board of Directors since 1989. As Chairman of our Board of Directors, Mr. Dunlap is responsible for our overall strategy and direction. From January 1996 to December 2001, Mr. Dunlap served as chairman of Nelnet’s predecessor. In addition, since August 2003, Mr. Dunlap has been the non-executive chairman of Union Bank and Trust Company and since January 1995, a director and president of Farmers & Merchants Investment Inc. (the parent of Union Bank and Trust Company). Union Bank and Trust Company and Farmers & Merchants Investment Inc. are affiliates of Nelnet (see “Related Party Transactions”). From January 2001 to August 2003, Mr. Dunlap served as chief executive officer of Union Bank and Trust Company. From January 1993 to January 2001, Mr. Dunlap served as executive vice president of Union Bank and Trust Company. Mr. Dunlap is also a member of the Nebraska State Bar Association. Mr. Dunlap received his B.S. degree in Finance and Accounting and his J.D. degree from the University of Nebraska.

***Stephen F. Butterfield***

Stephen F. Butterfield has served as our Co-Chief Executive Officer since August 2003, and as our Vice Chairman since March 2000. He served as vice chairman and a director of Nelnet's predecessor since January 1996. Mr. Butterfield is responsible for managing our capital market relationships and investor relations. Mr. Butterfield directs our overall management and direction, including asset purchasing, marketing of corporate services and coordination of our capital market activities. Mr. Butterfield has been involved in the student loan industry since January 1989, first as president of a for-profit student loan secondary marketing facility located in Scottsdale, Arizona, and second as president of the Student Loan Acquisition Authority of Arizona, a non-profit secondary marketing facility in Scottsdale, Arizona. Prior to his work in the student loan industry, Mr. Butterfield spent 15 years as an investment banker, the last four years of which for Boettcher and Company, specializing in municipal finance. Mr. Butterfield received his B.S. degree in business administration from Arizona State University.

***Don R. Bouc***

Don R. Bouc has served as our President and a member of our Board of Directors since March 2000. In March 2001, Mr. Bouc became president of Nelnet Corporation, a subsidiary of Nelnet. From May 1997 through March 2001, Mr. Bouc served as president of National Education Loan Network, Inc., a subsidiary of Nelnet. From 1990 to 1997, Mr. Bouc served as president of Nebraska Higher Education Loan Program, Inc., or NEBHELP. During his tenure, he assisted in creating the Education Finance Council and later served as its chairman. In 1985, Mr. Bouc founded Midwest Computing, Inc., the developer of EASEL, a servicing and related software package used by over 50 financial institutions in the student loan industry. From 1974 to 1985, Mr. Bouc worked for the University of Nebraska Central Administration Computing Services network leaving as director of administrative computing. Mr. Bouc earned an undergraduate degree in math education in 1969 and an M.S. in computer science in 1974 from the University of Nebraska-Lincoln. He served on the Board of Trustees of Lincoln General Hospital from 1996 to 1998, and currently he serves on the Board of Trustees of Health Lincoln, of Junior Achievement/Lincoln and for the Nebraska Independent College Foundation. Mr. Bouc has been appointed by the Secretary of Education to the Federal Advisory Committee on Student Financial Assistance.

***Terry J. Heimes***

Terry J. Heimes has served as our Chief Financial Officer and as Executive Director in charge of Finance since March 2001. He is responsible for the coordination of all financial and accounting functions. Active in our strategic planning and direction, Mr. Heimes oversees the preparation and issuance of financial statements, corporate accounting/tax matters and our asset-backed securitization and warehousing activities. Mr. Heimes served as our Director from March 2001 until August 2003 and as executive vice president of our subsidiary National Education Loan Network, Inc., or NELNI, from March 2001 until October 2002. In October 1998, in connection with the conversion and acquisition of NEBHELP, Mr. Heimes became the vice president of finance of National Education Loan Network, Inc., a subsidiary of Nelnet. Prior to joining NEBHELP, Mr. Heimes worked for the public accounting firm of KPMG LLP through 1992 as a manager in the audit department. Mr. Heimes graduated magna cum laude from the University of Nebraska-Kearney with a B.S. degree in business administration with an emphasis in accounting.

***Hilario J. Arguinchona***

Hilario J. Arguinchona is our Executive Director in charge of Idaho Financial Associates, Inc., which does business as IFA Systems. Mr. Arguinchona served as the executive vice president of NELNI from January 2001 until October 2002, when he became an executive director of NELNI, and served as one of our Directors from January 2001 until August 2003. As president of IFA Systems, Mr. Arguinchona is responsible for the development, maintenance and implementation of student loan software systems used by us and our clients. Mr. Arguinchona has been active in the student loan business since 1978 and was a founding director for both a guaranty agency and secondary market in Idaho. In 1986, Mr. Arguinchona started Idaho Financial Associates, Inc. (dba IFA Systems), a private secondary market for student loans, which eventually became a company that developed software for use in the student loan industry. Mr. Arguinchona was a founding director and serves as chairman of the board of directors of Syringa Bank in Boise, Idaho. He received his B.S. degree in business administration from the University of Idaho.

***David A. Bottegal***

David A. Bottegal is one of our Executive Directors and our Chief Marketing Officer. Mr. Bottegal served as a senior vice president of NELNI from September 2001 until he became an executive director in October 2002, and also served as one of our Directors from September 2001 until August 2003. Mr. Bottegal is responsible for Nelnet Marketing Solutions, our sales division. In addition, Mr. Bottegal assists in our overall strategic direction as well as fostering our significant client relationships. Prior to joining us, Mr. Bottegal spent 18 years with Sallie Mae in various areas of the company, including vice president of sales and marketing from 1998 to 2001. Mr. Bottegal received his M.B.A from Marymount University and his B.A. from Catholic University in Washington, DC.

***Raymond J. Ciarvella***

Raymond J. Ciarvella is one of our Executive Directors and has been our Chief Information Officer since May 2003. Mr. Ciarvella has over 13 years experience with us in various capacities, serving as one of our Directors from January 1995 until August 2003. As our Chief Information Officer, Mr. Ciarvella oversees our internal Information Technology areas along with a number of our subsidiary companies, including Charter Systems, IFA Systems and Nelnet Canada Inc., and a number of our affiliates, including 5280 Solutions, Inc. and FirstMark Services, LLC. As Chief Information Officer, Mr. Ciarvella is responsible for the information technology and computer systems that support our enterprise goals. Mr. Ciarvella is also engaged in other strategic partnerships and key client initiatives. Mr. Ciarvella served as the chief operating officer of UNIPAC Service Corporation from September 1993 until March 2000. Prior to joining us, Mr. Ciarvella had over 11 years of experience with Electronic Data Systems in all facets of information technology services. Mr. Ciarvella received a B.S. degree in computer science from Colorado State University.

***Todd M. Eicher***

Todd M. Eicher has served as our Executive Director in charge of Loan Generation since May 2003. Mr. Eicher oversees and directs School Product Support, Business Integration and all aspects of our Loan Origination operations. Mr. Eicher also has responsibility for our relationship with ELM as the ELM NDN service provider. Prior to his current role, he served as a senior vice president from July 1997 until May 2003, when he became an Executive Director. Mr. Eicher received his J.D. degree from the University of Nebraska College of Law.

***Matthew D. Hall***

Matthew D. Hall is our Executive Director responsible for Loan Servicing. Mr. Hall served as one of our Directors until August 2003 and as a senior vice president of NELNI until he became an executive director of NELNI in October 2002. Mr. Hall oversees and directs lender product support, customer service, customer accounting, process engineering, conversions, claims and all aspects of school and repayment loan servicing for our various loan servicing operations. Prior to his current position, Mr. Hall managed our loan origination and loan servicing operations. Before entering operations in 1992, Mr. Hall was employed in our information systems department and was responsible for the maintenance and development of our student loan servicing system. Mr. Hall has ten years of operations management experience and eight years of experience in information systems, programming and management within the banking and financial industries. He earned a bachelor’s degree in business finance from Indiana University.

***Charles Hosea***

Charles Hosea is our Executive Director in charge of GuaranTec, LLP, our subsidiary, which provides system and operational support and services to guaranty agencies participating in the FFEL Program. Mr. Hosea has more than 17 years of education loan experience with various organizations, including financial institutions, guaranty agencies and third-party service providers. Mr. Hosea served as senior vice president of NELNI until October 2002, when he became an executive director of NELNI. Prior to becoming president of GuaranTec in 1996, he served as regional vice president for Electronic Data Systems in Tallahassee, Florida. Mr. Hosea received his B.S. degree in business administration from Southeast Missouri State University.

***Dennis Leach***

Dennis Leach is our Executive Director responsible for Corporate Planning. This function develops and maintains strategies for our product and service offerings within the organization. In addition, Corporate Planning assists with key initiatives that have strategic impact for us. Mr. Leach served as senior vice president of NELNI until January 2001, when he became an executive director of NELNI. Prior to that, he served as vice president of our subsidiary, InTuition Solutions, Inc., from April 1998 until January 2001. Mr. Leach has been involved in education financing since 1983. He held a number of positions within Sallie Mae and had a consulting practice serving a cross-section of clients in the student loan industry. Prior to this position, he was responsible for Nelnet’s product development for business and technology planning with InTuition, and was the president of InTuition Solutions (prepaid college tuition plan administration). Mr. Leach has a degree in philosophy and economics from the University of Northern Iowa.

***Edward P. Martinez***

Edward P. Martinez is our Executive Director responsible for Legal, Policy Support, Facilities and Purchasing. Mr. Martinez joined us in April 1989. Prior to joining us, Mr. Martinez was general counsel to the Student Loan Division of the Colorado Department of Higher Education, was an assistant attorney general with the Colorado Attorney General’s Office and was an associate with the law firm of Davis Graham & Stubbs LLP in Denver, Colorado. Mr. Martinez received a J.D. degree from the University of Colorado School of Law.

***Jeffrey R. Noordhoek***

Jeffrey R. Noordhoek is our Executive Director in charge of Capital Markets. Mr. Noordhoek heads up our Capital Markets area and is responsible for our securitization and capital markets funding efforts. Mr. Noordhoek served as senior vice president of NELNI from March 2001 until October 2002, when he became an executive director of NELNI, and served as a vice president of Nelnet’s predecessor prior to that. Mr. Noordhoek has been in our capital markets area since 1996. Prior to joining us, Mr. Noordhoek served as a senior associate for State Street Capital Corporation where he assisted in the establishment of commercial paper conduit financing vehicles. Mr. Noordhoek received his B.S. degree in business administration from the University of Nebraska and his M.B.A. from Boston University.

***Richard H. Pierce***

Richard H. Pierce is our Executive Director in charge of Portfolio Management. Mr. Pierce served as a Director until August 2003 and as an executive vice president of NELNI from January 2001 until he became an executive director of NELNI in October 2002. Mr. Pierce developed the MES Foundation and has headed that company since its origin in 1983. He has served in both the Maine House of Representatives and the Maine Senate, serving as a Senate Majority Leader from 1978-1982. Among his many experiences, Mr. Pierce has served as the commissioner of the Education Commission of the State of Maine, on the White House Commission on Presidential Scholars, as Director of the National Council of Higher Education Loan Programs and as a member of the review panel for the Harry S. Truman

Scholarship Foundation. Regionally, he has served on the New England Financial Aid Policy Council, the New England Board of Higher Education and on several legislative task forces. He was a founding member of the Education Finance Council and served several terms on its board, including two years as its chairman. Mr. Pierce served as one of our Directors from January 2001 until August 2003. Mr. Pierce received his A.B. degree from Boston University and a M.S.Ed. from the University of Maine.

***Dominic Rotondi***

Dominic Rotondi is our Executive Director in charge of Charter Account Systems, a subsidiary of Nelnet. Mr. Rotondi was one of the founders of Charter Account Systems and serves as president of that company. He has been involved in eduction finance and data processing for 26 years, including positions at the New England Student Loan Marketing Association and the New York Higher Eduction Services Corporation. Mr. Rotondi received a B.S. degree in management from Rensselaer Polytechnic Institute.

***Cheryl Watson***

Cheryl Watson is our Executive Director responsible for Investor Relations. Ms. Watson served as one of our Directors from April 2002 until August of 2003 and served as an executive vice president of NELNI from April 2002 until she became an executive director of NELNI in October 2002. She also serves as president of EFS, Inc., one of our wholly owned subsidiaries. In addition, she participates in our strategic planning and capital markets initiatives. Prior to joining us, Ms. Watson was employed with Sallie Mae, Inc. and USA Group Secondary Market Services, Inc. and was vice president and treasurer of Sallie Mae Servicing, LLP and president and chief financial officer of USA Group Secondary Market Services, Inc. She has held financial service positions in education lending and private industry for over 18 years. She serves on the board of directors for the Greater Indianapolis Area YMCA and serves as treasurer for the Riverview Hospital Foundation. Ms. Watson received a B.S. degree from Indiana University and is a certified public accountant.

***James P. Abel***

James P. Abel has served as a member of our Board of Directors since August 2003. Mr. Abel has served as a director of our subsidiary, NHELP-I, Inc., from 2000 until becoming our Director in August 2003. Since 1983, Mr. Abel has served as president and chief executive officer of NEBCO, Inc., a company with interests in the manufacture of building materials, construction, insurance, mining, railroading, farming and real estate. Mr. Abel serves on the boards of directors of Ameritas Life Insurance Corp. and Linweld, Inc. He is an Advisory Board Member for the US Bank Lincoln. Mr. Abel received a B.S. degree from Arizona State University.

***Thomas E. Henning***

Thomas E. Henning has served as a member of our Board of Directors since August 2003. Mr. Henning has served as a director of Security Financial Life Insurance Company since 1987 and as president and chief operating officer since 1990. Mr. Henning serves as chairman, president and chief executive officer of Security Mutual Life Nebraska, as well as its wholly owned subsidiary, Security Financial Life Insurance Company. Previously, Mr. Henning served as president and chief operating officer of National Bank of Commerce of Lincoln, Nebraska and executive vice president of First Commerce Bancshares between 1985 and 1990. Mr. Henning is a graduate of the University of Nebraska as well as Stonier Graduate School of Banking at Rutgers University. He also has completed the Wharton School’s Effective Management Program. Mr. Henning holds the CLU and CFA designations. Mr. Henning is a member of the Investment and Executive Committee and board of the University of Nebraska Foundation and serves on Lincoln Plating Company’s Advisory Board.

***Lee E. Mikles***

Lee E. Mikles has served as a member of our Board of Directors since August 2003. Mr. Mikles has served as a director of our subsidiary, Nelnet Education Loan Funding, Inc., since 1998. Mr. Mikles has served since 1992 as chairman of Mikles/Miller Mgmt., Inc., a registered investment adviser, and as chairman of Mikles/Miller Securities, L.L.C., a registered broker-dealer, from 1998 to the present. Formed in 1992, Mikles/Miller Mgmt., Inc. is the managing general partner of the Kodiak family of investment funds. The firm manages funds for institutional clients worldwide. Prior to the formation of Mikles/Miller Mgmt., Inc., Mr. Mikles headed Mikles/Miller Group, an affiliate of Shearson Lehman Brothers. Mr. Mikles serves on the boards of directors of Coastcast Corporation and Boss Holdings, Inc.

***Arturo Moreno***

Arturo Moreno has served as a member of our Board of Directors since August 2003. Mr. Moreno served as president, chief operating officer and director of Outdoor Systems, Inc. from 1984 until 1999. Under Mr. Moreno’s leadership, Outdoor Systems became the largest outdoor advertising organization in North America and was the first such company to go public. In 1999, the company was sold to Infinity/CBS and in 2000 it merged with Viacom. In June of 2003, Mr. Moreno purchased the Anaheim Angels Professional Baseball Team and currently serves as its president. As founder of The Moreno Family Foundation, he is deeply involved with issues related to children and education. Mr. Moreno received his B.S. degree in marketing from the University of Arizona in 1973.

***Brian J. O’Connor***

Brian J. O’Connor has served as a member of our Board of Directors since August 2003. Mr. O’Connor has served as a director of our subsidiaries, Nelnet Education Loan Funding, Inc., since 1998 and Nelnet Private Student Loan Corporation-I, since 2001. Since 1997, Mr. O’Connor has held the position of senior vice president at Hutchinson, Shockey, Erley & Co., which underwrites and trades securities for various local governments in Arizona and the western United States. From 1990 to 1997, he was a senior vice president with Alden Capital Markets, Inc.; from 1988 to 1990, he served as senior vice president with Capital Markets Corporation; from 1987 to 1988, he was a vice president for Security Pacific Merchant Bank in Phoenix; and from 1983 to 1987, Mr. O’Connor was with Boettcher & Company, Inc., a regional investment banking firm specializing in municipal finance. In addition, Mr. O’Connor served as a member of the board of directors and audit committee of Outdoor Systems, Inc. from 1992 to 1999.

***James H. VanHorn***

James H. VanHorn has served as a member of our Board of Directors since March 2001. Mr. VanHorn is the former Executive Director of Loan Generation, which provides fee-based lender servicing and educational support services to government and private entities. Mr. VanHorn served as our Senior Vice President from March 2000 until October 2002, when he became our Executive Director. Mr. VanHorn left his position as Executive Director in June 2003 and thereafter has served as president and chief executive officer of InTuition Development Holdings, LLC, which is not affiliated with Nelnet. Mr. VanHorn has more than 28 years of operational experience with Bethlehem Steel, Astro Metallurgical, InTuition, Inc. and Nelnet. Prior to our acquisition of InTuition, Inc., he joined InTuition in 1994, became president in 1998 and continued serving as president of InTuition, Inc. until June 2003. Before serving as president of InTuition, Inc., Mr. VanHorn served as vice president of operations at Astro Metallurgical in Wooster, Ohio. He earned his M.B.A. at Jacksonville University and his B.S.C.E. at Valparaiso University.

**Board Composition**

Our board of directors is composed of a majority of independent directors as defined by the rules of the New York Stock Exchange.

**Board Committees**

Our board of directors has established an audit committee, a compensation committee, an executive committee and a nominating and corporate governance committee. Each committee, other than the executive committee, is composed entirely of independent directors.

Our audit committee is composed of Messrs. Henning, Mikles and O'Connor. The audit committee provides assistance to our board of directors in its oversight of the integrity of our financial statements, the qualifications and independence of our independent auditors, the performance of our internal audit functions, the procedures undertaken by the independent auditors and our compliance with other regulatory and legal requirements. Our audit committee operates pursuant to a formal written charter.

Our compensation committee is composed of Messrs. Abel, Mikles and Moreno. The compensation committee oversees our compensation and benefit policies. Our compensation policies are designed with the goal of maximizing shareholder value over the long term. The compensation committee believes that this goal is best realized by utilizing a compensation program which serves to attract and retain superior executive talent by providing management with performance-based incentives and closely aligning the financial interests of management with those of our shareholders. Our compensation program combines two components: base salary and annual bonus. The level of compensation is based on numerous factors, including achievement of results and financial objectives established by our compensation committee and our board of directors. Salary and bonus compensation awards are reviewed regularly for competitiveness and are determined in large part by reference to compensation levels for comparable positions at comparable companies.

Our nominating and corporate governance committee is composed of                    . The nominating and corporate governance committee is responsible for identifying and recommending qualified nominees to serve on our board of directors as well as developing and overseeing our internal corporate governance processes.

**Compensation Committee Interlocks and Insider Participation**

Prior to August 2003, Messrs. Dunlap, Butterfield, Bouc, Pierce and K. Jon Kern, a former Executive Director, participated in deliberations concerning executive officer compensation. No member of our compensation committee serves or in the past has served as a member of another entity's board of directors or compensation committee, which entity has one or more executive officers serving as a member of our board of directors or compensation committee.

**Compensation of Directors**

Our independent directors receive an annual retainer of $50,000. We also pay an additional annual retainer of $10,000 to those independent directors who serve on the audit committee, the compensation committee, the executive committee or the nominating and corporate governance committee, as applicable. Independent directors also earn a fee of $1,000 for each board meeting attended and $1,000 for each committee meeting attended. Our directors, other than our independent directors, do not receive any consideration for participation in board meetings or committee meetings.

We have adopted a share-based compensation plan for nonemployee directors pursuant to which our nonemployee directors will have an election to receive their annual retainer fees in the form of cash or our Class A common stock. Up to 100,000 shares may be issued under the plan. If a nonemployee director elects to receive Class A common stock, the number of shares of Class A common stock that will be awarded will be equal to the amount of the annual retainer fee otherwise payable in cash divided by 85% of the fair market value of a share of Class A common stock on the date the fee is payable. Nonemployee directors who choose to receive Class A common stock may also elect to defer receipt of the Class A common stock until termination of their service on our board of directors. Any dividends paid in respect of deferred shares during the deferral period will also be deferred in the form of additional shares and paid out at termination from our board of directors. The plan may be amended or terminated by our board of directors at any time, but no amendment or termination will adversely affect a nonemployee director's rights with respect to previously deferred shares without the consent of the nonemployee director.

**Agreements with Employees**

In May 2001, Richard H. Pierce, our Executive Director in charge of Portfolio Management, entered into an employment agreement with one of our subsidiaries, Nelnet Corporation. The agreement extends until April 2006, after which it shall renew for successive one-year terms unless terminated earlier by Nelnet Corporation or Mr. Pierce upon the occurrence of certain events or upon 90 days' notice from either party prior to the end of the initial term or any renewal term. Mr. Pierce received a base salary of $382,000 in 2001, which amount gradually decreases until it reaches $300,000 in 2006. In addition, Mr. Pierce is entitled to receive an annual bonus tied to our pretax earnings, which shall not exceed $700,000. Nelnet Corporation shall continue to pay Mr. Pierce's base salary and a pro-rated portion of the bonus he would have received during the year his employment terminates, if Nelnet Corporation terminates the agreement without cause or if Mr. Pierce resigns from his position with good reason, in each case as defined in the employment agreement. The agreement also prohibits Mr. Pierce from having any business-related contact with competitors, customers or service providers of Nelnet Corporation or any of its affiliates so long as Mr. Pierce continues to receive compensation payments from Nelnet Corporation.

We have not entered into employment agreements with any of our other named executive officers.

**Executive Compensation**

The following table sets forth summary information relating to compensation paid for services rendered for our fiscal year ended December 31, 2002, with respect to the compensation paid and bonuses granted to our Co-Chief Executive Officers as well as each of our other five most highly compensated executive officers, each of whose aggregate compensation during the last fiscal year was greater than $100,000. Messrs. Dunlap's and Butterfield's annual salaries, effective August 1, 2003, are $1,000,000 each, and Mr. Bouc's annual salary, effective August 1, 2003, which will be payable by us, is $350,000. In addition, they are each entitled to receive bonus compensation as described below under "— Executive Officers Bonus Plan." Further, in the third quarter of 2003, Mr. Heimes will receive a bonus of $408,000 in connection with the termination of our consulting agreement with Great Plains Financial, LLC, which is described under "Related Party Transactions — Transactions with Miscellaneous Related Parties," and Mr. Ciarvella will receive a bonus of $897,000 in connection with the termination of his employment agreement. Salaries and bonuses are paid at the discretion of our board of directors. For purposes of this prospectus, we will refer to the executive officers named in the table below as the named executive officers.

## Summary Compensation Table

| Name and principal position | Year | Annual compensation(a) Salary ($) | Bonus ($)(b) | All other compensation ($)(c) |
|---|---|---|---|---|
| Michael S. Dunlap<br>Co-Chief Executive Officer | 2002 | 450,000 | 675,198 | 2,642 |
| Stephen F. Butterfield<br>Co-Chief Executive Officer | 2002 | 450,000 | 675,198 | 2,642 |
| Don R. Bouc<br>President | 2002 | 700,000(d) | — | 1,830 |
| Terry J. Heimes<br>Chief Financial Officer | 2002 | 179,167 | 150,000 | 5,232 |
| David A. Bottegal<br>Executive Director and Chief Marketing Officer | 2002 | 179,167 | 150,000 | 5,307 |
| Raymond J. Ciarvella<br>Executive Director and Chief Information Officer | 2002 | 240,000 | 510,000 | 6,076 |
| Richard H. Pierce<br>Executive Director | 2002 | 380,000 | 700,000 | 6,100 |

(a) Executive officers may receive perquisites and personal benefits, the dollar amounts of which are below current Securities and Exchange Commission thresholds for reporting requirements.

(b) Amounts represent bonuses paid in 2003 for services rendered during the 2002 calendar year.

(c) Amounts represent matching contributions under our 401(k) plan in the following amounts: Mr. Dunlap $2,450, Mr. Butterfield $2,450, Mr. Bouc $1,710, Mr. Heimes $4,872, Mr. Bottegal $4,947, Mr. Ciarvella $5,500 and Mr. Pierce $5,500; and premiums on life insurance in the following amounts: Mr. Dunlap $192, Mr. Butterfield $192, Mr. Bouc $120, Mr. Heimes $360, Mr. Bottegal $360, Mr. Ciarvella $576 and Mr. Pierce $600.

(d) $650,000 of Mr. Bouc’s salary was paid by Great Plains Financial, LLC, which had a consulting arrangement with Nelnet. See “Related Party Transactions — Transactions with Miscellaneous Related Parties” for a description of the consulting arrangement.

## Options/SARs/Restricted Stock/LTIPs

We do not have any stock option, SAR, restricted stock or other long-term incentive plans, and we have not issued any stock options, SARs or restricted shares.

### Employee Share Purchase Plan

Our board of directors has adopted an employee share purchase plan pursuant to which our employees and employees of our designated subsidiaries will be entitled to purchase our Class A common stock. The employee share purchase plan is intended to enhance our ability to attract and retain employees and to better enable such persons to participate in our long-term success and growth.

The employee share purchase plan will be administered by our compensation committee. Subject to the express provisions of the employee share purchase plan, our compensation committee has the power to determine the terms and conditions of each offering of shares to employees under the plan, and it has the authority to adopt and revise rules governing the plan and to interpret the terms and provisions of the plan.

A total of 1,000,000 shares of our Class A common stock are reserved for issuance under the employee share purchase plan, subject to equitable adjustment by the compensation committee in the event of stock dividends, recapitalizations and other similar corporate events. All of our employees and those employees of our participating subsidiaries, other than those whose customary employment is 20 hours or less per week, who have been employed for at least six months, or another period determined by our compensation committee not in excess of two years, will be eligible to purchase Class A common stock under the plan. The participating subsidiaries will be those designated by the compensation committee to participate in the employee share purchase plan.

The plan is designed to qualify as an "employee stock purchase plan" under Section 423 of the Code. The plan will allow participating employees to purchase our Class A common stock through payroll withholding. The plan provides for consecutive six-month offering periods (or other periods of not more than 27 months, as determined by our compensation committee) under which participating employees can elect to have amounts withheld from their total compensation during the offering period and applied to purchase our Class A common stock at the end of the period. Unless otherwise determined by our compensation committee before an offering period, the purchase price will be the lesser of 85% of the fair market value of our Class A common stock at the beginning or end of the offering period. Applicable Code limitations specify, in general, that a participant's right to purchase stock under the plan cannot accrue at a rate in excess of $25,000 (based on the value at the beginning of the applicable offering periods) per calendar year.

The employee share purchase plan will terminate when all shares authorized to be issued under it have been exhausted. Our board of directors may discontinue the employee share purchase plan at any time and may amend it from time to time.

**Executive Officers Bonus Plan**

Our board of directors has adopted, and we will maintain, an executive officers bonus plan pursuant to which our Co-Chief Executive Officers and President will be entitled to receive annual bonus compensation based upon our consolidated net income before taxes. The purpose of the executive officers bonus plan is to provide our Co-Chief Executive Officers and President with an opportunity to earn annual bonus compensation as an incentive and reward for their leadership, ability and exceptional services. The executive officers bonus plan will be administered by our compensation committee.

Our Co-Chief Executive Officers and President will each be entitled to receive an annual bonus equal to 0.85% of our consolidated net income before taxes, computed in accordance with generally accepted accounting principles. Our President's annual bonus may not exceed $500,000. Annual bonuses payable under the plan will be paid in cash after the end of each calendar year.

Our board of directors may terminate the executive officers bonus plan and may amend it from time to time, but no termination or amendment will adversely affect the rights of an executive to a previously earned but unpaid bonus.

## PRINCIPAL SHAREHOLDERS

The following table sets forth information regarding the beneficial ownership of each class of our common stock immediately before and after the sale of shares of our Class A common stock in this offering by:

- each person, entity or group known by us to beneficially own more than five percent of the outstanding shares of any class our common stock;
- each of the named executive officers;
- each of our directors; and
- all of our executive officers and directors as a group.

Beneficial ownership is determined in accordance with the rules and regulations of the Securities and Exchange Commission. Under these rules, a person is deemed to beneficially own a share of our common stock if that person has or shares voting power or investment power with respect to that share, or has the right to acquire beneficial ownership of that share within 60 days, including through the exercise of any option, warrant or other right or the conversion of any other security.

The number of shares of Class B common stock for each person in the tables below assumes such persons do not convert any Class B common stock into Class A common stock. Unless otherwise indicated in a footnote, the address of each five percent beneficial owner is c/o Nelnet, Inc., 121 South 13th Street, Suite 201, Lincoln, Nebraska 68508. As of the date of this prospectus, Nelnet had holders of record of its Class A common stock and four holders of record of its Class B common stock. Unless otherwise indicated in a footnote, the persons named in the tables below have sole voting and investment power with respect to all shares of common stock shown as being beneficially owned by them.

### Beneficial Ownership Before This Offering

| Name | Number of shares beneficially owned | | | Percentage of shares beneficially owned(1) | | | Percentage of combined voting power of all classes of stock(2) |
|---|---|---|---|---|---|---|---|
| | Class A | Class B | Total | Class A | Class B | Total | |
| Michael S. Dunlap | 16,121,021(3) | 9,830,204(4) | 25,951,225 | 52.0% | 70.0% | 57.6% | 66.8% |
| Stephen F. Butterfield | — | 5,779,941(5)(6) | 5,779,941 | — | 41.2% | 12.8% | 33.8% |
| Angela L. Mulheisen | 18,080,416(7) | 2,000,000(8) | 20,080,416 | 58.3% | 14.3% | 44.9% | 22.2% |
| Union Bank and Trust Company(9) | 5,052,417 | 2,000,000 | 7,052,417 | 16.3% | 14.3% | 15.7% | 14.6% |
| Packers Service Group, Inc.(10) | 11,068,604 | — | 11,068,604 | 35.7% | — | 24.6% | 6.5% |
| Don R. Bouc(11) | 1,571,990 | — | 1,571,990 | 5.1% | — | 3.5% | * |
| Marphy Butterfield(12) | 840,000 | — | 840,000 | 2.7% | — | 1.9% | * |
| Terry J. Heimes | 218,190 | — | 218,190 | * | — | * | * |
| Hilario J. Arguinchona | 522,900 | — | 522,900 | 1.7% | — | 1.2% | * |
| David A. Bottegal | 449,610 | — | 449,610 | 1.4% | — | 1.0% | * |
| Raymond J. Ciarvella | 349,104 | — | 349,104 | 1.1% | — | * | * |
| Todd M. Eicher(13) | 402,301 | — | 402,301 | 1.3% | — | * | * |
| Matthew D. Hall | 204,901 | — | 204,901 | * | — | * | * |
| Charles Hosea | 115,080 | — | 115,080 | * | — | * | * |
| Dennis Leach | 21,000 | — | 21,000 | * | — | * | * |
| Edward P. Martinez | 92,131 | — | 92,131 | * | — | * | * |
| Jeffrey R. Noordhoek(14) | 750,000 | — | 750,000 | 2.4% | — | 1.7% | * |
| Richard H. Pierce | 460,740 | — | 460,740 | 1.5% | — | 1.0% | * |

| Name | Number of shares beneficially owned: Class A | Class B | Total | Percentage of shares beneficially owned(1): Class A | Class B | Total | Percentage of combined voting power of all classes of stock(2) |
|---|---|---|---|---|---|---|---|
| Dominic Rotondi | 12,600 | — | 12,600 | * | — | * | * |
| Cheryl Watson | 69,999 | — | 69,999 | * | — | * | * |
| James P. Abel | — | — | — | — | — | — | — |
| Thomas E. Henning | — | — | — | — | — | — | — |
| Lee E. Mikles | — | — | — | — | — | — | — |
| Arturo Moreno | — | — | — | — | — | — | — |
| Brian J. O'Connor | — | — | — | — | — | — | — |
| James H. VanHorn | 115,080 | — | 115,080 | * | — | * | * |
| Executive officers and directors as a group (22 persons) | 21,476,647 | 14,023,454 | 35,500,101 | 69.2% | 100.0% | 78.8% | 94.4% |

## Beneficial Ownership After This Offering

| Name | Number of shares beneficially owned: Class A | Class B | Total | Percentage of shares beneficially owned(1): Class A | Class B | Total | Percentage of combined voting power of all classes of stock(2) |
|---|---|---|---|---|---|---|---|
| Michael S. Dunlap | 16,121,021(3) | 9,830,204(4) | 25,951,225 | | | | |
| Stephen F. Butterfield(5) | — | 5,779,941(5)(6) | 5,779,941 | | | | |
| Angela L. Mulheisen | 18,080,416(7) | 2,000,000(8) | 20,080,416 | | | | |
| Union Bank and Trust Company(9) | 5,052,417 | 2,000,000 | 7,052,417 | | | | |
| Packers Service Group(10) | 11,068,604 | — | 11,068,604 | | | | |
| Don R. Bouc(11) | 1,571,990 | — | 1,571,990 | | | | |
| Marphy Butterfield(12) | 840,000 | — | 840,000 | | | | |
| Terry J. Heimes | 218,190 | — | 218,190 | | | | |
| Hilario J. Arguinchona | 522,900 | — | 522,900 | | | | |
| David A. Bottegal | 449,610 | — | 449,610 | | | | |
| Raymond J. Ciarvella | 349,104 | — | 349,104 | | | | |
| Todd M. Eicher(13) | 402,301 | — | 402,301 | | | | |
| Matthew R. Hall | 204,901 | — | 204,901 | | | | |
| Charles Hosea | 115,080 | — | 115,080 | | | | |
| Dennis Leach | 21,000 | — | 21,000 | | | | |
| Edward P. Martinez | 92,131 | — | 92,131 | | | | |
| Jeffrey R. Noordhoek(14) | 750,000 | — | 750,000 | | | | |
| Richard H. Pierce | 460,740 | — | 460,740 | | | | |
| Dominic Rotondi | 12,600 | — | 12,600 | | | | |
| Cheryl Watson | 69,999 | — | 69,999 | | | | |
| James P. Abel | — | — | — | | | | |
| Thomas E. Henning | — | — | — | | | | |
| Lee E. Mikles | — | — | — | | | | |
| Arturo Moreno | — | — | — | | | | |
| Brian J. O'Connor | — | — | — | | | | |
| James H. VanHorn | 115,080 | — | 115,080 | | | | |
| Executive officers and directors as a group (22 persons) | 21,476,647 | 14,023,454 | 35,500,101 | | | | |

* Less than 1%.

(1) Based on:

- 31,015,034 shares of Class A common stock and 14,023,454 shares of Class B common stock outstanding after giving effect to our recapitalization but immediately before this offering; and

- shares of Class A common stock and 14,023,454 shares of Class B common stock outstanding immediately after the sale of shares of our Class A common stock in this offering.

(2) These percentages reflect the different voting rights of our Class A common stock and our Class B common stock. Each share of Class A common stock has one vote and each share of Class B common stock has ten votes on all matters to be voted upon by our shareholders.

(3) Consists of shares owned by entities which Mr. Dunlap may be deemed to control, consisting of: 11,068,604 shares owned by Packers Service Group, of which Mr. Dunlap is a director and president and owns 28.3% of the outstanding capital stock, 842,417 shares owned by Union Bank as Trustee for the University of Nebraska Foundation and 4,210,000 shares owned by Union Bank as Trustee under several grantor retained annuity trusts (the "Class A GRATs"). Mr. Dunlap is non-executive chairman of and controls Union Bank through Farmers & Merchants Investment Inc., of which Mr. Dunlap is a director and president and owns or controls 38.4% of the outstanding voting stock. Mr. Dunlap disclaims beneficial ownership of the shares held by Union Bank as Trustee for the University of Nebraska Foundation and under the Class A GRATs. He also disclaims beneficial ownership of the shares held by Packers Service Group, except to the extent of his pecuniary interest therein.

(4) Includes 1,701,000 shares owned by Mr. Dunlap's spouse, 1,586,691 shares owned by Union Financial Services, Inc., of which Mr. Dunlap is chairman and owns 50.0% of the outstanding capital stock, and 2,000,000 shares owned by Union Bank as Trustee under two grantor retained annuity trusts (the "Class B GRATs"). Mr. Dunlap disclaims beneficial ownership of the shares held by Union Financial Services, Inc., except to the extent of his pecuniary interest therein. Mr. Dunlap also disclaims beneficial ownership of the shares held by Union Bank as Trustee under the Class B GRATs, except for his retained beneficial interest in 1,400,000 shares of Class B common stock held in trust on his behalf under one of the Class B GRATs.

(5) Does not include 600,000 shares of Class B common stock held by Union Bank as Trustee under one of the Class B GRATs in which Mr. Butterfield has a retained beneficial ownership.

(6) Includes 1,586,691 shares owned by Union Financial Services, Inc., of which Mr. Butterfield is a director and president and owns 50.0% of the outstanding capital stock. Mr. Butterfield disclaims beneficial ownership of the shares held by Union Financial Services, Inc., except to the extent of his pecuniary interest therein.

(7) Includes 88,864 shares jointly owned by Ms. Mulheisen and her spouse, 851,000 shares owned by her spouse and 16,121,021 shares that are owned by entities that Ms. Mulheisen may be deemed to control, consisting of: 11,068,604 shares owned by Packers Service Group, of which Ms. Mulheisen is a director and owns or controls 27.0% of the outstanding capital stock, 842,417 shares owned by Union Bank as Trustee for the University of Nebraska Foundation and 4,210,000 shares owned by Union Bank as Trustee under the Class A GRATs. Ms. Mulheisen, the sister of Michael S. Dunlap, is a director, president and chief executive officer of and controls Union Bank through Farmers & Merchants Investment Inc., of which Ms. Mulheisen is a director and executive vice president and owns or controls 35.9% of the outstanding capital stock. Ms. Mulheisen disclaims beneficial ownership of the shares held by Union Bank as Trustee for the University of Nebraska Foundation and as Trustee under the Class A GRATs, except for her retained beneficial interest in 1,700,000 shares of Class A common stock held in trust on her behalf and on behalf of her spouse under two of the Class A GRATs. She also disclaims beneficial ownership of the shares held by Packers Service Group, except to the extent of her pecuniary interest therein.

(8) Includes 2,000,000 shares owned by Union Bank as Trustee under the Class B GRATs. Ms. Mulheisen disclaims beneficial ownership of the shares held by Union Bank as Trustee under the Class B GRATs.

(9) The Class A common stock beneficially owned by Union Bank consists of 842,417 shares owned as Trustee for the University of Nebraska Foundation and 4,210,000 shares owned as Trustee under the Class A GRATs. The Class B common stock beneficially owned by Union Bank is owned as Trustee under the Class B GRATs. The address for Union Bank is P.O. Box 82529, Lincoln, NE 68501, Attention: Michael S. Dunlap.

(10) The address for Packers Service Group is c/o Farmers & Merchants Investment Inc., Attention: Michael S. Dunlap, 6801 South 27th Street, Lincoln, NE 68512.

(11) Includes 1,371,930 shares owned by Great Plains Financial, LLC, a limited liability company of which Mr. Bouc is the sole member; does not include 300,000 shares of Class A common stock held by Union Bank as Trustee under one of the Class A GRATs in which Mr. Bouc has a retained beneficial ownership and 400,000 shares of Class A common stock held by Union bank under one of the Class A GRATs in which his spouse has a retained beneficial ownership.

(12) Does not include 840,000 shares of Class A common stock held by Union Bank as Trustee under one of the Class A GRATs in which Ms. Butterfield has a retained beneficial ownership. The address for Ms. Butterfield is 7001 N. Tatum Boulevard, Paradise Valley, AZ 85253.

(13) Includes 310,170 shares owned by The Judy Eicher & Todd Eicher Partnership, of which Mr. Eicher is a general partner.

(14) Does not include 300,000 shares of Class A common stock held by Union Bank as Trustee under one of the Class A GRATs in which Mr. Noordhoek has a retained beneficial ownership.

## RELATED PARTY TRANSACTIONS

Some of our directors and members of our management beneficially own shares of stock or other ownership interests in other entities with which we do business and, in some cases, they serve on the board of directors and/or as executive officers of one or more such entities. These related parties include:

- *Union Bank and Trust Company and Farmers & Merchants Investment Inc., or Farmers & Merchants* — Union Bank is controlled by Farmers & Merchants, which owns 80.9% of Union Bank's stock. Michael S. Dunlap, our Co-Chief Executive Officer, owns or controls 38.4% of the stock of Farmers & Merchants, while Mr. Dunlap's sister, Angela L. Mulheisen, owns or controls 35.9% of such stock. Mr. Dunlap serves as a director and president of Farmer & Merchants and as non-executive chairman of Union Bank. Ms. Mulheisen serves as director and executive vice president of Farmers & Merchants and as a director, president and chief executive officer of Union Bank. Union Bank beneficially owns 15.7% of our common stock as Trustee for the University of Nebraska Foundation and for the Class A and Class B Grantor Retained Annuity Trusts, or GRATs. Farmers & Merchants does not own 5% or more of our stock; however, the stock holdings of both Union Bank and Farmers & Merchants are deemed to be beneficially owned by both Mr. Dunlap and Ms. Mulheisen, respectively. Before this offering, Mr. Dunlap beneficially owned 57.6% of our outstanding common stock, and Ms. Mulheisen beneficially owned 44.9% of our outstanding common stock.

- *Packers Service Group, Inc., or Packers Service Group* — Packers Service Group beneficially owned 24.6% of our common stock before this offering. Mr. Dunlap owns 28.3% of the stock of Packers Service Group and also serves as president and a director of that corporation. Ms. Mulheisen owns or controls 27.0% of the stock of Packers Service Group and also serves as one of its directors.

- *Union Financial Services, Inc., or Union Financial* — Union Financial is 50% owned by Mr. Dunlap and 50% owned by Stephen F. Butterfield, our Co-Chief Executive Officers. Mr. Butterfield also serves as president of Union Financial. Union Financial does not own 5% or more of our common stock; however, its holdings are deemed to be beneficially owned by both Mr. Dunlap and Mr. Butterfield. Before this offering, Mr. Butterfield beneficially owned 12.8% of our outstanding common stock.

- *Great Plains Financial, LLC, or Great Plains* — Great Plains is controlled by Don R. Bouc, who is its sole member as well as our President. Great Plains does not own 5% or more of our common stock; however, its holdings are deemed to be beneficially owned by Mr. Bouc. Before this offering, Mr. Bouc beneficially owned 5.4% of our outstanding common stock.

- *UFS Securities, LLC* — UFS Securities is one of our wholly owned subsidiaries; however, prior to August 2003, it was owned by Packers Service Group and Union Financial.

Prior to the date of this prospectus, the directors and members of management referenced above resigned from all executive officer positions they held with these entities, except for Michael S. Dunlap, who remains president of Packers Service Group and Farmers & Merchants, and Stephen F. Butterfield, who remains president of Union Financial.

The chart below sets forth the total payments we made to each of the above-mentioned related parties for the year ended December 31, 2002:

| Related Party | Aggregate payments for the year ended December 31, 2002 |
|---|---|
| | (dollars in thousands) |
| Union Bank and Trust Company | $6,747 |
| Farmers & Merchants Investment Inc. | 1,400 |
| Packers Service Group, Inc. | 1,000 |
| Union Financial Services, Inc. | 1,650 |
| Great Plains Financial, LLC | 1,750 |
| UFS Securities, LLC | 1,425 |

For a detailed description of the relationships between management and the entities with which we transact business, see "Management" and "Principal Shareholders."

Going forward, our independent directors will be responsible for reviewing and approving all new transactions, and any material amendments or modifications to existing transactions, between Nelnet and Union Bank or any other affiliated party.

**Transactions with Union Bank**

We have entered into a series of agreements with Union Bank, including transactions to sell interests in student loans to Union Bank in its capacity as trustee, to purchase student loans from Union Bank, to provide student loan servicing to Union Bank, to sublease real estate from Union Bank and to provide consulting services to and receive consulting services from Union Bank. Union Bank is a major source of student loan origination and sales volume for us, and these purchases were accomplished through a series of free standing loan purchase agreements until 1997. In June 1997, Union Bank entered into a commitment to sell to us rights with respect to future originations of guaranteed student loans which exceed the annual aggregate amount of $120 million; however, Union Bank holds an option to retain 25% of its originations in excess of $240 million in a given year and to retain the rights to any of the remaining 75% of originations in excess of $240 million by paying to us an amount equal to the amount by which the fair market value of such originations exceeds the principal balance. We pay Union Bank a purchase price equal to 100% of the outstanding principal balance and accrued and unpaid interest on the loans purchased pursuant to this agreement, and we also reimburse Union Bank for origination fees required to be paid to the DOE (50 basis points of the principal balance) and for origination costs (initially $6.00 per purchased loan, which amount subsequentially increased to $25.00 per purchased loan). We also paid to Union Bank a one-time amount of $3.5 million in 1997 to acquire these origination rights. We granted to Union Bank an option to sell us up to $120 million of federally guaranteed student loans per year at the same purchase price described above. During 2002, Nelnet paid to Union Bank an aggregate sum of approximately $6.4 million plus the outstanding balances of loans purchased from Union Bank pursuant to this agreement and related purchases. We purchased an aggregate of approximately $378 million of student loans from Union Bank in 2002 pursuant to this agreement and related loan purchase agreements. This agreement renews automatically for successive one-year terms unless both parties mutually agree to terminate it.

Effective January 1999, we entered into an agreement with Union Bank to reimburse certain of Union Bank's student loan-related marketing expenses arising from Union Bank engaging in its ordinary student loan marketing activities. Union Bank agreed to bear the first $240,000 of annual marketing costs incurred by it. In April 2001, as a part of an amendment to this agreement, we agreed to assume the bulk of marketing responsibilities for Union Bank and to hire Union Bank's marketing personnel if Union Bank decided to reduce its marketing personnel commitment. The amendment adjusted the marketing expense sharing arrangement to more closely approximate a prorated portion of the costs associated with the volume of loans we acquire from Union Bank. During 2002, we received from Union Bank marketing expenses in the net amount of approximately $519,000. This marketing expense reimbursement agreement is coterminous with the student loan origination transfer agreement described in the preceding paragraph. As consideration for our assumption of the costs with respect to Union Bank's marketing employees, Union Bank granted us rights to hire its marketing personnel, transferred servicing and origination software to us and increased the origination fee paid to us from $6.00 per loan to $25.00 per loan. The $25.00 origination fee that Union Bank agreed to pay to us for originating Union Bank's student loans is reimbursed to Union Bank when we acquire those loans from Union Bank pursuant to the agreement described in the preceding paragraph. Our obligation to share Union Bank's marketing expenses is indirectly related to the volume of originations resulting from such marketing efforts.

In 1999, we entered into a 360-day commitment with Union Bank to purchase its federally guaranteed student loans, in which Union Bank retained rights pursuant to the agreement above at par. This purchase commitment has been renewed annually for successive terms after its inception. The commitment has grown into an obligation to purchase an aggregate amount of up to $1.25 billion of student loans from Union Bank. The consideration we received is Union Bank's obligation to sell us $37.5 million of student loans per year at a premium of 1.5% above par. In accordance with the terms of this agreement, in 2002, Union Bank sold us student loans with an aggregate outstanding balance of approximately $37.5 million, which was included in the $378 million aggregate sale figure referenced above. Union Bank has also granted us a right to purchase student loans it may wish to sell to third parties and, if such right is exercised, the purchase price will be 101.5% of outstanding principal and 100% of accrued interest. Such rights to purchase are applicable to loans in which Union Bank retains origination rights (the first $120 million per year originated and 25% of the originations in excess of $240 million per year). This purchase commitment agreement is terminable by either party by the giving of notice of termination at least 90 days prior to the end of the then current 360-day term.

Pursuant to a June 2001 agreement, Union Bank, in its capacity as trustee for various grantor trusts, agreed to purchase from us up to $750 million of participation interests in student loans. We retain a portion of the interest earned from the participated loans at a rate equal to the difference between the borrower's interest rate on the loans and the 90-day commercial paper rate plus 30 basis points. However, we also must continue to pay the servicing costs with respect to such participated loans. We sold to Union Bank, as trustee, participation interests with balances of approximately $149 million as of December 31, 2002. We have the option to purchase the participation interests from these grantor trusts at the end of a 364-day term upon termination of the participation certificate. The agreement automatically renews for additional 364-day terms unless either party gives notice to terminate. The agreement is also 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 us on a short-term basis.

We have serviced loans for Union Bank since 1978, and, pursuant to a servicing agreement dated January 1, 1998, as amended, we charge a standard origination and servicing fee at a level substantially commensurate to those charged to the majority (in terms of volume of loans serviced) of our non-affiliated servicing clients. Those fees are as follows: $1.67 per Stafford or PLUS loan per month in school; $2.92 per Stafford or PLUS loan per month other than in school; $2.89 per loan per month for consolidation loans; and $25.00 per loan origination fee. Union Bank paid us fees pursuant to this servicing agreement aggregating approximately $5.5 million in 2002. Our accounts receivable as of December 31, 2002 included approximately $371,000 for loan servicing fees due from Union Bank. The servicing agreement is for a month-to-month term, subject to a removal fee of $13.32 per loan and a deconversion fee of $10.66 per loan. The agreement may be terminated in the event of a material uncured breach by us.

Beginning in May 2001, we subleased 4,124 square feet of office space from Union Bank at a price of $8.50 per square foot and 320 square feet of storage space for $3.00 per square foot. These terms are the same rental terms as are charged to Union Bank by the non-affiliated landlord. During 2002, we made rent payments to Union Bank of approximately $36,000. This sublease agreement is coterminous with the master lease between Union Bank and the non-affiliated landlord.

Starting in June 2001, we obtained the right to acquire from Union Bank 100% of the participation interests in an unspecified volume of private loans which comply with our internal underwriting criteria (as modified from time to time). On these participations, we earn 100% of the borrower interest rate, less servicing costs thereon in an amount equal to 1% per annum of the aggregate average outstanding principal balances of such participations. The parties mutually agree upon the volume of such participations from time to time. In 2002, we did not purchase any participation interests in private loans pursuant to this agreement. The agreement is subject to termination upon 30 days' notice by either party.

In December 2000, we entered into an agreement to assist Union Bank in marketing and providing program operations related to the Nebraska College Savings Plan, or the College Savings Plan, a plan under Section 529 of the Code. Union Bank has agreed to pay us fees in an amount equal to 50% of the net profits, if any, associated with Union Bank's program management agreement with the College Savings Plan. Union Bank is entitled to a fee as program manager pursuant to its program management agreement with the College Savings Plan and is not entitled to other payments pursuant to that agreement. We have agreed to share 50% of the expenses relating to the program, up to a capped amount of $1.25 million over the life of the agreement, as well as 50% of mutually agreeable costs related to the program operations, if any, which exceed the aggregate of $1.25 million. In 2002, we incurred a net expense of approximately $219,000 arising from this agreement. This consulting and services agreement terminates when Union Bank's program manager agreement with the College Savings Plan terminates, in approximately eight years.

Since October 1998, we have invested in student loans from time to time by establishing several grantor trusts with Union Bank as trustee for Union Bank's Short Term Federal Investment Trust. As a grantor, we place cash into the trust account, and Union Bank uses such cash to acquire interests in student loans on our behalf. We earn the yield on the student loans purchased by the trust and pay to Union Bank a trustee fee in an amount ranging from 75 basis points to 375 basis points per annum of amounts invested, depending upon the type of investment asset being acquired in the trust account. We invested approximately $12.9 million in these trusts as of December 31, 2002. Union Bank has created almost 1,000 similar Short Term Federal Investment Trusts with non-affiliated trust beneficiaries, and the fees and terms applicable to the trust agreements it has entered into with us are the same as the fees charged by Union Bank to the majority (in terms of assets) of non-affiliated persons. As trustee, Union Bank has agreed to return our funds invested in these trusts or assets held on our behalf in these trusts upon 30 days' notice from us at any time and thus terminate the trusts. We utilize these trust arrangements as a short-term investment facility.

In January 2001, we, Union Bank and UFS Securities, LLC, or UFS Securities (which was then controlled by Michael S. Dunlap and Stephen F. Butterfield, but which we subsequently have acquired), entered into an employee sharing arrangement with respect to a small group of employees. The arrangement requires each counterparty receiving services from any such employee to pay for the share of the employee's salary and payroll equal to the approximate percentage of such employee's time devoted to such recipient. This agreement renews automatically for one-year terms unless the parties mutually agree not to renew.

We have retained Union Bank to administer our 401(k) profit sharing and related employee benefit plans pursuant to a series of agreements, the most recent of which was entered into in April 2003. The fees charged by Union Bank are commensurate with those Union Bank charges to other employee benefit customers. We paid Union Bank the sum of approximately $92,000 in 2002 for these services, based upon fees ranging between 0.25% and 0.125% of the plan assets, plus a recordkeeping fee, depending upon the aggregate of plan assets. This agreement may be terminated upon 60 days' notice from either party, but we must pay liquidated damages if we terminate prior to April 2004.

**Transactions with Farmers & Merchants and Its Related Parties**

In August 2001, we provided to The First Marblehead Corporation, or First Marblehead, and each special purpose entity, or SPE, named in the agreement a guarantee of liabilities of First National Bank Northeast, or First National, pursuant to indemnity covenants given by First National to First Marblehead with respect to a sale of loans from First National to First Marblehead. Our liability under such guarantee is limited to an aggregate amount of $10 million, plus costs incurred by First Marblehead with respect to recovery efforts. In consideration for such guarantee, First Marblehead agreed to pay or cause a SPE to pay us the sum of 1% of the outstanding balance of private loans sold by First National to First Marblehead. This guarantee remains in effect until First Marblehead and the SPEs receive written notice from us to discontinue the guarantee or until all obligations of First National pursuant to its indemnity of First Marblehead are paid in full. We earned nothing in 2002 from this agreement and have not paid out any sums pursuant to the indemnity covenants thereunder. Michael S. Dunlap is a director of First National, and Farmers & Merchants owns, indirectly, approximately 25% of the outstanding capital stock of that financial institution.

In September 2000, we engaged Farmers & Merchants, one of our shareholders at the time, as well as the holding company of Union Bank, to provide consulting services with respect to financial matters, merger and acquisition activities, student loan marketing and legislative support and other advisory matters. In 2002, we paid consulting fees in the amount of approximately $1.4 million to Farmers & Merchants and an additional $1 million to Packers Service Group, as assignee of Farmers & Merchants. This agreement was terminated in June 2002.

We obtained an unsecured operating line of credit from Farmers & Merchants in November 2001. The interest rate we were charged was equal to 165 basis points above 30-day LIBOR, which was the same cost to Farmers & Merchants from a third-party credit provider at the time to cover Farmers & Merchants' lending commitment. The commitment amount under this line of credit was $30 million, which was drawn upon and later repaid in full as of the end of 2002. No funds were borrowed by Nelnet under this agreement in 2003. This line of credit was recently terminated. In January 2002, we entered into an intercreditor agreement with Farmers & Merchants and Bank of America, N.A., pursuant to which Farmers & Merchants agreed to subordinate certain of its rights as one of our lenders to the rights of Bank of America. This intercreditor agreement will terminate upon discharge of all of our indebtedness to Bank of America pursuant to its commitment which expires in January 2005.

In May 2002, we transferred our preferred stock holdings in Packers Service Group to Infovisa, Inc., one of our subsidiaries at that time. In May 2002, we then sold 91.43% of the outstanding capital stock of Infovisa, Inc. to Farmers & Merchants for a purchase price equal to that company's book value of approximately $6 million.

**Transactions with Miscellaneous Related Parties**

In November 2000, we entered into an agreement with Union Financial pursuant to which Union Financial furnished consulting services to us. We paid Union Financial consulting fees in the amount of $1.65 million in 2002. This agreement was terminated in 2002.

In December 2000, we entered into an agreement to obtain consulting services on a broad range of matters from Great Plains, which until recently owned 6.8% of our common stock. Don R. Bouc, our President and one of our Directors, owned a 75% interest in Great Plains, and Terry J. Heimes, Chief Financial Officer and an Executive Director of Nelnet, owned a 7% interest. We paid Great Plains consulting fees of approximately $1.75 million during 2002 pursuant to this agreement, a portion of which constituted payment for Mr. Bouc's consulting services provided to Nelnet during 2002. This agreement was terminated in July 2003.

Since January 2001, we have owned 50% of a technology firm, 5280 Solutions, Inc., or 5280 Solutions, which provided us with contract programming and related technological support starting in January 2002. In 2002, we paid 5280 Solutions approximately $7.0 million for its services. Since March 2002, we have owned 50% of FirstMark Services, LLC, or FirstMark Services. In March 2002, FirstMark Services agreed to provide subcontracting servicing functions on our behalf with respect to private loan services. We incurred expenses with respect to private loan servicing provided by FirstMark Services of approximately $4.6 million in 2002. We provided a $2.5 million operating line of credit to FirstMark Services in March 2002, and this line of credit will expire in March 2004. During 2002, Raymond J. Ciarvella and Matthew D. Hall owned interests in both companies, and Todd M. Eicher and Edward P. Martinez owned interests in 5280 Solutions. They currently own no interest in these companies.

**UFS Securities Transactions with Miscellaneous Related Parties**

Prior to August 2003, UFS Securities, LLC was owned by Packers Service Group and Union Financial. In August 2003, we acquired a 100% ownership interest in UFS Securities for the purchase price of $2.6 million. Thus, although transactions with UFS Securities prior to August 2003 would have been treated previously as affiliate transactions, such transactions are now with our wholly owned subsidiary. We have retained UFS Securities in a series of advisory arrangements pursuant to which UFS Securities provides advisory services in connection with our offerings of debt securities. We paid approximately $1.4 million in fees to UFS Securities in 2002 for such services.

In December 2002, UFS Securities retained Union Bank to administer the UFS Securities 401(k) profit sharing plan for fees which are commensurate with those charged to other 401(k) profit sharing plans. No fees were paid to Union Bank in 2002 pursuant to this agreement. This agreement may be terminated by either party upon 60 days' notice. If UFS Securities terminates this agreement before a one year term, it must pay liquidated damages to Union Bank.

In August 2001, UFS Securities entered into an agreement with Farmers & Merchants pursuant to which UFS Securities, for a fee equal to the amount received by Farmers & Merchants, assists with the performance of mortgage loan consulting services that Farmers & Merchants provides for a bank. UFS Securities received fees of approximately $237,000 in 2002 from this agreement. This agreement terminates when the agreement between Farmers & Merchants and the third-party bank terminates.

In March 2001, UFS Securities began serving as distributor on behalf of Union Bank for all advisor-sold accounts with the College Savings Plan. UFS Securities is entitled to approximately 10 basis points of plan assets pursuant to this agreement. This agreement may be terminated by either party upon 30 days' notice. In November 2001, UFS Securities began acting as distributor on behalf of Union Bank for the TD Waterhouse accounts within the College Savings Plan. This agreement terminates upon termination of the TD Waterhouse distribution agreement for the College Savings Plan. UFS Securities received payments aggregating approximately $77,000 from these agreements in 2002.

In October 2002, UFS Securities agreed to act as the principal underwriter for the Stratus Funds, Inc., or Stratus Funds, a group of mutual funds associated with Union Bank and of which Michael S. Dunlap serves as president. UFS Securities did not receive any fees in 2002 pursuant to this agreement. This agreement has a one-year term that renews automatically, with the Stratus Funds' prior approval, for successive one-year terms unless terminated by a vote of the majority of the board of directors, including a majority of disinterested directors, of the Stratus Funds or a majority of its shareholders. UFS Securities may also terminate this agreement on 60 days' notice. In April 2000, UFS Securities leased office space and office amenities from Union Bank at the rate of $15.00 per square foot, or $1,000 per month. This agreement terminates in April 2004, but will automatically renew for successive one-year terms unless either party terminates upon written notice. In March 2001, UFS Securities, together with Union Bank, hired Adminisystems, Inc., one of our affiliates, which we refer to as Adminisystems, and Union Bank, to perform certain administrative services in connection with the investment portfolios maintained by the College Savings Plan. The fees to be paid under this agreement equal 40% of the distribution fees that UFS Securities receives with respect to certain accounts placed with the College Savings Plan. UFS Securities paid Adminisystems the sum of approximately $51,000 in 2002. This agreement may be terminated by any party upon 60 days' notice.

In March 2000, Farmers & Merchants furnished a $1 million unsecured line of credit to UFS Securities with interest accruing at the prime rate. No monies have ever been drawn or advanced on this line. The initial term of this line of credit expires in March 2005.

In January 2002, we retained UFS Securities for a one time fee of $25,000 to provide advisory services in connection with a swap agreement to which we were a party.

In April 2002, UFS Securities retained Union Financial to provide consulting services in connection with an advisory agreement between UFS Securities and J.P. Morgan Securities Inc. This agreement is coterminous with the advisory agreement between UFS Securities and J.P. Morgan Securities Inc. UFS Securities paid to Union Financial the sum of approximately $1.87 million in 2002 pursuant to this agreement.

In June 2000, Union Bank agreed to permit UFS Securities to gain certain access to Union Bank customers by permitting marketing efforts in Union Bank facilities, in consideration for 90% of UFS Securities' gross commissions, after deducting trading and closing expenses. UFS Securities paid Union Bank approximately $245,000 in 2002 pursuant to this agreement.

## DESCRIPTION OF CAPITAL STOCK

### General

Our amended and restated articles of incorporation, which we refer to as our articles of incorporation, provide that we have the authority to issue 615,000,000 shares of common stock, par value $0.01 per share. The common stock is divided into two classes, consisting of 600,000,000 shares of Class A common stock and 15,000,000 shares of Class B common stock. Upon consummation of the offering, shares of Class A common stock and 14,023,454 shares of Class B common stock will be issued and outstanding.

Our articles of incorporation also provide that we have authority to issue 50,000,000 shares of preferred stock, par value $0.01 per share. Our board of directors may fix the relative rights and preferences of each series of preferred stock in a resolution of the board of directors.

### Common Stock

#### *Voting Rights*

Holders of Class A common stock are entitled to one vote per share and holders of Class B common stock are entitled to ten votes per share on all matters submitted to a vote of shareholders. Except as otherwise required by law, Class A common stock and Class B common stock shall vote as a single class on all matters to be voted on by our shareholders, including, without limitation, any consolidation or merger of us into or with any other corporation or the sale or transfer by us of all or substantially all of our assets. With the approval of a majority of the shares of Class B common stock, voting separately as a class, we may lower the number of votes per share each share of Class B common stock shall be entitled to have.

#### *Dividends*

Holders of common stock are entitled to receive ratably dividends payable in cash, in stock or otherwise if, as and when declared by the board of directors out of assets legally available therefor, subject to any preferential rights of any outstanding preferred stock.

#### *Conversion*

Each share of Class B common stock shall automatically be converted into one share of Class A common stock, without any action by us or further action by the holder thereof, upon the transfer of such share, other than the following transfers:

- to any other holder of Class B common stock or an affiliate of a holder of Class B common stock which holder is a natural person or a "business organization," as defined in our articles of incorporation;

- to a spouse, sibling, parent, grandparent or descendant, whether natural or adopted, of a holder of Class B common stock;

- to a trust for the sole benefit of:
  - a holder of Class B common stock who is a natural person,
  - a spouse, sibling, parent, grandparent or descendent, whether natural or adopted, of a holder of Class B common stock, and/or
  - a charitable foundation or other organization qualified under Section 501(c)(3) of the Internal Revenue Code of 1986, as amended;

- by will to:
  - a spouse, sibling, parent, grandparent or descendent, whether natural or adopted, of a holder of Class B common stock,
  - a charitable foundation or other organization qualified under Section 501(c)(3) of the Internal Revenue Code of 1986, as amended, or
  - to a trust as described above;

- pursuant to the laws of descent and distribution to a spouse, sibling, parent, grandparent or descendant, whether natural or adopted, of a holder of Class B common stock;

- to any charitable foundation or other organization qualified under Section 501(c)(3) of the Internal Revenue Code of 1986, as amended; or

- to us.

Notwithstanding the foregoing, Class B common stock shall automatically convert into Class A common stock upon any transfer pursuant to a divorce or separation agreement or order.

For purposes of this paragraph, “affiliate” means, with respect to any business organization, any natural person or business organization that, directly or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, such business organization.

Each share of Class B common stock shall, at the option of the holder thereof, be convertible into one share of Class A common stock at any time.

In the event at any time the shares of Class B common stock outstanding constitute less than 50% of the Class B common stock outstanding on the date hereof, each remaining share of Class B common stock outstanding shall automatically be converted into one share of Class A common stock.

***Other Rights***

On liquidation, dissolution or winding up of Nelnet, after payment in full of the amounts required to be paid to the holders of any outstanding preferred stock, all holders of common stock are entitled to receive ratably any assets available for distribution to holders of common stock after the payment of all of our debts and other liabilities. No shares of common stock have preemptive rights to purchase additional shares of common stock. All the outstanding shares of common stock are, and the shares sold hereunder will be, fully paid and nonassessable. The rights, preferences and privileges of holders of common stock will be subject to and may be adversely affected by the rights of holders of any preferred stock that may be issued in the future. All shares of Class A common stock and Class B common stock which are acquired by us shall be available for reissuance by us at any time.

**Preferred Stock**

Our board of directors is authorized, subject to limitations prescribed by law, without further shareholder approval, to issue from time to time up to an aggregate of 50,000,000 shares of preferred stock, in one or more series, and to determine or alter the designations, preferences, rights and any qualifications, limitations or restrictions of the shares of each such series thereof, including dividend rights, dividend rates, conversion rights, voting rights, terms of redemption (including sinking fund provisions), redemption price or prices, liquidation preferences and the number of shares constituting any series or designations of such series. The exercise of this authority eliminates delays associated with a shareholder vote in specific instances. The ability of the board of directors to issue preferred stock, while providing flexibility in connection with possible acquisitions and other corporate purposes, could have the effect of making it more difficult for a third party to acquire, or of discouraging a third party from acquiring, a majority of our outstanding voting stock.

The voting and other rights of the holders of common stock will be subject to, and may be adversely affected by, the rights of holders of any preferred stock that may be issued in the future.

**Nebraska Anti-takeover Law and Certain Charter and By-law Provisions**

Provisions of our articles of incorporation and our amended and restated by-laws, which we refer to as our by-laws, could discourage potential acquisition proposals and could delay or prevent a change in control of Nelnet. These provisions are intended to enhance the likelihood of continuity and stability in the composition of the board of directors and in the policies formulated by the board of directors and to discourage types of transactions that may involve an actual or threatened change in control of Nelnet.

### *Board of Directors*

Our by-laws provide that a vacancy in the board of directors occurring from an increase in the number of directors or otherwise may be filled by the vote of a majority of directors then in office, though less than a quorum. This precludes a third party or a majority of shareholders from removing incumbent directors and simultaneously gaining control of the board of directors by filling, with its own nominees, the vacancies created by removal.

### *Special Meetings of Shareholders*

Our articles of incorporation do not permit our shareholders to call special meetings of shareholders, except to the extent provided by applicable law. Nebraska law provides that the holders of shares of common stock representing 10% or more of the voting power of a Nebraska corporation may call a special meeting of shareholders at any time.

### *Advance Notice Requirements for Shareholder Proposals and Director Nominations*

Our by-laws establish an advance notice procedure for the nomination, other than by or at the direction of the board of directors or a committee thereof, of candidates for election as directors as well as for other shareholder proposals to be considered at shareholders' meetings. A notice regarding any nomination must contain, as to each nominee, all information relating to such person that is required to be disclosed in solicitations of proxies for the election of directors, or that is otherwise required, in each case pursuant to Regulation 14A of the Securities Exchange Act of 1934, including each such person's written consent to serving as a director if elected. A notice regarding any business, including nomination of directors, to be brought before an annual meeting must contain the following:

- a brief description of the business desired to be brought before the annual meeting and the reasons for conducting such business at the annual meeting;
- the name and address of the shareholder proposing such business;
- the class and number of shares of our stock beneficially owned by the shareholder; and
- any material interest of the shareholder in such business.

Although the notice provisions do not give the board of directors any power to approve or disapprove shareholders' nominations or proposals for action by us, they may have the effect of precluding a contest for the election of directors or the consideration of shareholder proposals if the procedures established by our by-laws are not followed and of discouraging or deterring a third party from conducting a solicitation of proxies to elect its own slate of directors or to approve its proposal, without regard to whether consideration of such nominees or proposals might be harmful or beneficial to us and our shareholders. The purpose of requiring advance notice is to afford the board of directors an opportunity to consider the qualifications of the proposed nominees or the merits of other shareholder proposals and, to the extent deemed necessary or desirable by the board of directors, to inform shareholders about those matters.

### *Shareholder Rights*

Our articles of incorporation authorize our board of directors to create and issue, whether or not in connection with the issuance and sale of any of our securities or property, rights entitling the holders thereof to purchase our securities or any other corporation. The times at which and the terms upon which such rights are to be issued are to be determined by the board of directors and set forth in the contracts or other instruments that evidence such rights. The authority of the board of directors with respect to such rights shall include, without limitation, the determination of the initial purchase price, the times and circumstances under which such rights may be exercised, provisions denying holders of a specified percentage of our outstanding capital stock the right to exercise such rights and provisions to permit us to redeem or exchange such rights. This provision in our articles of incorporation could have the effect of discouraging third parties from seeking, or impairing their ability to seek, to acquire a significant portion of our outstanding securities, to engage in any transaction which might result in a change in control of us or to enter into any agreement, arrangement or understanding with another party to accomplish the foregoing or for the purpose of acquiring, holding, voting or disposing of any of our securities.

***Nebraska Shareholders Protection Act***

We are a Nebraska corporation and are therefore subject to the provisions of the Nebraska Shareholders Protection Act. The Nebraska Shareholders Protection Act, subject to certain exemptions, prohibits a Nebraska corporation from engaging in any of a broad range of “business combinations” involving an “interested” shareholder, or any affiliate or associate of such interested shareholder, for a period of five years following the date that such shareholder became an interested shareholder, unless prior to such date the board of directors of the corporation approved either the business combination or the transaction that resulted in the shareholder becoming an interested shareholder. A “business combination” includes a merger, asset sale or other transaction resulting in a financial benefit to the shareholder. The Nebraska Shareholders Protection Act also provides that shares acquired in a control-share acquisition have no voting rights with respect to matters other than the election of directors unless approved by a vote of shareholders of the corporation, and that any such control share acquisition is effective only if approved by a majority of the corporation’s voting shares that are “not interested” shares. A control-share “acquisition” is an acquisition of voting stock in a corporation that, when added to the shares the shareholder had prior to the acquisition, would elevate the shareholder’s voting power into one the three following ranges: (i) between 20% and 33 1/3%, (ii) between 33 1/3% and 50% and (iii) over 50%. For purposes of the Nebraska Shareholders Protection Act, an “interested shareholder” is a person who owns 10% or more of a corporation’s outstanding voting stock, or an affiliate or associate of the corporation that owns, or within five years prior did own, 10% or more of the corporation’s outstanding voting stock. These provisions may have the effect of discouraging, delaying, deferring or preventing a change in control of Nelnet.

**Registration Rights**

Michael S. Dunlap, Stephen F. Butterfield and persons related to them and trusts in which they have beneficial interests have the right to make two written demands of Nelnet for registration with the Securities and Exchange Commission of all or part of their common stock. However, we need not effect a demand registration unless it includes securities with an aggregate offering price, net of underwriting discounts and commissions, of at least $5 million. The first such demand may not be made prior to the first anniversary of this offering, and the second such demand may not be made within 12 months after the first demand. We are obligated to comply with any such demand unless our independent directors determine that such sale would be contrary to the best interests of Nelnet. Our independent directors may consider several factors in making any such determination, including share price performance after the date of this offering, equity market conditions and our operating results. These shareholders also have piggyback registration rights for their common stock. The number of securities to be included in an offering by these shareholders will be subject to reduction by the applicable underwriter in some cases. We will bear all expenses incident to our performance of our registration obligations, other than some of the costs or expenses of selling shareholders. The foregoing registration rights are not transferable and may be amended or waived only with the written consent of Nelnet and the applicable shareholders.

**Limitation of Directors’ Liability**

Our articles of incorporation contain a provision which limits the personal liability of each of our directors for monetary damages for breaches of fiduciary duty as one of our directors, except for liability of a director for the following:

- breach of the duty of loyalty to us or our shareholders;
- acts or omissions not in good faith or involving intentional misconduct or a knowing violation of law;
- any transaction from which the director derived an improper personal benefit; or
- violations under provisions of the Nebraska Business Corporation Act relating to unlawful payments of dividends or unlawful stock purchases or redemptions.

The inclusion of this provision in our articles of incorporation may have the effect of reducing the likelihood of derivative litigation against directors, and may discourage or deter shareholders or management from bringing a lawsuit against directors for breach of their duty of care, even though such an action, if successful, might otherwise have benefited us and our shareholders. Our by-laws also contain provisions indemnifying our directors and officers to the fullest extent permitted by the Nebraska Business Corporation Act. Management believes that these provisions will assist us in attracting and retaining qualified individuals to serve as directors.

**Indemnification and Insurance**

Our articles of incorporation provide that we will indemnify each person who was or is made a party or threatened to be made a party to or is otherwise involved in any action, suit or proceeding, whether civil, criminal, administrative or investigative, by reason of the fact that he or she or a person of whom he or she is the legal representative is or was one of our directors or officers, to the fullest extent allowed by the Nebraska Business Corporation Act. This right of indemnification shall include the right to be paid by us the expenses, including attorneys' fees, incurred in defending any such proceeding in advance of its final disposition. However, if Nebraska law so requires, the advancement of such expenses will only be made upon the delivery to us of an undertaking by or on behalf of such person to repay all amounts so advanced if it shall ultimately be determined by final judicial decision, from which there is no further right to appeal, that such person is not entitled to be indemnified for such expenses by us.

In addition, our articles of incorporation provide that we may maintain insurance to protect ourselves and any of our directors, officers, employees or agents against any expense, liability or loss, whether or not we would have the power to indemnify a person against any expense, liability or loss under Nebraska law. Our articles of incorporation further provide that we may, to the extent permitted by the board of directors, grant rights to indemnification, and rights to advancement of expenses, to any of our employees or agents. We have obtained insurance for the benefit of our officers and directors insuring such persons against liabilities, including liabilities under the securities laws.

**Share Retention Policy**

Under our share retention policy, none of our officers or the officers of any of our direct or indirect subsidiaries at or above the level of Executive Director, defined for purposes of the policy as Executives, may sell or otherwise dispose of a number of shares of common stock in any calendar year in excess of one-third of the number of shares of common stock beneficially owned by the Executive on the first day of the calendar year. The policy applies to Executives during and following their employment by us, provided that following five years from the closing date of this offering, an Executive will be free to sell or otherwise dispose of all of his or her shares.

Exceptions that apply to the share retention policy are as follows:

- Transfers to family members and family-owned partnerships or other family-owned entities will not be prohibited, so long as such transfers are effected only for estate planning purposes and the transferee agrees to comply with the share retention policy (treating the transferee(s) as the transferring Executive).

- It shall not be prohibited for any Executive to sell or otherwise dispose of up to $500,000 in value of shares of common stock during any calendar year.

- All restrictions under the share retention policy shall cease in the event of the death or retirement at normal retirement age of an Executive.

**Transfer Agent and Registrar**

The transfer agent and registrar for our common stock will be Mellon Investor Services LLC.

**Listing**

We intend to apply to have our Class A common stock listed on the New York Stock Exchange under the symbol “NNI.”

**Recapitalization**

Effective August 14, 2003, we recapitalized our outstanding capital stock. In connection therewith, our outstanding 2,859.99 shares of Class A voting common stock, par value $0.10 per share, and our outstanding 211,609 shares of Class B non-voting common stock, par value $0.10 per share, were converted into an aggregate of 31,015,034 shares of Class A common stock, par value $0.01 per share, and 14,023,454 shares of Class B common stock, par value $0.01 per share. We also changed our name from Nelnet Loan Services, Inc. to Nelnet, Inc. effective August 14, 2003.

## SHARES ELIGIBLE FOR FUTURE SALE

### Sales of Restricted Shares

Upon the completion of this offering, we will have shares of our Class A common stock outstanding. Of these shares, the shares of our Class A common stock sold in this offering will be freely tradeable by persons other than our affiliates, as that term is defined in Rule 144 under the Securities Act of 1933, without restriction or further registration under the Securities Act of 1933.

All of the remaining shares of our Class A common stock outstanding upon completion of this offering, and the 14,023,454 shares of Class A common stock issuable upon the conversion of our Class B common stock outstanding upon completion of this offering, are deemed "restricted" securities under Rule 144 under the Securities Act of 1933. None of these restricted securities will be eligible for sale in the public market on the date of this prospectus. Upon expiration of the lock-up agreements described below, 180 days after the date of this prospectus, up to an additional shares of our Class A common stock, including shares of Class A common stock issuable upon the conversion of our outstanding Class B common stock, will be eligible for sale in the public market pursuant to Rule 144.

In general, under Rule 144, a shareholder who has beneficially owned his or her restricted shares for at least one year is entitled to sell, within any three-month period, a number of shares of our Class A common stock that does not exceed the greater of:

- one percent of the then-outstanding shares of our Class A common stock, which is approximately shares of our Class A common stock immediately after the completion of this offering; or

- the average weekly trading volume in our Class A common stock on the New York Stock Exchange during the four calendar weeks preceding the date on which notice of such sale is filed, provided certain requirements concerning availability of public information, manner of sale and notice of sale are satisfied.

In addition, our affiliates must comply with the restrictions and requirements of Rule 144, other than the one-year holding period requirement, in order to publicly sell shares of our Class A common stock which are not restricted securities. A shareholder who is not one of our affiliates and has not been our affiliate for at least three months prior to the sale and who has beneficially owned restricted shares of our Class A common stock for at least two years may resell the shares without limitation. In meeting the one- and two-year holding periods described above, a holder of restricted shares of our Class A common stock can include the holding period of a prior owner who was not our affiliate. The one- and two-year holding periods described above do not begin to run until the full purchase price or other consideration is paid by the person acquiring the restricted shares of our Class A common stock from us or one of our affiliates.

### Registration Rights

Michael S. Dunlap, Stephen F. Butterfield and persons related to them have the right, subject to limitations, to make two written demands of Nelnet for registration with the Securities and Exchange Commission of all or part of their common stock. These shareholders also have piggyback registration rights for their common stock. See "Description of Capital Stock — Registration Rights."

### Lock-up Agreements

We and our executive officers and directors and all of our shareholders have agreed that, with some exceptions, during the period beginning from the date of this prospectus and continuing to and including the date 180 days after the date of this prospectus, none of us will, directly or indirectly, sell, offer to sell, contract to sell or grant any option to sell (including without limitation any short sale), pledge, transfer, establish an open "put equivalent position" within the meaning of Rule 16a-1(h) under the Securities Exchange Act of 1934, as amended, or otherwise dispose of any shares of our common stock, options or warrants to acquire shares of our common stock currently or hereafter owned either of record or beneficially by us, or publicly announce an intention to do any of the foregoing, without the prior written consent of J.P. Morgan Securities Inc. and Banc of America Securities LLC. In addition, we and our executive officers and directors and these shareholders have agreed that, without the prior written consent of J.P. Morgan Securities Inc. and Banc of America Securities LLC, none of us will, from the date of this prospectus and through the period ending 180 days after the date of this prospectus, make any demand for, or exercise any right with respect to, the registration of any shares of our common stock.

**Share Retention Policy**

Our share retention policy prohibits our Executives from selling or otherwise disposing of a number of shares of Class A common stock in any calendar year in excess of one-third of the number of shares of common stock beneficially owned by the Executive officers on the first day of the calendar year, subject to limited exceptions. This policy applies to Executive officers during and, unless their employment is terminated due to death or retirement at normal retirement age, following termination of their employment by Nelnet and expires five years from the closing date of this offering. We retain the ability in our discretion to waive compliance with the Share Retention Policy. See “Description of Capital Stock — Share Retention Policy.”

## UNITED STATES TAX CONSEQUENCES TO NON-U.S. HOLDERS OF CLASS A COMMON STOCK

The following is a general discussion of certain material U.S. federal income and estate tax consequences of the ownership and disposition of our Class A common stock by a beneficial owner thereof that is a “Non-U.S. Holder.” A “Non-U.S. Holder” is a person or entity that, for U.S. federal income tax purposes, is a non-resident alien individual, a foreign corporation or a foreign estate or trust. The test for whether an individual is a resident of the U.S. for federal estate tax purposes differs from the test used for federal income tax purposes. Some individuals, therefore, may be “Non-U.S. Holders” for purposes of the federal income tax discussion below, but not for purposes of the federal estate tax discussion, and vice versa.

This discussion is based on the U.S. Internal Revenue Code of 1986, as amended, judicial decisions and administrative regulations and interpretations in effect as of the date of this prospectus, all of which are subject to change, including changes with retroactive effect. This discussion does not address all aspects of U.S. federal income and estate taxation that may be relevant to Non-U.S. Holders in light of their particular circumstances (including, without limitation, Non-U.S. Holders who are pass-through entities or who hold their Class A common stock through pass-through entities) and does not address any tax consequences arising under the laws of any state, local or non-U.S. jurisdiction. Prospective holders should consult their tax advisors with respect to the federal income and estate tax consequences of holding and disposing of our Class A common stock in light of their particular situations and any consequences to them arising under the laws of any state, local or non-U.S. jurisdiction.

### Dividends

Subject to the discussion below, dividends, if any, paid to a Non-U.S. Holder of our Class A common stock out of our current or accumulated earnings and profits generally will be subject to withholding tax at a 30% rate or such lower rate as may be specified by an applicable income tax treaty. To obtain a reduced rate of withholding under a treaty, a Non-U.S. Holder generally will be required to provide us with a properly executed IRS Form W-8BEN certifying the Non-U.S. Holder’s entitlement to benefits under that treaty. U.S. Treasury Regulations provide special rules to determine whether, for purposes of determining the applicability of a tax treaty, dividends paid to a Non-U.S. Holder that is an entity should be treated as paid to the entity or to those holding an interest in that entity.

There will be no withholding tax on dividends paid to a Non-U.S. Holder that are effectively connected with the Non-U.S. Holder’s conduct of a trade or business within the United States if a properly-executed IRS Form W-8ECI, stating that the dividends are so connected, is filed with us. Instead, the effectively connected dividends will be subject to regular U.S. income tax, generally in the same manner as if the Non-U.S. Holder were a U.S. citizen or resident alien or a domestic corporation, as the case may be, unless a specific treaty exemption applies. A corporate Non-U.S. Holder receiving effectively connected dividends may also be subject to an additional “branch profits tax,” which is imposed, under certain circumstances, at a rate of 30% (or such lower rate as may be specified by an applicable treaty) of the corporate Non-U.S. Holder’s effectively connected earnings and profits, subject to certain adjustments.

### Gain on Disposition of Class A Common Stock

A Non-U.S. Holder generally will not be subject to U.S. federal income tax with respect to gain realized on a sale or other disposition of our Class A common stock unless (i) the gain is effectively connected with a trade or business of such holder in the United States and a specific treaty exemption does not apply to eliminate the tax, (ii) if a tax treaty would otherwise apply to eliminate the tax, the gain is attributable to a permanent establishment of the Non-U.S. Holder in the United States, (iii) in the case of Non-U.S. Holders who are nonresident alien individuals and hold our Class A common stock as a capital asset, such individuals are present in the United States for 183 or more days in the taxable year of the disposition and certain other conditions are met, (iv) the Non-U.S. Holder is subject to tax pursuant to the provisions of the Code regarding the taxation of U.S. expatriates, or (v) we are or have been a "United States real property holding corporation" within the meaning of Code Section 897(c)(2) at any time within the shorter of the five-year period preceding such disposition or such holder's holding period. We believe that we are not, and do not anticipate becoming, a United States real property holding corporation. Even if we are treated as a United States real property holding corporation, gain realized by a Non-U.S. Holder on a disposition of our Class A common stock will not be subject to U.S. federal income tax so long as (i) the Non-U.S. Holder is considered to have beneficially owned no more than five percent of our Class A common stock at all times within the shorter of (a) the five year period preceding the disposition or (b) the holder's holding period and (ii) our Class A common stock is regularly traded on an established securities market. There can be no assurance that our Class A common stock will continue to qualify as regularly traded on an established securities market.

**Information Reporting Requirements and Backup Withholding**

Generally, we must report to the U.S. Internal Revenue Service, or the IRS, the amount of dividends paid, the name and address of the recipient and the amount, if any, of tax withheld. A similar report is sent to the holder. Pursuant to tax treaties or certain other agreements, the IRS may make its reports available to tax authorities in the recipient's country of residence.

Backup withholding will generally not apply to payments of dividends made by us or our paying agents to a Non-U.S. Holder if the holder has provided its federal taxpayer identification number, if any, or the required certification that it is not a U.S. person (which is generally provided by furnishing a properly executed IRS Form W-8BEN), unless the payer otherwise has knowledge that the payee is a U.S. person.

Under current U.S. federal income tax law, information reporting and backup withholding imposed at a rate of 28.0% will apply to the proceeds of a disposition of our Class A common stock effected by or through a U.S. office of a broker unless the disposing holder certifies as to its non-U.S. status or otherwise establishes an exemption. Generally, U.S. information reporting and backup withholding will not apply to a payment of disposition proceeds where the transaction is effected outside the United States through a non-U.S. office of a non-U.S. broker. However, U.S. information reporting requirements (but not backup withholding) will apply to a payment of disposition proceeds where the transaction is effected outside the United States by or through an office outside the United States of a broker that fails to maintain documentary evidence that the holder is a Non-U.S. Holder and that certain conditions are met, or that the holder otherwise is entitled to an exemption, and the broker is (i) a U.S. person, (ii) a foreign person which derived 50% or more of its gross income for certain periods from the conduct of a trade or business in the United States, (iii) a "controlled foreign corporation" for U.S. federal income tax purposes, or (iv) a foreign partnership (a) at least 50% of the capital or profits interest in which is owned by U.S. persons or (b) that is engaged in a U.S. trade or business. Backup withholding will apply to a payment of disposition proceeds if the broker has actual knowledge that the holder is a U.S. person.

Backup withholding is not an additional tax. Rather, the tax liability of persons subject to backup withholding will be reduced by the amount of tax withheld. If withholding results in an overpayment of taxes, a refund may be obtained, provided that the required information is furnished to the IRS.

**Federal Estate Tax**

An individual Non-U.S. Holder who is treated as the owner of, or has made certain lifetime transfers of, an interest in our Class A common stock will be required to include the value thereof in his gross estate for U.S. federal estate tax purposes, and may be subject to U.S. federal estate tax unless an applicable estate tax treaty provides otherwise.

## UNDERWRITING

J.P. Morgan Securities Inc. and Banc of America Securities LLC are acting as joint book-running managers for this offering.

We and the underwriters named below have entered into an underwriting agreement covering the Class A common stock to be sold in this offering. J.P. Morgan Securities Inc., Banc of America Securities LLC, Credit Suisse First Boston LLC and Morgan Stanley & Co. Incorporated are acting as representatives of the underwriters. Each underwriter has agreed to purchase the number of shares of Class A common stock set forth opposite its name in the following table.

| Name | Number of shares |
| --- | --- |
| J.P. Morgan Securities Inc. | |
| Banc of America Securities LLC | |
| Credit Suisse First Boston LLC | |
| Morgan Stanley & Co. Incorporated | |
| Total | |

The underwriting agreement provides that if the underwriters take any of the shares presented in the table above, then they must take all of these shares. No underwriter is obligated to take any shares allocated to a defaulting underwriter except under limited circumstances. The underwriting agreement provides that the obligations of the underwriters are subject to certain conditions precedent, including the absence of any material adverse change in our business and the receipt of certain certificates, opinions and letters from us, our counsel and our independent auditors.

The underwriters are offering the shares of Class A common stock, subject to the prior sale of shares, and when, as and if such shares are delivered to and accepted by them. The underwriters will initially offer to sell shares to the public at the initial public offering price shown on the front cover page of this prospectus. The underwriters may sell shares to securities dealers at a discount of up to $ per share from the initial public offering price. Any such securities dealers may resell shares to certain other brokers or dealers at a discount of up to $ per share from the initial public offering price. After the initial public offering, the underwriters may vary the public offering price and other selling terms.

If the underwriters sell more shares than the total number shown in the table above, the underwriters have the option to buy up to an additional shares of Class A common stock from us to cover such sales. They may exercise this option during the 30-day period from the date of this prospectus. If any shares are purchased with this option, the underwriters will purchase shares in approximately the same proportion as shown in the table above. If any additional shares of Class A common stock are purchased, the underwriters will offer the additional shares on the same terms as those on which the shares are being offered.

The following table shows the per share and total underwriting discounts that we will pay to the underwriters. These amounts are shown assuming both no exercise and full exercise of the underwriters' option to purchase additional shares.

| | Without overallotment exercise | With overallotment exercise |
|---|---|---|
| Per share | $ | $ |
| Total | $ | $ |

The representatives have advised us that, on behalf of the underwriters, they may make short sales of our Class A common stock in connection with this offering, resulting in the sale by the underwriters of a greater number of shares than they are required to purchase pursuant to the underwriting agreement. The short position resulting from those short sales will be deemed a "covered" short position to the extent that it does not exceed the shares subject to the underwriters' overallotment option and will be deemed a "naked" short position to the extent that it exceeds that number. A naked short position is more likely to be created if the underwriters are concerned that there may be downward pressure on the trading price of the Class A common stock in the open market that could adversely affect investors who purchase shares in this offering. The underwriters may reduce or close out their covered short position either by exercising the overallotment option or by purchasing shares in the open market. In determining which of these alternatives to pursue, the underwriters will consider the price at which shares are available for purchase in the open market as compared to the price at which they may purchase shares through the overallotment option. Any "naked" short position will be closed out by purchasing shares in the open market. Similar to the other stabilizing transactions described below, open market purchases made by the underwriters to cover all or a portion of their short position may have the effect of preventing or retarding a decline in the market price of our Class A common stock following this offering. As a result, our Class A common stock may trade at a price that is higher than the price that otherwise might prevail in the open market.

The representatives have advised us that, pursuant to Regulation M under the Securities Act of 1933, they may engage in transactions, including stabilizing bids or the imposition of penalty bids, that may have the effect of stabilizing or maintaining the market price of the shares of Class A common stock at a level above that which might otherwise prevail in the open market. A "stabilizing bid" is a bid for or the purchase of shares of Class A common stock on behalf of the underwriters for the purpose of fixing or maintaining the price of the Class A common stock. A "penalty bid" is an arrangement permitting the representatives to claim the selling concession otherwise accruing to an underwriter or syndicate member in connection with the offering if the Class A common stock originally sold by that underwriter or syndicate member is purchased by the representatives in the open market pursuant to a stabilizing bid or to cover all or part of a syndicate short position. The representatives have advised us that stabilizing bids and open market purchases may be effected on the New York Stock Exchange, in the over-the-counter market or otherwise and, if commenced, may be discontinued at any time.

One or more of the underwriters may facilitate the marketing of this offering online directly or through one of its affiliates. In those cases, prospective investors may view offering terms and a prospectus online and, depending upon the particular underwriter, place orders online or through their financial advisor.

The following table details the estimated offering expenses payable by us:

| | |
|---|---|
| Securities and Exchange Commission registration fee | $ |
| National Association of Securities Dealers, Inc. filing fee | |
| New York Stock Exchange listing fee | |
| Printing and engraving expenses | |
| Legal fees and expenses | |
| Accounting fees and expenses | |
| Transfer agent fees and expenses | |
| Miscellaneous | |
| Total | $ |

We have agreed to indemnify the underwriters against certain liabilities, including liabilities under the Securities Act of 1933.

We and our executive officers and directors and all of our shareholders have agreed that, during the period beginning from the date of this prospectus and continuing to and including the date 180 days after the date of this prospectus, none of us will, directly or indirectly, offer, sell, offer to sell, contract to sell or otherwise dispose of any shares of our common stock except in limited circumstances, without the prior written consent of J.P. Morgan Securities Inc. and Banc of America Securities LLC.

The underwriters have informed us that they do not intend sales to discretionary accounts to exceed five percent of the total number of shares of our Class A common stock offered by them and that no sales to discretionary accounts may be made without prior written approval of the customer.

At our request, the underwriters have reserved shares of Class A common stock for sale to our directors, officers and employees, and other persons with whom we have a business relationship, who have expressed an interest in participating in this offering. We expect these persons to purchase no more than five percent of the Class A common stock offered in this offering. The number of shares available for sale to the general public will be reduced to the extent such persons purchase such reserved shares.

We intend to apply to list the Class A common stock on the New York Stock Exchange under the symbol “NNI.” The underwriters intend to sell shares of our Class A common stock to a minimum of 2,000 beneficial owners in lots of 100 or more so as to meet the distribution requirements of this listing.

There has been no public market for the Class A common stock prior to this offering. We and the underwriters will negotiate the initial public offering price. In determining the initial public offering price, we and the underwriters expect to consider a number of factors in addition to prevailing market conditions, including:

- the history of and prospects for our industry and for student loan companies generally;
- an assessment of our management;
- our present operations;
- our historical results of operations;
- the trend of our revenues and earnings; and
- our earnings prospects.

We and the underwriters will consider these and other relevant factors in relation to the price of similar securities of generally comparable companies. Neither we nor the underwriters can assure investors that an active trading market will develop for the Class A common stock, or that the Class A common stock will trade in the public market at or above the initial public offering price.