



## Nelnet Inc (NNI)

---

Spring 2021

Walker Davis, Financials, Senior Analyst  
Shivam Lahoti, Financials, Senior Analyst  
Jonathan Huang, Financials, Analyst  
Mitchell Taylor, Financials, Analyst



Buy NNI at 1.5% Allocation (PT: \$99.68, Implied Upside: 34.9%)

1

## Fed-Backed Floor Income

- 90% of current Nelnet assets are Federal Family Education Loan Program (FFELP) student loans. This is Federally guaranteed student loan interest income that was discontinued in 2010 and the majority of which will wind down over the next 8 years.
- They also benefit from the low interest rate environment with a floating rate feature while the borrower pays a fixed rate. Nelnet's loan book provides a strong outlook of guaranteed future cash flow.

2

## Promising Education Technology Business

- Nelnet Business Services (NBS), Nelnet's fast growing, highly profitable SAAS Payment Tech business has grown revenues 22% over last 5 years and produced \$75M EBITDA in 2020. It has penetrated 40% of all US K-12 private schools and 30% of all US higher institutions.
- Standalone competitors trade at 20x EBITDA. Nelnet shareholders own this business for virtually nothing.

3

## Strong Capital Allocation

- Nelnet has compounded book value over 17% annually since inception. We are confident in Nelnet's ability to continue successfully investing capital as the student loan portfolio unwinds and the business diversifies.
- Nelnet has ventured into the development of a solar cell site, the expansion of a fiber optic broadband network and obtained an FDIC bank charter.

## Business Description

- Nelnet, Inc. is a diverse company with a focus on delivering education-related products and services and student loan asset management.
- The largest operating businesses engage in student loan servicing, tuition payment processing and school information systems, and communications.
- A significant portion of the Company's revenue is net interest income earned on a portfolio of federally insured student loans.

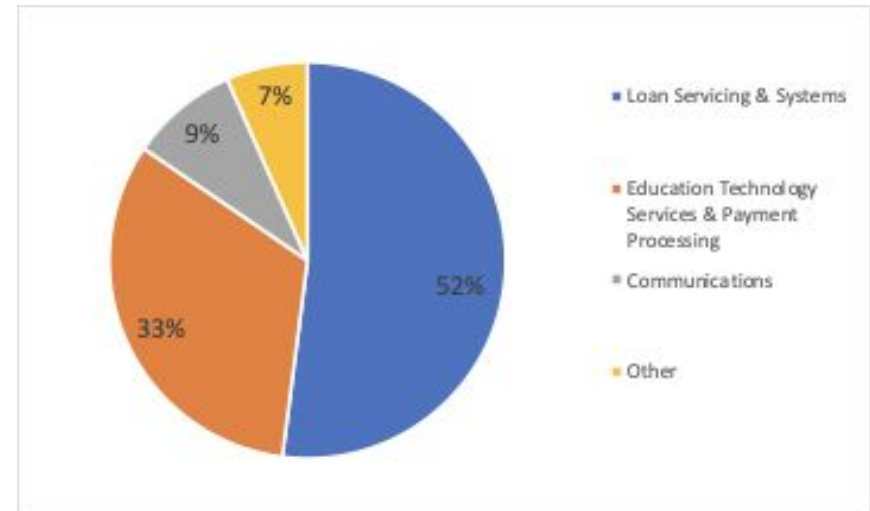
## Key Statistics

<b>GICS Sub-Industry</b>	Diversified Financial Services
<b>Market Cap</b>	\$2.83B
<b>Revenue</b>	\$1.40B
<b>Current Price</b>	\$73.90
<b>52-Week Range</b>	\$38.44 / \$77.50
<b>Beta</b>	0.73
<b>Dividend Yield</b>	1.20%
<b>Credit Rating</b>	BBB+

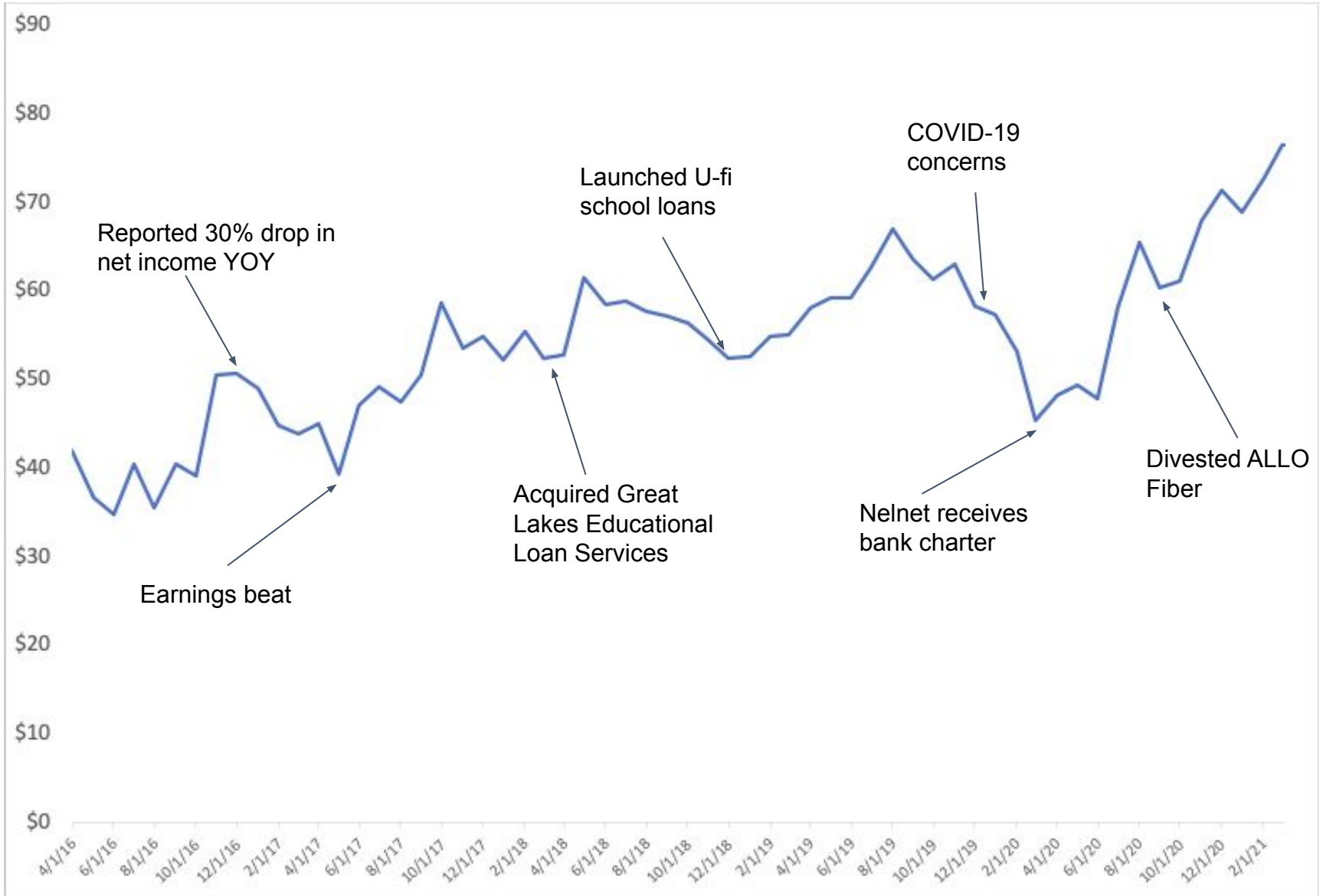
## Chairman Bio

- Michael Dunlap received his undergraduate degree and JD from the University of Nebraska before co-founding Nelnet in Lincoln, NE.
- Often drawing comparisons to Warren Buffett because of their shared home state, Dunlap has taken a similar approach to growing Nelnet's book of public and private investments. Where Buffett used insurance capital, Dunlap is using student loans.
- Dunlap has used excess capital to fund Nelnet ventures such as Hudl and its fiber optic segment which recently sold off a 48% stake for \$197M

## Segment Breakdown



# 5-Year Stock Performance



## Transition from Loan Book

- As Nelnet's loan book winds down, capital allocation becomes a core responsibility of management
- Management places special emphasis on opportunities currently unmet within their geographic proximity
- Recent pursuits include the expansion of NBS and launch of Nelnet Bank with their recent bank charter
- In addition, Nelnet has invested heavily in communications, renewable energy and over 35 independent ventures

## Student Loan Forgiveness Implications

- If the Biden administration were to execute on their plan to forgive student loans, Nelnet would stand to benefit from this legislation
- According to Joseph Cioffi, a partner at Davis & Gilbert LLP, "Loan forgiveness could be a boon to student loan ABS by providing prepayments and liquidity immediately upon forgiveness." "Whether the loans are federal or private, the lender would be paid and prepayment rates will go up but at least distressed borrowers will be less likely to default."

## Chairman Market View

- In his letter to shareholders, Nelnet Chairman Michael Dunlap expressed his views on the market and raised concerns over speculative bubbles such as the boom in SPAC filings and the emergence of wild equity valuations like Gamestop and AMC, urging the importance of cautious investing now more than ever
- Dunlap also outlines Nelnet's fundamental capital allocation strategy, stating "When we (Nelnet) make investments and buy businesses, we look at the discounted cash we will create over time and then look for ways to reinvest that cash into the future."

## Commitment to Long Term Value Generation

- Shareholders have long questioned the possibility for the spinoff of certain Nelnet business segments, specifically NBS, in an attempt to realize a higher market valuation
- In response to talks of a spinoff, Dunlap writes "We are owner shareholders and treat our shareholders' cash like it is our own - because it is. Could Nelnet hype, spin out, and financially engineer a short-term higher market value? Maybe."

## In Response to Talks of a Spin Off

Could Nelnet hype, spin out, and financially engineer a short-term higher market value? Maybe. Would that help our customers? Our associates? Our communities? We would argue it would hurt all three. It may help our shareholders in the short term, but long term we see no value and most likely it would create negative long-term value because of the added costs, distractions, and lack of diversification. But, someone could use the new spun out stock as currency to buy other overpriced, overhyped companies. So, are we going to merge our cash flowing great businesses with another company's hype, dreams, negative cash flow, and potential prospects that must perform perfectly to justify the value? Where is the margin of error on the projections if everything doesn't go perfectly? We would then have 50% of the cash flow supporting 100% of an inflated market value of the combined entity. If we were to do this ten times and subsequently don't find a greater fool to cash out to in time, we would all be left with pennies on the dollar. What about the additional cost and impact to our customers caused by the distraction, or the impact to our associates, and communities? We have always worked to balance all four of our constituencies (customers, associates, communities, and shareholders).

## On Satisfying Shareholder Expectations

I wish all of our shareholders had the exact same investment philosophy, objectives and time frame as I do but I realize that we do have a diverse group of smart people in our shareholder group. That said, the bottom line is if you are looking for the quick pop in value you may get from Bitcoin, or the newest hyped entrant to the market, then Nelnet is the wrong investment. If you want us to invest your money for the long term, we will try and maximize the long term cash flow and long term sustainable value to the best of our abilities.

## AGM & Loan Servicing

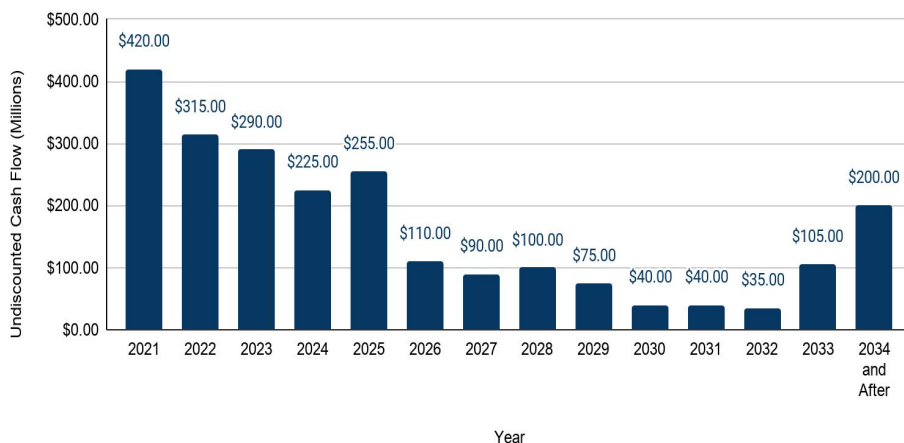
- Asset Generation & Management deals with the federal-backed student loan portfolio that was originated before 2010
- Pre discounted cash flow of ~ \$2.50/share each quarter over next 8 quarters will flow onto the balance sheet, almost \$39/share over next 5 years
- Loan Servicing is their second largest revenue segment and offers processing services on the loans they originated
- 90% of this revenue stream is from the federal government, Department of Education

## Education Technology

- Nelnet Business Services is a fast growing, highly profitable SAAS payment technology company including brands such as FACTS, Catholic Faith Technologies and Nelnet International
- Offers tuition payment plans and billing services, sticking with the student loan theme
- High market penetration, captured over 40% of all US K-12 private schools, successful with Catholic schools
- Growing revenues 22% over last 5 years, \$75m 2020 EBITDA, standalone student loan processing competitors like FirstData and Heartland Payments were recently bought out at 18x and 22x EBITDA

## ABS Cash Flow Forecast

Asset-backed Securitization Cash Flow Forecast



## Capital Allocation

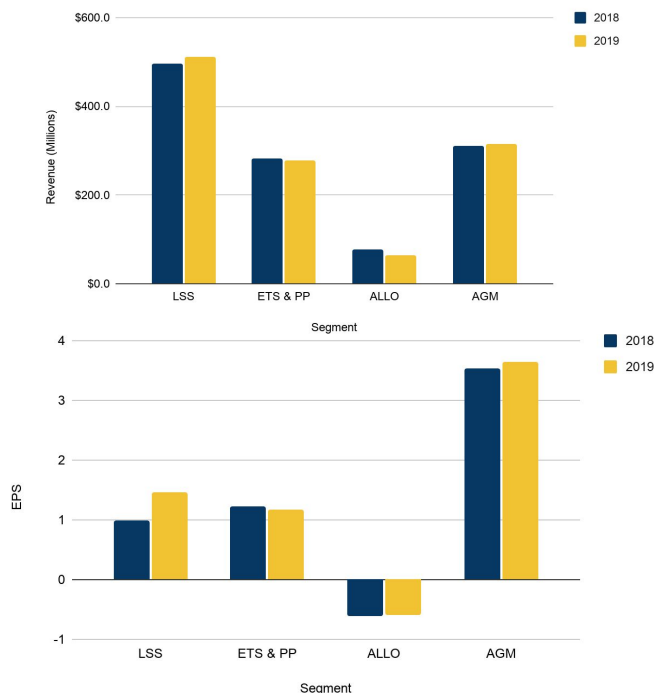
(All Numbers are in Millions of Dollars) ▲

	2018	2019	2020
ALLO acquisition and capital expenditures	\$87	\$45	\$48
Business acquisitions	\$153		\$30
Debt repurchases	\$13		\$26
Dividends	\$27	\$29	\$32
FFELP loan/residual acquisitions, net of financing	\$105	\$71	\$141
Hudl investment			\$26
Nelnet Bank			\$100
Other capital expenditures (non-ALLO)	\$38	\$48	\$65
Other investments (venture capital/real estate/solar)	\$67	\$103	\$396
Private and consumer loan/residual acquisitions, net of financing	\$188	\$61	\$71
Stock repurchases	\$45	\$40	\$73

## ALLO Communications

- ALLO offers high speed fiber optic broadband service to rural Midwest homes and businesses as well as across the nation
- Capital intensive to expand, SDC acquired 48% equity stake from Nelnet for \$200 million to help fund ALLO
- 23% YOY revenue growth, EBITDA positive with \$25 million in 2020 and \$50 million expected by 2023
- Publicly traded comp TCX grows at 6% but trades at nearly 14x 2020 EBITDA

## Segment Mix



## Bank Charter & Venture Investments

- Recently acquired a bank charter to launch Nelnet Bank, an Internet Utah-chartered industrial bank focused on the private education loan marketplace
- Only Square and Nelnet have acquired bank charters from the FDIC since 2008
- Committed to renewable energy, recently investing \$150 million to fund the development and operation of solar sites across the US to generate 214 megawatts of power
- Over 35 venture investments, most promising of which is HUDL, recently reaching unicorn status and Nelnet participated in an early funding round, owning a 19% stake
- Recently participated in another round of funding for HUDL with Bain Capital in which they invested \$26 million





Company	Market Cap	5Y Rev CAGR	P/E	P/B	Operating Margin	Net Profit Margin	Dividend Yield	Payout Ratio
Nelnet	\$2.84B	8.80%	8.49	1.12	32.10%	24.70%	1.15%	9.10%
Lendingclub	\$858.2M	5.00%	N/A	1.1	-27.10%	-27.20%	N/A	N/A
Firstcash	\$2.74B	3.60%	26.78	2.2	10.50%	6.50%	1.50%	42.10%
ACI Worldwide	\$4.32B	4.40%	63.08	3.71	11.10%	5.60%	N/A	N/A
<b>Median</b>	\$2.84B	4.70%	26.78	1.66	11%	6%	1.33%	42.10%

## Highlights

- **Margins** - Nelnet has significantly better Operating and Profit margin compared to its peers
- **Growth** - Highest 5y Rev CAGR amongst peers
- **Dividends** - Grown for 13 years straight, maintains stable yield while paying out only 9% of income

## Potential for Multiple Expansion

- **Room for Expansion** - With a P/E of 8.49, Nelnet trades at a significant discount to the broader market
- **Shifting Revenue Mix** - As the majority of their revenue mix shifts from AGM to their SAAS Education Technology, ALLO Communications network and Nelnet Bank, multiple expansion will follow

## This is the output from the Gordon Growth Model

*Firm Details: from inputs on prior page*

Current Dividends per share = **\$0.88**

Cost of Equity = **9.70%**

Bloomberg

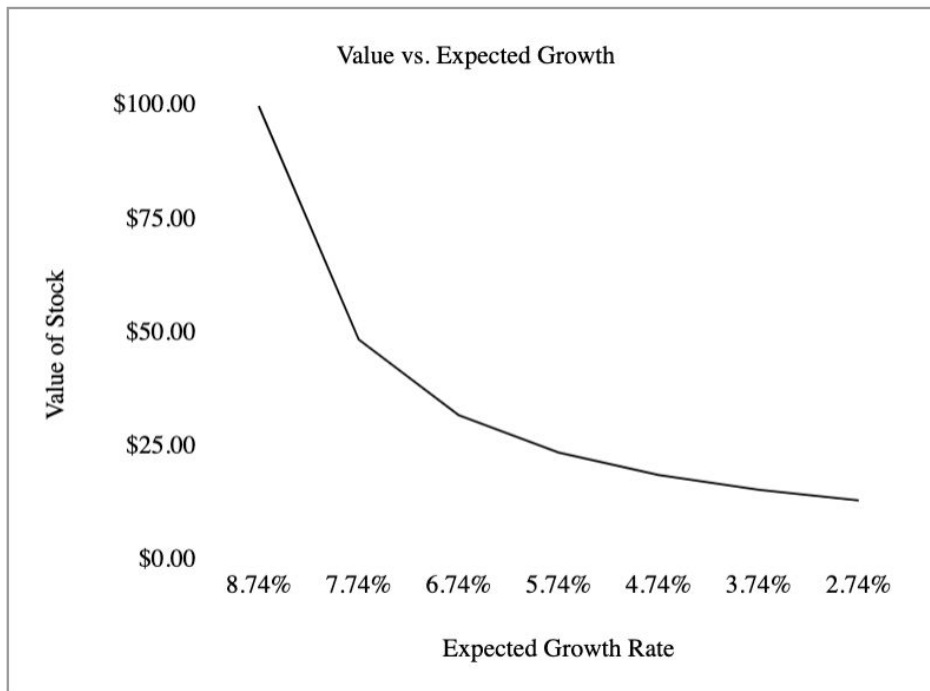
Expected Growth rate = **8.74%**

Multiply 5yr ROE by 1-payout ratio

Gordon Growth Model Value =

99.67833333

Growth rate	Value
8.74%	\$99.68
7.74%	\$48.37
6.74%	\$31.73
5.74%	\$23.50
4.74%	\$18.58
3.74%	\$15.32
2.74%	\$12.99



		Risk	Mitigation
1	<b>Tax Exposure</b>	<ul style="list-style-type: none"> <li>- Nelnet's tax liability is highly variable from year to year due to its complex financial structure</li> </ul>	<ul style="list-style-type: none"> <li>- Investments in renewable energy projects obtain government regulatory tax credits</li> <li>- \$150 million committed to solar panel development</li> </ul>
2	<b>Government Student Loan Forgiveness</b>	<ul style="list-style-type: none"> <li>- The government has weighed the possibility of cancelling student debt and debate has picked up recently</li> </ul>	<ul style="list-style-type: none"> <li>- Cancellation would lead to Fed likely paying off all loans with one time payment</li> <li>- This would accelerate cash flows and benefit Nelnet</li> </ul>
3	<b>Capital Misallocation</b>	<ul style="list-style-type: none"> <li>- FFELP cash flows cannot be reinvested into origination of additional loan portfolios</li> </ul>	<ul style="list-style-type: none"> <li>- Nelnet to continue to diversify among a number of revenue generating segments across various sub industries</li> <li>- Sticking with student loan theme to build synergies</li> </ul>

## Extremely Low Risk Student Loan Portfolio

- We like the cash flow the student loan book will provide in both the short and medium term, ~ \$39/share over next 5 years.
- Cash flows increasing as a result of near 0% interest rates, but fixed rate interest paid by borrowers.

## NBS and ALLO at Bargain Valuation

- The messy student loan business distracts from Nelnet's high growth technology sectors, allowing them to be owned at little extra cost.
- When looking at NBS in comparison to standalone peers like FirstData or ALLO in comparison to its standalone competition like CableOne or TCX, a spin off or sale of these segments could generate large one time gains for Nelnet.

## Commitment to Shareholder Value Generation

- In 2015, Dunlap purchased ALLO fiber optic network for \$46.25M. In 2020, he sold a 48% equity stake for \$197M.
- Development and diversification of key new revenue segments as student loan portfolio unwinds, 19% stake in HUDL which recently reached unicorn status.

## Rationale: Buy NNI at 1.5% Allocation (PT: \$99.68, Implied Upside: 34.9%)

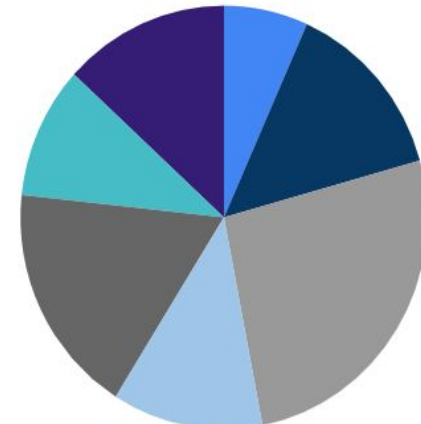
- Current ETF allocation leaves us with too much exposure to US big banks
- NNI has defensible traits and should perform well on a risk adjusted basis over full market cycle
- Increase concentration in our portfolio
- We plan to reval our ½ allocation in ESNT next

### Current Portfolio



● ESNT ● ICE ● MS ● PAYX ● PFG ● XLF

### Prospective Portfolio



● ESNT ● ICE ● MS ● PAYX ● PFG ● XLF ● NNI

<u>Name</u>	<u>Position</u>	<u>Phone Number</u>	<u>Email</u>
Walker Davis	Senior Analyst	(770) 687-4395	walkerdavis34@gmail.com
Shivam Lahoti	Senior Analyst	(404) 384-4542	shivamlahoti@gatech.edu
Jonathan Huang	Analyst	(845) 867-7352	jkhuang3@gatech.edu
Mitchell Taylor	Analyst	(404) 906-4644	mitchntaylor@gmail.com
<b>Nikhil Reddy</b>	<b>Sector Head</b>	<b>(404) 953-2378</b>	<b>nikhil.reddy@gatech.edu</b>