

Written Interview with Mike Dunlap, the Chairman of Nelnet

1. *I think of Nelnet as a mini-Berkshire Hathaway, but instead of using insurance to build operating businesses and investments, Nelnet is using student loans and student loan servicing. Is this an appropriate way to think about student loans and Nelnet?*

Comparing Nelnet to Berkshire is like comparing Vikes ice cream shop in Waverly, Nebraska (there is one) to Dairy Queen (which as you know Berkshire owns). What we do have in common is that we are focused on trying to invest in businesses that create long term cash, have a defendable mote niche, diversified (Nelnet is not nearly as diversified as Berkshire) and try do things the right way. Student loans are messy and a political hot potato creating a niche I have been involved in my whole career (40 years). Making educational dreams was our only mission at the beginning of the company. As we have grown and diversified, this mission has broadened depending on the business line. As time goes on student loans are most likely going to be smaller part of Nelnet both nominally (FFELP pays down) and as a percent of our business. Insurance at Berkshire will continue to grow larger nominally at Berkshire.

2. *One thing I hear from other investors is worry about the politics of student loans. And a few of your competitors have left the market either due to costs or other problems. How do you think about being the largest student loan servicing company while student loan debt is such a front-page issue?*

Student loans have always been messy (in the beginning, lots of paper, bureaucracy and complicated). This is a two-edged sword, on the one side painful on the other not a lot of people are dying to get into the business. We have a lot of expertise and experience that has been built up over the last 46 years; that is hard to replicate. That being said, it is volatile.

3. *Another way I think about Nelnet is to call Nelnet the Quiet Technology Compounder, because when I look at the company, it looks like a financial company or student loan company but strip out the large student loan book and with Nelnet Business Services (payments), Allo, HUDL and a VC portfolio, Nelnet is actually a technology and payments company. How do you view your non-student loan businesses?*

The actual student loan business has also been a technology business. Dozens of our competitors over the years have used our software to service their student loans. We look for businesses that involve one or more of the following: finance, payments, servicing, and software/technology SAAS/HAAS (Allo HAAS hardware as a service). When you add excellent customer service with great software/hardware you start to build a moat. NDS (100% ownership stake), NBS (100% ownership stake), ALLO (44% ownership stake), and Hudl (20% ownership stake) do an excellent job here in my opinion.

4. *Why did you decide to sell a 50% stake in your fiber network business Allo to SDC Capital Partners?*

Our core values are 1. Excellent customer service, 2. Create a great work environment, 3. DIVERSIFICATION, 4. Open communication, 5. Give back to the communities we work in and work with.

The fiber business is incredibly capital intensive. SDC brought additional capital and expertise as we grow the business. If we wanted to, we could have put 100% of our excess cash flow into fiber growth. We need to balance our investment with our third value, Diversification.

5. *Can you talk about what you see in solar and alternative energy financing? Why is this a good or natural business for Nelnet to be in?*

It is fairly complicated financing and we have developed an expertise in the tax equity world which we are leveraging deeper into solar. It is a long-term asset like student loans and fiber that creates good cash flow.

6. *Why did Nelnet start a bank? How long until Nelnet Bank is profitable?*

The ABS market has completely blown up every 7-12 years with a decent amount of volatility on funding/basis cost in between. The bank gives us consistent funding at very attractive rates, so our customers know we are going to be there consistently for the long term. Follow our filings to see when the bank is profitable. We do not give earnings guidance or do quarterly earnings calls, similar to Berkshire we want to spend our energy focusing on our customers and growing our business not beating the hype drum.

7. *In an earlier letter, you wrote that “We measure success based on the free cash flow created in each of our businesses, return on invested capital, and growth in per share book value of the company overall”. This is clearly something that you are good at, and not an approach that can be applied to venture investing. I’m curious as to why the company decided to enter the VC space. What process do you follow to identify and evaluate opportunities? What are the key advantages that Nelnet brings which will enable it to succeed?*

Two-part answer. We entered the angel space in Nebraska and the Midwest to seed tech talent in our geographic footprints to build the wholistic tech ecosystem and attract talent to the ecosystem and Nelnet. Some of these angel investments have grown into venture capital investments we like and have been with from the start. (HUDL for example)

Second, in our areas of specific expertise around financial services, software, servicing, payments we think we have some competitive insights. We also leverage our connections through other funds and look for side car opportunities in our areas of expertise.

8. *In the past, Nelnet primarily repurchased shares below book value and now you are consistently buying above book value. Does this have anything to do with what was mentioned in the annual letter about the difference between the true market value and book value or is it more to do with opportunity set?*

We deploy cash a number of different ways, growing our own businesses, adding bolt on acquisitions, unrelated acquisitions, dividends, and stock buy backs. Depending on any point in time we may have excess cash or need to borrow to fund our growth. All these factors figure into the decision to buy back our stock. Some of the GAAP accounting treatment we receive on some of our assets we think may undervalue them based on book value accounting. Bottom line

we buy back the stock when we have a long view sight on having excess cash and we think the price is attractive.

9. *How does inflation influence your thinking in terms of your overall business?*

As I said at our annual shareholders meeting, some of the businesses benefit from higher rates (payment plan float and the bank if rates do not go crazy high), and some of our businesses are hurt when rates go up (ALLO because of the debt and our fixed rate floor portfolio). We try and hedge our portfolio at opportunistic times which I think we have done a decent job accomplishing.

10. *Your track record of growing book value at over 17% since you went public in 2004, is a great record, and it may not be appreciated by many since you went public at 8 times book, so it really hasn't yet shown up in your stock price. How do you think about repeating that impressive track record and more importantly, what future investment opportunities are you focused on?*

We don't give earnings guidance. I am not sure what our returns will be in the future. We will continue to focus on our core values Customer, Associate, Diversification trying to leverage future opportunities into our strengths in Finance, Servicing, Software, and payments.

11. *I think about the reinvestment opportunities now, because your loan book is going to throw off so much cash, approximately \$275 million this year and \$770 million in the next 2.5 years. What is Nelnet going to do with all this cash?*

Invest in our businesses and associates, look for bolt on acquisitions, look for unrelated acquisitions in our sweet spots mentioned above, make cash management investments, dividends, and stock buybacks.

12. *With the stock market turning down and signs of distress beginning to appear out there, this seems like a great time for Nelnet to be flush with cash. Are you seeing any signs of distress? Do you see signs of opportunity? Would you buy public company securities?*

Depending on the point in time there are usually different areas of the market in distress and euphoria. Sometimes the market becomes almost entirely euphoric or depressed. Today I think maybe we are normalizing off of some euphoric highs we hit in the last 18 months. Yes, we have bought some public company securities over the years.

13. *Any final lessons or thoughts you would want investors to consider either for Nelnet or for the overall market?*

I do not know if I have any lessons. Nelnet will focus on our customers first then our associates and diversify our holdings in our sweet spots (payments, software, service, finance) into businesses we think have defensible products and services creating long term cash flow. If you are looking for maximum short-term share price (returns), Nelnet is not the investment for you. If you are looking for a company focused on creating long-term cash flow that is our goal.