

For Release: 11/2/2007

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Nelnet, Inc. supplemental financial information for the third quarter 2007

The following supplemental information should be read in connection with the third-quarter 2007 earnings press release of Nelnet, Inc. (the "Company"), dated November 2, 2007.

Information contained in this earnings supplement, other than historical information, may be considered forward-looking in nature and is subject to various risks, uncertainties, and assumptions. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those anticipated, estimated, or expected. Among the key factors that may have a direct bearing on the Company's operating results, performance, or financial condition expressed or implied by the forward-looking statements are the uncertain nature of the estimated expenses that may be incurred and cost savings that may result from the Company's strategic initiatives, changes in terms of student loans and the educational credit marketplace, changes in legislation impacting the student loan market, changes in the demand for educational financing or in financing preferences of educational institutions, students and their families, or changes in the general interest rate environment and in the securitization markets for education loans. Certain prior year amounts have been reclassified to conform to the current period presentation. Information as of September 30, 2007 and 2006 and for the three months and nine months ended September 30, 2007 and 2006 is unaudited. For more information see our filings with the Securities and Exchange Commission.

Condensed Consolidated Statements of Operations

	Three months ended			Nine months ended	
	September 30, 2007 (unaudited)	June 30, 2007 (unaudited)	September 30, 2006 (unaudited)	September 30, 2007 (unaudited)	September 30, 2006 (unaudited)
(dollars in thousands, except share data)					
Interest income:					
Loan interest	\$ 460,103	439,720	401,704	1,317,936	1,133,093
Variable-rate floor income	597	-	-	597	-
Amortization of loan premiums and deferred origination costs	(23,449)	(22,634)	(21,568)	(67,142)	(64,555)
Investment interest	21,023	18,783	25,938	61,231	69,664
Total interest income	458,274	435,869	406,074	1,312,622	1,138,202
Interest expense:					
Interest on bonds and notes payable	393,875	367,893	333,766	1,112,263	893,559
Net interest income	64,399	67,976	72,308	200,359	244,643
Less provision for loan losses	18,340	2,535	1,700	23,628	13,508
Net interest income after provision for loan losses	46,059	65,441	70,608	176,731	231,135
Other income (expense):					
Loan and guarantee servicing income	33,040	31,610	32,212	95,116	91,428
Other fee-based income	38,025	38,262	31,221	116,316	65,450
Software services income	5,426	5,848	4,399	17,022	11,826
Other income	7,520	2,937	13,578	17,336	18,471
Derivative market value, foreign currency, and put option adjustments	18,449	5,547	(79,908)	11,866	(11,565)
Derivative settlements, net	(2,336)	5,196	4,973	7,100	16,419
Total other income (expense)	100,124	89,400	6,475	264,756	192,029
Operating expenses:					
Salaries and benefits	60,545	59,761	57,134	182,010	161,386
Other expenses	52,511	54,394	50,965	159,792	130,108
Amortization of intangible assets	10,885	6,491	6,189	24,014	17,304
Impairment of assets	49,504	-	-	49,504	-
Total operating expenses	173,445	120,646	114,288	415,320	308,798
Income (loss) before taxes	(27,262)	34,195	(37,205)	26,167	114,366
Income tax expense (benefit)	(10,664)	13,306	(13,744)	9,906	42,336
Income (loss) before minority interest	(16,598)	20,889	(23,461)	16,261	72,030
Minority interest in net earnings of subsidiaries	-	-	-	-	(242)
Income (loss) from continuing operations	(16,598)	20,889	(23,461)	16,261	71,788
Income (loss) from discontinued operations, net of tax	909	(6,135)	1,107	(2,416)	3,677
Net income (loss)	\$ (15,689)	14,754	(22,354)	13,845	75,465
Earnings (loss) per share, basic and diluted:					
Income (loss) from continuing operations	\$ (0.34)	0.42	(0.44)	0.32	1.33
Income (loss) from discontinued operations, net of tax	0.02	(0.12)	0.02	(0.04)	0.07
Net income (loss)	\$ (0.32)	0.30	(0.42)	0.28	1.40
Weighted average shares outstanding	49,018,091	49,452,960	53,348,466	49,810,552	53,959,075

Condensed Consolidated Balance Sheets and Financial Data

	As of September 30, 2007 (unaudited)	As of December 31, 2006	As of September 30, 2006 (unaudited)
	(dollars in thousands)		
Assets:			
Student loans receivable, net	\$ 26,596,123	23,789,552	22,933,718
Cash, cash equivalents, and investments	1,451,772	1,773,751	1,803,476
Goodwill	164,695	191,420	185,405
Intangible assets, net	119,242	161,588	164,630
Assets of discontinued operations	-	27,309	37,445
Other assets	1,010,632	853,253	785,914
Total assets	<u>\$ 29,342,464</u>	<u>26,796,873</u>	<u>25,910,588</u>
Liabilities:			
Bonds and notes payable	\$ 28,234,147	25,562,119	24,690,245
Liabilities of discontinued operations	-	7,732	15,284
Other liabilities	516,424	555,172	523,798
Total liabilities	<u>28,750,571</u>	<u>26,125,023</u>	<u>25,229,327</u>
Shareholders' equity	<u>591,893</u>	<u>671,850</u>	<u>681,261</u>
Total liabilities and shareholders' equity	<u>\$ 29,342,464</u>	<u>26,796,873</u>	<u>25,910,588</u>
Return on average total assets	0.07%	0.27%	0.41%
Return on average equity	2.99%	9.64%	14.08%
Shareholders' equity to total assets	2.02%	2.51%	2.63%

Legislative Developments

On September 27, 2007, the President signed into law the College Cost Reduction and Access Act of 2007 (the "Act"). This legislation contains provisions with significant implications for participants in the Federal Family Education Loan Program ("FFEL Program" or "FFELP") by cutting funding to the FFEL Program by \$20 billion over the next five years as estimated by the Congressional Budget Office. Among other things, the Act:

- Reduces special allowance payments to for-profit lenders and not-for-profit lenders by 0.55 percentage points and 0.40 percentage points, respectively, for both Stafford and Consolidation Loans disbursed on or after October 1, 2007;
- Reduces special allowance payments to for-profit lenders and not-for-profit lenders by 0.85 percentage points and 0.70 percentage points, respectively, for PLUS loans disbursed on or after October 1, 2007;
- Increases origination fees paid by lenders on all FFELP loan types, from 0.5 percent to 1.0 percent, for all loans first disbursed on or after October 1, 2007;
- Eliminates all provisions relating to Exceptional Performer status, and the monetary benefit associated with it, effective October 1, 2007; and
- For loans first disbursed on or after October 1, 2012, reduces default insurance to 95 percent of the unpaid principal of such loans.

The impact of this legislation will reduce the annual yield on FFELP loans originated after October 1, 2007.

Upon passage of the Act, management evaluated the carrying amount of goodwill and certain intangible assets. Based on the legislative changes and the student loan business model modifications the Company implemented as a result of the legislative changes (see "Restructuring" below), the Company recorded an impairment charge of \$39.4 million (\$24.5 million after tax) during the third quarter of 2007. This charge is included in "impairment of assets" on the Company's consolidated statements of operations.

During the three month period ended September 30, 2007, the Company also recorded an expense of \$15.7 million (\$9.7 million after tax) to increase the Company's allowance for loan losses related to the increase in risk share as a result of the elimination of the Exceptional Performer program.

On September 6, 2007, the Company announced a strategic initiative to create efficiencies and lower costs in advance of the anticipated passage of federal legislation impacting the student loan programs in which the Company participates.

The Company estimates that the charge to earnings associated with these strategic decisions will be fully recognized during 2007 and will total approximately \$20.5 million (\$12.7 million after tax), consisting of approximately \$6.4 million (\$4.0 million after tax) in severance costs, approximately \$4.0 million (\$2.5 million after tax) in contract termination costs, and approximately \$10.1 million (\$6.2 million after tax) in non-cash charges primarily related to the impairment of property and equipment.

During the three month period ended September 30, 2007, the Company recorded restructuring charges of \$15.0 million (\$9.3 million after tax). Selected information relating to the restructuring charge follows:

	Employee termination benefits	Lease terminations	Write-down of property and equipment	Total
	(dollars in thousands)			
Restructuring costs recognized during the three month period ended September 30, 2007	\$ 4,788 (a)	168 (b)	10,060 (c)	15,016
Write-down of assets to net realizable value	-	-	(10,060)	(10,060)
Cash payments	(2,542)	-	-	(2,542)
Restructuring accrual as of September 30, 2007	\$ 2,246	168	-	2,414

(c) Costs related to the write-down of property and equipment are included in "impairment of assets" on the consolidated statements of operations.

Selected information relating to the restructuring charge by operating segment and Corporate Activity and Overhead follows:

Operating segment	Restructuring costs recognized during the three month period ended September 30, 2007	Write-down of assets to net realizable value	Cash payments	Restructuring accrual as of September 30, 2007
			(dollars in thousands)	
Asset Generation and Management	\$ 2,169	(248)	(1,428)	493
Student Loan and Guaranty Servicing	1,231	-	(389)	842
Tuition Payment Processing and Campus Commerce	-	-	-	-
Enrollment Services and List Management	737	-	(509)	228
Software and Technical Services	58	-	-	58
Corporate Activity and Overhead	10,821	(9,812)	(216)	793
	<u>\$ 15,016</u>	<u>(10,060)</u>	<u>(2,542)</u>	<u>2,414</u>

Operating segment	Estimated total restructuring costs	Restructuring costs recognized during the three month period ended September 30, 2007 (dollars in thousands)	Remaining restructuring costs expected to be recognized during the three month period ended December 31, 2007 (4th quarter 2007)
Asset Generation and Management	\$ 2,688	2,169	519
Student Loan and Guaranty Servicing	1,818	1,231	587
Tuition Payment Processing and Campus Commerce	-	-	-
Enrollment Services and List Management	969	737	232
Software and Technical Services	58	58	-
Corporate Activity and Overhead	14,920	10,821	4,099
	<u>\$ 20,453</u>	<u>15,016</u>	<u>5,437</u>

Discontinued Operations

On May 25, 2007, the Company sold EDULINX Canada Corporation ("EDULINX"), a Canadian student loan service provider and subsidiary of the Company. As a result of this transaction, the results of operations for EDULINX are reported as discontinued operations in the accompanying consolidated statements of operations for all periods presented. The components of the income (loss) from discontinued operations are presented below:

	Three months ended			Nine months ended	
	September 30, 2007	June 30, 2007	September 30, 2006	September 30, 2007	September 30, 2006
	(dollars in thousands)				
Operating income of discontinued operations, net of tax	\$ -	2,906	1,107	5,716	3,677
Gain (loss) on disposal, net of tax	909	(9,041)	-	(8,132)	-
Income (loss) from discontinued operations, net of tax	<u>\$ 909</u>	<u>(6,135)</u>	<u>1,107</u>	<u>(2,416)</u>	<u>3,677</u>

The following operations related to EDULINX have been segregated from continuing operations and reported as discontinued operations through the date of disposition.

	Three months ended			Nine months ended	
	September 30, 2007	June 30, 2007	September 30, 2006	September 30, 2007	September 30, 2006
	(dollars in thousands)				
Net interest income	\$ -	53	48	124	176
Other income	-	12,480	16,256	31,511	48,190
Operating expenses	-	(7,669)	(14,554)	(22,357)	(42,563)
Income before income taxes	-	4,864	1,750	9,278	5,803
Income tax expense	-	1,958	643	3,562	2,126
Operating income of discontinued operations, net of tax	<u>\$ -</u>	<u>2,906</u>	<u>1,107</u>	<u>5,716</u>	<u>3,677</u>

Non-GAAP Performance Measures

In accordance with the rules and regulations of the Securities and Exchange Commission (“SEC”), the Company prepares financial statements in accordance with generally accepted accounting principles (“GAAP”). In addition to evaluating the Company’s GAAP-based financial information, management also evaluates the Company on a non-GAAP performance measure referred to as base net income. While base net income is not a substitute for reported results under GAAP, the Company provides base net income as additional information regarding its financial results.

Base net income is the primary financial performance measure used by management to develop financial plans, allocate resources, track results, evaluate performance, establish corporate performance targets, and determine incentive compensation. The Company’s board of directors utilizes base net income to set performance targets and evaluate management’s performance. The Company also believes analysts, rating agencies, and creditors use base net income in their evaluation of the Company’s results of operations. While base net income is not a substitute for reported results under GAAP, the Company utilizes base net income in operating its business because base net income permits management to make meaningful period-to-period comparisons by eliminating the temporary volatility in the Company’s performance that arises from certain items that are primarily affected by factors beyond the control of management. Management believes base net income provides additional insight into the financial performance of the core business activities of the Company’s operations.

The following table provides a reconciliation of GAAP net income (loss) to base and adjusted base net income (loss).

	Three months ended			Nine months ended	
	September 30, 2007	June 30, 2007	September 30, 2006	September 30, 2007	September 30, 2006
	(dollars in thousands, except share data)				
GAAP net income (loss)	\$ (15,689)	14,754	(22,354)	13,845	75,465
Base adjustments:					
Derivative market value, foreign currency, and put option adjustments	(18,449)	(5,547)	79,908	(11,866)	11,565
Amortization of intangible assets	10,885	6,491	6,189	24,014	17,304
Non-cash stock based compensation related to business combinations	503	476	476	1,456	1,271
Variable-rate floor income	(597)	-	-	(597)	-
Total base adjustments before income taxes	(7,658)	1,420	86,573	13,007	30,140
Net tax effect (a)	2,971	(568)	(31,554)	(4,128)	(10,002)
Total base adjustments	(4,687)	852	55,019	8,879	20,138
Base net income (loss)	(20,376)	15,606	32,665	22,724	95,603
Discontinued operations, net of tax:					
Operating income of discontinued operations	-	(2,906)	(1,107)	(5,716)	(3,677)
(Gain) loss on disposal	(909)	9,041	-	8,132	-
Base net income (loss), excluding discontinued operations	(21,285)	21,741	31,558	25,140	91,926
Adjustments to base net income (loss):					
Special allowance yield adjustment (b)	-	-	-	-	(24,460)
Derivative settlements, net	-	-	(7,909)	-	(19,794)
Total adjustments to base net income (loss) before income taxes	-	-	(7,909)	-	(44,254)
Net tax effect (a)	-	-	3,006	-	16,817
Total adjustments to base net income (loss)	-	-	(4,903)	-	(27,437)
Adjusted base net income (loss), excluding discontinued operations	\$ (21,285)	21,741	26,655	25,140	64,489
Earnings (loss) per share, basic and diluted:					
GAAP net income (loss)	\$ (0.32)	0.30	(0.42)	0.28	1.40
Total base adjustments	(0.10)	0.02	1.03	0.18	0.37
Base net income (loss)	(0.42)	0.32	0.61	0.46	1.77
Discontinued operations, net of tax:					
Operating income of discontinued operations	-	(0.06)	(0.02)	(0.12)	(0.07)
(Gain) loss on disposal	(0.02)	0.18	-	0.16	-
Base net income (loss), excluding discontinued operations	(0.44)	0.44	0.59	0.50	1.70
Total adjustments to base net income (loss)	-	-	(0.10)	-	(0.50)
Adjusted base net income (loss), excluding discontinued operations	\$ (0.44)	0.44	0.49	0.50	1.20

(a) Tax effect computed at 38%. The change in the value of the put options are not tax effected as this is not deductible for income tax purposes.

- (b) On January 19, 2007, the Company entered into a Settlement Agreement (the "Agreement") with the Department of Education (the "Department") to resolve the audit by the Department's Office of Inspector General (the "OIG") of the Company's portfolio of student loans receiving 9.5% special allowance payments. Under the terms of the Agreement, all 9.5% special allowance payments were eliminated for periods on and after July 1, 2006. The Company had been deferring recognition of 9.5% special allowance payments related to those loans subject to the OIG audit effective July 1, 2006 pending satisfactory resolution of this issue.

Limitations of Base Net Income

While GAAP provides a uniform, comprehensive basis of accounting, for the reasons discussed above, management believes base net income is an important additional tool for providing a more complete understanding of the Company's results of operations. Nevertheless, base net income is subject to certain general and specific limitations that investors should carefully consider. For example, unlike financial statements prepared in accordance with GAAP, the Company's base net income presentation does not represent a comprehensive basis of accounting. In addition, the Company's base net income is not a defined term within GAAP and may not be comparable to similarly titled measures reported by other companies. Investors, therefore, may not be able to compare the Company's performance with that of other companies based upon base net income. Base net income results are only meant to supplement GAAP results by providing additional information regarding the operational and performance indicators that are most closely monitored and used by the Company's management and board of directors to assess performance and information which the Company believes is important to analysts, rating agencies, and creditors.

Other limitations of base net income arise from the specific adjustments that management makes to GAAP results to derive base net income results. These differences are described below.

Differences between GAAP and Base Net Income

Management's financial planning and evaluation of operating results does not take into account the following items because their volatility and/or inherent uncertainty affect the period-to-period comparability of the Company's results of operations. A more detailed discussion of the differences between GAAP and base net income follows.

Derivative market value, foreign currency, and put option adjustments: Base net income excludes the periodic unrealized gains and losses that are caused by the change in fair value on derivatives in which the Company does not qualify for "hedge treatment" under GAAP. Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities* ("SFAS No. 133"), requires that changes in fair value of derivative instruments be recognized currently in earnings unless specific hedge accounting criteria, as specified by SFAS No. 133, are met. The Company maintains an overall interest rate risk management strategy that incorporates the use of derivative instruments to reduce the economic effect of interest rate volatility. Derivative instruments primarily used by the Company include interest rate swaps, basis swaps, interest rate floor contracts, and cross-currency interest rate swaps. Management has structured all of the Company's derivative transactions with the intent that each is economically effective. However, the Company does not qualify its derivatives for "hedge treatment" as defined by SFAS No. 133, and the stand-alone derivative must be marked-to-market in the income statement with no consideration for the corresponding change in fair value of the hedged item. The Company believes these point-in-time estimates of asset and liability values associated with its derivatives that are subject to interest rate fluctuations make it difficult to evaluate the ongoing results of operations against its business plan and affect the period-to-period comparability of the

results of operations. Included in base net income are the economic effects of the Company's derivative instruments, which includes any cash paid or received being recognized as an expense or revenue upon actual derivative settlements. These settlements are included in "Derivative settlements, net" on the Company's consolidated statements of operations.

Base net income excludes the foreign currency transaction gains or losses caused by the re-measurement of the Company's Euro-denominated bonds to U.S. dollars. In connection with the issuance of the Euro-denominated bonds, the Company has entered into cross-currency interest rate swaps. Under the terms of these agreements, the principal payments on the Euro-denominated notes will effectively be paid at the exchange rate in effect at the issuance date of the bonds. The cross-currency interest rate swaps also convert the floating rate paid on the Euro-denominated bonds' (EURIBOR index) to an index based on LIBOR. Included in base net income are the economic effects of any cash paid or received being recognized as an expense or revenue upon actual settlements of the cross-currency interest rate swaps. These settlements are included in "Derivative settlements, net" on the Company's consolidated statements of operations. However, the gains or losses caused by the re-measurement of the Euro-denominated bonds to U.S. dollars and the change in market value of the cross-currency interest rate swaps are excluded from base net income as the Company believes the point-in-time estimates of value that are subject to currency rate fluctuations related to these financial instruments make it difficult to evaluate the ongoing results of operations against the Company's business plan and affect the period-to-period comparability of the results of operations. The re-measurement of the Euro-denominated bonds correlates with the change in fair value of the cross-currency interest rate swaps. However, the Company will experience unrealized gains or losses related to the cross-currency interest rate swaps if the two underlying indices (and related forward curve) do not move in parallel.

Base net income also excludes the change in fair value of put options issued by the Company for certain business acquisitions. The put options are valued by the Company each reporting period using a Black-Scholes pricing model. Therefore, the fair value of these options is primarily affected by the strike price and term of the underlying option, the Company's current stock price, and the dividend yield and volatility of the Company's stock. The Company believes these point-in-time estimates of value that are subject to fluctuations make it difficult to evaluate the ongoing results of operations against the Company's business plans and affects the period-to-period comparability of the results of operations.

The gains and/or losses included in "Derivative market value, foreign currency, and put option adjustments" on the Company's consolidated statements of operations are primarily caused by interest rate and currency volatility, changes in the value of put options based on the inputs used in the Black-Scholes pricing model, as well as the volume and terms of put options and of derivatives not receiving hedge treatment. Base net income excludes these unrealized gains and losses and isolates the effect of interest rate, currency, and put option volatility on the fair value of such instruments during the period. Under GAAP, the effects of these factors on the fair value of the put options and the derivative instruments (but not the underlying hedged item) tend to show more volatility in the short term.

Amortization of intangible assets: Base net income excludes the amortization of acquired intangibles, which arises primarily from the acquisition of definite life intangible assets in connection with the Company's acquisitions, since the Company feels that such charges do not drive the Company's operating performance on a long-term basis and can affect the period-to-period comparability of the results of operations.

Non-cash stock based compensation related to business combinations: The Company has structured certain business combinations in which the stock consideration paid has been dependent on the sellers' continued employment with the Company. As such, the value of the consideration paid is recognized as compensation expense by the Company over the term of the applicable employment agreement. Base net income excludes this expense because the Company believes such charges do not drive its operating performance on a long-term basis and can affect the period-to-period comparability of the results of operations. If the Company did not enter into the employment agreements in connection with the acquisition, the amount paid to these former shareholders of the acquired entity would have been recorded by the Company as additional consideration of the acquired entity, thus, not having an effect on the Company's results of operations.

Variable-rate floor income: Loans that reset annually on July 1 can generate excess spread income compared with the rate based on the special allowance payment formula in declining interest rate environments. The Company refers to this additional income as variable-rate floor income. The Company excludes variable-rate floor income from its base net income since its timing and amount (if any) is uncertain, it has been eliminated by legislation for all loans originated on and after April 1, 2006, and it is in excess of expected spreads. In addition, because variable-rate floor income is subject to the underlying rate for the subject loans being reset annually on July 1, it is a factor beyond the Company's control which can affect the period-to-period comparability of results of operations.

Discontinued operations: In May 2007, the Company sold EDULINX. As a result of this transaction, the results of operations for EDULINX are reported as discontinued operations for all periods presented. The Company presents base net income excluding discontinued operations since the operations and cash flows of EDULINX have been eliminated from the ongoing operations of the Company.

Special allowance yield adjustment and related hedging activity: The Company excludes the special allowance yield adjustment and the net settlements received or paid on those derivative instruments used to hedge the student loans that were earning 9.5% special allowance payments. Pursuant to the settlement agreement entered into with the Department, effective July 1, 2006, the Company no longer receives 9.5% special allowance payments. Prior to this agreement, the Company excluded the special allowance yield adjustments from base net income because the Company expected 9.5% special allowance payments to decline over time due to the fact that in April 2004 it ceased adding loans receiving 9.5% special allowance payments to its portfolio.

Impact of Legislative and Restructuring Charges to Base Net Income

The following table summarizes the impact of the legislative and restructuring charges recognized by the Company during the three and nine month periods ended September 30, 2007 to the Company's non-GAAP performance measure referred to as base net income (see "Non-GAAP Performance Measures.") Additional detail related to the legislative and restructuring charges can be found under "Legislative Developments" and "Restructuring" in this earnings supplement.

	Three months ended			Nine months ended	
	September 30, 2007	June 30, 2007	September 30, 2006	September 30, 2007	September 30, 2006
	(dollars in thousands, except share data)				
Adjusted base net income (loss), excluding discontinued operations	\$ (21,285)	21,741	26,655	25,140	64,489
Legislative charges, net of tax	34,197	-	-	34,197	-
Restructuring charges, net of tax	9,310	-	-	9,310	-
Adjusted base net income (loss), excluding discontinued operations, legislative charges (net of tax), and restructuring charges (net of tax)	<u>\$ 22,222</u>	<u>21,741</u>	<u>26,655</u>	<u>68,647</u>	<u>64,489</u>
Earnings (loss) per share, basic and diluted:					
Adjusted base net income (loss), excluding discontinued operations	\$ (0.44)	0.44	0.49	0.50	1.20
Legislative charges, net of tax	0.70	-	-	0.69	-
Restructuring charges, net of tax	0.19	-	-	0.19	-
Adjusted base net income (loss), excluding discontinued operations, legislative charges (net of tax), and restructuring charges (net of tax)	<u>\$ 0.45</u>	<u>0.44</u>	<u>0.49</u>	<u>1.38</u>	<u>1.20</u>

Operating Segments

The Company has five operating segments as defined in Statement of Financial Accounting Standards No. 131, *Disclosures about Segments of Enterprise and Related Information* ("SFAS No. 131") as follows: Asset Generation and Management, Student Loan and Guaranty Servicing, Tuition Payment Processing and Campus Commerce, Enrollment Services and List Management, and Software and Technical Services. The Company's operating segments are defined by the products and services they offer or the types of customers they serve, and they reflect the manner in which financial information is currently evaluated by management. The accounting policies of the Company's operating segments are the same as those described in the summary of significant accounting policies included in the Company's consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2006. Intersegment revenues are charged by a segment to another segment that provides the product or service. Intersegment revenues and expenses are included within each segment consistent

with the income statement presentation provided to management. Changes in management structure or allocation methodologies and procedures may result in changes in reported segment financial information.

The management reporting process measures the performance of the Company's operating segments based on the management structure of the Company as well as the methodology used by management to evaluate performance and allocate resources. Management, including the Company's chief operating decision maker, evaluates the performance of the Company's operating segments based on their profitability. Management measures the profitability of the Company's operating segments based on base net income. Accordingly, information regarding the Company's operating segments is provided based on base net income. While base net income is not a substitute for reported results under GAAP, the Company relies on base net income to manage each operating segment because it believes this measure provides additional information regarding the operational and performance indicators that are most closely assessed by management.

In May 2007, the Company sold EDULINX, a Canadian student loan service provider and subsidiary of the Company. As a result of this transaction, the results of operations for EDULINX are reported as discontinued operations for all periods presented. The operating results of EDULINX were included in the Student Loan and Guaranty Servicing operating segment. The Company presents base net income excluding discontinued operations since the operations and cash flows of EDULINX have been eliminated from the ongoing operations of the Company. Therefore, the results of operations for the Student Loan and Guaranty Servicing segment exclude the operating results of EDULINX for all periods presented.

Asset Generation and Management

In the Company's Asset Generation and Management segment, the Company generates primarily federally guaranteed student loans through direct origination or through acquisitions. The student loan assets are held in a series of education lending subsidiaries designed specifically for this purpose. Revenues are primarily generated from net interest income on the student loan assets. Earnings and earnings growth are directly affected by the size of the Company's portfolio of student loans, the interest rate characteristics of its portfolio, the costs associated with financing, servicing, and managing its portfolio, and the costs associated with origination and acquisition of the student loans in the portfolio, which includes, among other things, borrower benefits and rebate fees paid to the federal government. The Company generates the majority of its earnings from the spread, referred to as its student loan spread, between the yield it receives on its student loan portfolio and the costs previously described. While the spread may vary due to fluctuations in interest rates, the special allowance payments the Company receives from the federal government ensure the Company receives a minimum yield on its student loans, so long as certain requirements are met.

Student Loan and Guaranty Servicing

The Student Loan and Guaranty Servicing segment provides for the servicing of the Company's student loan portfolios and the portfolios of third parties and servicing provided to guaranty agencies. The servicing activities include application processing, underwriting, disbursement of funds, customer service, account maintenance, federal reporting and billing collections, payment processing, default aversion, claim filing, and recovery/collection services. These activities are performed internally for the Company's portfolio in addition to generating fee revenue when

performed for third-party clients. The following are the primary product and service offerings the Company offers as part of its Student Loan and Guaranty Servicing segment:

- Origination and servicing of FFELP loans;
- Origination and servicing of non-federally insured student loans; and
- Servicing and support outsourcing for guaranty agencies.

Tuition Payment Processing and Campus Commerce

The Tuition Payment Processing and Campus Commerce segment provides actively managed tuition payment solutions, online payment processing, detailed information reporting, and data integration services to K-12 and post-secondary educational institutions, families, and students. In addition, this segment provides financial needs analysis for students applying for aid in private and parochial K-12 schools. This segment also provides customer-focused electronic transactions, information sharing, and account and bill presentment to educational institutions.

Enrollment Services and List Management

The Enrollment Services and List Management segment provides a wide range of direct marketing products and services to help schools and businesses reach the middle school, high school, college bound high school, college, and young adult market places. In addition, this segment offers products and services that are focused on helping i) students plan and prepare for life after high school and ii) colleges recruit and retain students.

Software and Technical Services

The Software and Technical Services segment provides information technology products and full-service technical consulting, with core areas of business in educational loan software solutions, business intelligence, technical consulting services, and Enterprise Content Management (ECM) solutions.

Segment Operating Results

The tables below reflect base net income for each of the Company's operating segments. Reconciliation of the segment totals to the Company's operating results in accordance with GAAP is also included in the tables below.

Three months ended September 30, 2007 (dollars in thousands)										
	Asset Generation and Management	Student Loan and Guaranty Servicing	Tuition Payment Processing and Campus Commerce	Enrollment Services and List Management	Software and Technical Services	Total Segments	Corporate Activity and Overhead	Eliminations and Reclassifications	"Base net income" Adjustments to GAAP Results	GAAP Results of Operations
Total interest income	\$ 454,053	1,182	990	110	—	456,335	1,875	(533)	597	458,274
Interest expense	384,793	—	—	1	—	384,794	9,614	(533)	—	393,875
Net interest income	69,260	1,182	990	109	—	71,541	(7,739)	—	597	64,399
Less provision for loan losses	18,340	—	—	—	—	18,340	—	—	—	18,340
Net interest income after provision for loan losses	50,920	1,182	990	109	—	53,201	(7,739)	—	597	46,059
Other income (expense):										
Loan and guarantee servicing income	170	32,870	—	—	—	33,040	—	—	—	33,040
Other fee-based income	3,526	—	10,316	23,471	—	37,313	712	—	—	38,025
Software services income	—	—	—	169	5,257	5,426	—	—	—	5,426
Other income	1,673	—	31	—	—	1,704	5,816	—	—	7,520
Intersegment revenue	—	22,237	168	(37)	4,805	27,173	1,492	(28,665)	—	—
Derivative market value, foreign currency, and put option adjustments	—	—	—	—	—	—	—	—	18,449	18,449
Derivative settlements, net	(4,065)	—	—	—	—	(4,065)	1,729	—	—	(2,336)
Total other income (expense)	1,304	55,107	10,515	23,603	10,062	100,591	9,749	(28,665)	18,449	100,124
Operating expenses:										
Salaries and benefits	6,154	21,961	5,312	8,095	6,537	48,059	9,691	2,292	503	60,545
Restructure expense - severance and contract termination costs	1,921	1,231	—	737	58	3,947	1,009	(4,956)	—	—
Impairment of assets	28,291	—	—	11,401	—	39,692	9,812	—	—	49,504
Other expenses	7,429	8,565	2,029	13,809	689	32,521	19,822	168	10,885	63,396
Intersegment expenses	20,924	1,613	(15)	67	147	22,736	3,433	(26,169)	—	—
Total operating expenses	64,719	33,370	7,326	34,109	7,431	146,955	43,767	(28,665)	11,388	173,445
Income (loss) before income taxes	(12,495)	22,919	4,179	(10,397)	2,631	6,837	(41,757)	—	7,658	(27,262)
Income tax expense (benefit) (a)	(4,748)	8,709	1,588	(3,951)	1,000	2,598	(16,233)	—	2,971	(10,664)
Net income (loss) from continuing operations	(7,747)	14,210	2,591	(6,446)	1,631	4,239	(25,524)	—	4,687	(16,598)
Income (loss) from discontinued operations, net of tax	—	—	—	—	—	—	—	—	909	909
Net income (loss)	\$ (7,747)	14,210	2,591	(6,446)	1,631	4,239	(25,524)	—	5,596	(15,689)

(a) Income taxes are based on a percentage of net income before tax for the individual operating segment.

Three months ended September 30, 2006

(dollars in thousands)

	Asset Generation and Management	Student Loan and Guaranty Servicing	Tuition Payment Processing and Campus Commerce	Enrollment Services and List Management	Software and Technical Services	Total Segments	Corporate Activity and Overhead	Eliminations and Reclassifications	"Base net income" Adjustments to GAAP Results	GAAP Results of Operations
Total interest income	\$ 402,014	2,471	1,098	144	24	405,751	498	(175)	—	406,074
Interest expense	327,166	—	3	—	—	327,169	6,772	(175)	—	333,766
Net interest income	74,848	2,471	1,095	144	24	78,582	(6,274)	—	—	72,308
Less provision for loan losses	1,700	—	—	—	—	1,700	—	—	—	1,700
Net interest income after provision for loan losses	73,148	2,471	1,095	144	24	76,882	(6,274)	—	—	70,608
Other income (expense):										
Loan and guaranty servicing income	—	32,212	—	—	—	32,212	—	—	—	32,212
Other fee-based income	2,538	—	8,810	19,873	—	31,221	—	—	—	31,221
Software services income	67	—	—	52	4,280	4,399	—	—	—	4,399
Other income	12,917	7	—	—	—	12,924	654	—	—	13,578
Intersegment revenue	—	15,831	137	(9)	4,629	20,588	310	(20,898)	—	—
Derivative market value, foreign currency, and put option adjustments	—	—	—	—	—	—	—	—	(79,908)	(79,908)
Derivative settlements, net	6,966	—	—	—	—	6,966	(1,993)	—	—	4,973
Total other income (expense)	22,488	48,050	8,947	19,916	8,909	108,310	(1,029)	(20,898)	(79,908)	6,475
Operating expenses:										
Salaries and benefits	14,367	20,320	4,285	5,437	5,736	50,145	10,052	(3,539)	476	57,134
Other expenses	11,627	8,495	1,901	13,344	766	36,133	14,832	—	6,189	57,154
Intersegment expenses	12,813	3,729	497	—	—	17,039	320	(17,359)	—	—
Total operating expenses	38,807	32,544	6,683	18,781	6,502	103,317	25,204	(20,898)	6,665	114,288
Income (loss) before income taxes	56,829	17,977	3,359	1,279	2,431	81,875	(32,507)	—	(86,573)	(37,205)
Income tax expense (benefit) (a)	21,595	6,831	1,276	486	924	31,112	(13,302)	—	(31,554)	(13,744)
Net income (loss) from continuing operations	35,234	11,146	2,083	793	1,507	50,763	(19,205)	—	(55,019)	(23,461)
Income (loss) from discontinued operations, net of tax	—	—	—	—	—	—	—	—	1,107	1,107
Net income (loss)	\$ 35,234	11,146	2,083	793	1,507	50,763	(19,205)	—	(53,912)	(22,354)

(a) Income taxes are based on a percentage of net income before tax for the individual operating segment.

Nine months ended September 30, 2007

(dollars in thousands)

	Asset Generation and Management	Student Loan and Guaranty Servicing	Tuition Payment Processing and Campus Commerce	Enrollment Services and List Management	Software and Technical Services	Total Segments	Corporate Activity and Overhead	Eliminations and Reclassifications	"Base net income" Adjustments to GAAP Results	GAAP Results of Operations
Total interest income	\$ 1,301,947	4,607	2,670	290	18	1,309,532	6,230	(3,737)	597	1,312,622
Interest expense	1,084,792	—	7	5	—	1,084,804	31,196	(3,737)	—	1,112,263
Net interest income	217,155	4,607	2,663	285	18	224,728	(24,966)	—	597	200,359
Less provision for loan losses	23,628	—	—	—	—	23,628	—	—	—	23,628
Net interest income after provision for loan losses	193,527	4,607	2,663	285	18	201,100	(24,966)	—	597	176,731
Other income (expense):										
Loan and guarantee servicing income	288	94,828	—	—	—	95,116	—	—	—	95,116
Other fee-based income	10,511	—	31,492	73,341	—	115,344	972	—	—	116,316
Software services income	—	—	—	456	16,566	17,022	—	—	—	17,022
Other income	7,617	11	59	—	—	7,687	9,649	—	—	17,336
Intersegment revenue	—	58,821	508	891	13,026	73,246	7,608	(80,854)	—	—
Derivative market value, foreign currency, and put option adjustments	—	—	—	—	—	—	—	—	11,866	11,866
Derivative settlements, net	(4,950)	—	—	—	—	(4,950)	12,050	—	—	7,100
Total other income (expense)	13,466	153,660	32,059	74,688	29,592	303,465	30,279	(80,854)	11,866	264,756
Operating expenses:										
Salaries and benefits	20,600	66,988	15,312	26,486	18,869	148,255	34,669	(2,370)	1,456	182,010
Restructure expense - severance and contract termination costs	1,921	1,231	—	737	58	3,947	1,009	(4,956)	—	—
Impairment of assets	28,291	—	—	11,401	—	39,692	9,812	—	—	49,504
Other expenses	22,940	26,219	6,522	42,957	2,224	100,862	58,762	168	24,014	183,806
Intersegment expenses	59,594	8,681	384	252	550	69,461	4,235	(73,696)	—	—
Total operating expenses	133,346	103,119	22,218	81,833	21,701	362,217	108,487	(80,854)	25,470	415,320
Income (loss) before income taxes	73,647	55,148	12,504	(6,860)	7,909	142,348	(103,174)	—	(13,007)	26,167
Income tax expense (benefit) (a)	27,986	20,956	4,752	(2,607)	3,006	54,093	(40,059)	—	(4,128)	9,906
Net income (loss) from continuing operations	45,661	34,192	7,752	(4,253)	4,903	88,255	(63,115)	—	(8,879)	16,261
Income (loss) from discontinued operations, net of tax	—	—	—	—	—	—	—	—	(2,416)	(2,416)
Net income (loss)	\$ 45,661	34,192	7,752	(4,253)	4,903	88,255	(63,115)	—	(11,295)	13,845

(a) Income taxes are based on a percentage of net income before tax for the individual operating segment.

Nine months ended September 30, 2006										
(dollars in thousands)										
	Asset Generation and Management	Student Loan and Guaranty Servicing	Tuition Payment Processing and Campus Commerce	Enrollment Services and List Management	Software and Technical Services	Total Segments	Corporate Activity and Overhead	Eliminations and Reclassifications	"Base net income" Adjustments to GAAP Results	GAAP Results of Operations
Total interest income	\$ 1,128,285	5,905	2,685	356	67	1,137,298	1,483	(579)	—	1,138,202
Interest expense	876,259	—	5	—	—	876,264	17,874	(579)	—	893,559
Net interest income	252,026	5,905	2,680	356	67	261,034	(16,391)	—	—	244,643
Less provision for loan losses	13,508	—	—	—	—	13,508	—	—	—	13,508
Net interest income after provision for loan losses	238,518	5,905	2,680	356	67	247,526	(16,391)	—	—	231,135
Other income (expense):										
Loan and guarantee servicing income	—	91,428	—	—	—	91,428	—	—	—	91,428
Other fee-based income	8,472	—	25,483	31,495	—	65,450	—	—	—	65,450
Software services income	182	1	—	92	11,551	11,826	—	—	—	11,826
Other income	16,720	68	—	—	—	16,788	1,683	—	—	18,471
Intersegment revenue	—	46,015	365	756	13,014	60,150	506	(60,656)	—	—
Derivative market value, foreign currency, and put option adjustments	—	—	—	—	—	—	—	—	(11,565)	(11,565)
Derivative settlements, net	18,412	—	—	—	—	18,412	(1,993)	—	—	16,419
Total other income (expense)	43,786	137,512	25,848	32,343	24,565	264,054	196	(60,656)	(11,565)	192,029
Operating expenses:										
Salaries and benefits	39,776	62,426	13,087	8,549	15,709	139,547	28,864	(8,296)	1,271	161,386
Other expenses	38,628	24,106	6,157	16,047	2,214	87,152	42,956	—	17,304	147,412
Intersegment expenses	38,959	9,386	497	—	—	48,842	3,518	(52,360)	—	—
Total operating expenses	117,363	95,918	19,741	24,596	17,923	275,541	75,338	(60,656)	18,575	308,798
Income (loss) before income taxes	164,941	47,499	8,787	8,103	6,709	236,039	(91,533)	—	(30,140)	114,366
Income tax expense (benefit) (a)	62,678	18,049	3,338	3,079	2,549	89,693	(37,355)	—	(10,002)	42,336
Net income (loss) before minority interest	102,263	29,450	5,449	5,024	4,160	146,346	(54,178)	—	(20,138)	72,030
Minority interest in subsidiary income	—	—	(242)	—	—	(242)	—	—	—	(242)
Net income (loss) from continuing operations	102,263	29,450	5,207	5,024	4,160	146,104	(54,178)	—	(20,138)	71,788
Income (loss) from discontinued operations, net of tax	—	—	—	—	—	—	—	—	3,677	3,677
Net income (loss)	\$ 102,263	29,450	5,207	5,024	4,160	146,104	(54,178)	—	(16,461)	75,465

(a) Income taxes are based on a percentage of net income before tax for the individual operating segment.

Corporate Activity and Overhead in the previous tables primarily includes the following items:

- Income earned on certain investment activities;
- Interest expense incurred on unsecured debt transactions;
- Other products and service offerings that are not considered operating segments; and
- Corporate activities and overhead functions such as executive management, human resources, accounting and finance, legal, marketing, and corporate technology support.

The adjustments required to reconcile from the Company's base net income measure to its GAAP results of operations relate to differing treatments for derivatives, foreign currency transaction adjustments, amortization of intangible assets, discontinued operations, and certain other items that management does not consider in evaluating the Company's operating results. See "Non-GAAP Performance Measures." The following tables reflect adjustments associated with these areas by operating segment and Corporate Activity and Overhead for the three and nine months ended September 30, 2007 and 2006:

	Asset Generation and Management	Student Loan and Guaranty Servicing	Tuition Payment Processing and Campus Commerce	Enrollment Services and List Management	Software and Technical Services	Corporate Activity and Overhead	Total
(dollars in thousands)							
Three months ended September 30, 2007							
Derivative market value, foreign currency, and put option adjustments	\$ (20,017)	—	—	—	—	1,568	(18,449)
Amortization of intangible assets	1,372	1,350	1,434	6,442	287	—	10,885
Non-cash stock based compensation related to business combinations	—	—	—	—	—	503	503
Variable-rate floor income	(597)	—	—	—	—	—	(597)
Income (loss) from discontinued operations, net of tax	—	(909)	—	—	—	—	(909)
Net tax effect (a)	7,312	(513)	(545)	(2,448)	(109)	(726)	2,971
Total adjustments to GAAP	<u>\$ (11,930)</u>	<u>(72)</u>	<u>889</u>	<u>3,994</u>	<u>178</u>	<u>1,345</u>	<u>(5,596)</u>
Three months ended September 30, 2006							
Derivative market value, foreign currency, and put option adjustments	\$ 76,404	—	—	—	—	3,504	79,908
Amortization of intangible assets	2,228	1,038	1,305	1,498	120	—	6,189
Non-cash stock based compensation related to business combinations	—	—	—	—	—	476	476
Variable-rate floor income	—	—	—	—	—	—	—
Income (loss) from discontinued operations, net of tax	—	(1,107)	—	—	—	—	(1,107)
Net tax effect (a)	(29,880)	(382)	(496)	(569)	(46)	(181)	(31,554)
Total adjustments to GAAP	<u>\$ 48,752</u>	<u>(451)</u>	<u>809</u>	<u>929</u>	<u>74</u>	<u>3,799</u>	<u>53,912</u>
Nine months ended September 30, 2007							
Derivative market value, foreign currency, and put option adjustments	\$ (7,801)	—	—	—	—	(4,065)	(11,866)
Amortization of intangible assets	5,197	3,744	4,372	9,797	904	—	24,014
Non-cash stock based compensation related to business combinations	—	—	—	—	—	1,456	1,456
Variable-rate floor income	(597)	—	—	—	—	—	(597)
Income (loss) from discontinued operations, net of tax	—	2,416	—	—	—	—	2,416
Net tax effect (a)	1,216	(1,423)	(1,661)	(3,723)	(343)	1,806	(4,128)
Total adjustments to GAAP	<u>\$ (1,985)</u>	<u>4,737</u>	<u>2,711</u>	<u>6,074</u>	<u>561</u>	<u>(803)</u>	<u>11,295</u>
Nine months ended September 30, 2006							
Derivative market value, foreign currency, and put option adjustments	\$ 7,744	—	—	—	—	3,821	11,565
Amortization of intangible assets	6,684	3,369	4,173	2,718	360	—	17,304
Non-cash stock based compensation related to business combinations	—	—	—	—	—	1,271	1,271
Variable-rate floor income	—	—	—	—	—	—	—
Income (loss) from discontinued operations, net of tax	—	(3,677)	—	—	—	—	(3,677)
Net tax effect (a)	(5,482)	(1,281)	(1,585)	(1,033)	(138)	(483)	(10,002)
Total adjustments to GAAP	<u>\$ 8,946</u>	<u>(1,589)</u>	<u>2,588</u>	<u>1,685</u>	<u>222</u>	<u>4,609</u>	<u>16,461</u>

(a) Tax effect computed at 38%. The change in the value of the put option (included in Corporate Activity and Overhead) is not tax effected as this is not deductible for income tax purposes.

Student Loans Receivable

Student loans receivable includes all student loans owned by or on behalf of the Company and includes the unamortized cost of acquisition or origination less an allowance for loan losses. The following table describes the components of the Company's loan portfolio:

	As of September 30, 2007		As of December 31, 2006		As of September 30, 2006	
	Dollars	Percent of total	Dollars	Percent of total	Dollars	Percent of total
	(dollars in thousands)					
Federally insured:						
Stafford	\$ 6,683,801	25.1 %	\$ 5,724,586	24.1 %	\$ 6,290,116	27.4 %
PLUS/SLS	419,940	1.6	365,112	1.5	391,981	1.7
Consolidation	18,824,726	70.9	17,127,623	72.0	15,672,102	68.3
Non-federally insured	251,503	0.9	197,147	0.8	180,462	0.8
Total	26,179,970	98.5	23,414,468	98.4	22,534,661	98.2
Unamortized premiums and deferred origination costs	460,167	1.7	401,087	1.7	424,151	1.9
Allowance for loan losses:						
Allowance - federally insured	(23,907)	(0.1)	(7,601)	(0.0)	(7,517)	0.0
Allowance - non-federally insured	(20,107)	(0.1)	(18,402)	(0.1)	(17,577)	(0.1)
Net	<u>\$ 26,596,123</u>	<u>100.0 %</u>	<u>\$ 23,789,552</u>	<u>100.0 %</u>	<u>\$ 22,933,718</u>	<u>100.0 %</u>

The following table sets forth the loans originated or acquired through each of the Company's channels:

	Three months ended			Nine months ended	
	September 30, 2007	June 30, 2007	September 30, 2006	September 30, 2007	September 30, 2006
	(dollars in thousands)				
Beginning balance	\$ 25,746,000	24,617,030	22,012,670	23,414,468	19,912,955
Direct channel:					
Consolidation loan originations	914,842	836,711	1,493,981	2,815,791	3,563,910
Less consolidation of existing portfolio	(537,539)	(438,993)	(726,700)	(1,450,326)	(1,727,900)
Net consolidation loan originations	377,303	397,718	767,281	1,365,465	1,836,010
Stafford/PLUS loan originations	426,740	141,882	385,997	923,450	843,162
Branding partner channel (a) (b)	125,220	255,703	94,229	583,213	841,258
Forward flow channel	178,226	392,174	336,775	946,342	1,268,288
Other channels (b)	24,373	560,796	2,070	791,087	480,528
Total channel acquisitions	1,131,862	1,748,273	1,586,352	4,609,557	5,269,246
Repayments, claims, capitalized interest, and other	(192,700)	(397,556)	(368,789)	(826,066)	(1,187,813)
Consolidation loans lost to external parties	(200,719)	(187,350)	(342,400)	(627,473)	(923,600)
Loans sold	(304,473)	(34,397)	(353,172)	(390,516)	(536,127)
Ending balance	<u>\$ 26,179,970</u>	<u>25,746,000</u>	<u>22,534,661</u>	<u>26,179,970</u>	<u>22,534,661</u>

- (a) Included in the branding partner channel are private loan originations of \$22.1 million, \$17.8 million, and \$14.9 million for the three months ended September 30, 2007, June 30, 2007, and September 30, 2006, respectively, and \$84.2 million and \$36.0 million for the nine months ended September 30, 2007 and 2006, respectively.
- (b) Included in other channels for the nine months ended September 30, 2006 is \$190.1 million of acquisitions that were previously presented as branding partner channel acquisitions. This reclassification was made for comparative purposes due to the nature of the transactions.

Student Loan Spread

The following table analyzes the student loan spread on the Company's portfolio of student loans. This table represents the spread on assets earned in conjunction with the liabilities used to fund the assets, including the effects of net derivative settlements.

	Three months ended			Nine months ended	
	September 30 2007	June 30, 2007	September 30, 2006	September 30, 2007	September 30, 2006
Student loan yield	7.83 %	7.93 %	7.91 %	7.87 %	7.84 %
Consolidation rebate fees	(0.76)	(0.78)	(0.72)	(0.77)	(0.71)
Premium and deferred origination costs amortization	(0.36)	(0.37)	(0.39)	(0.36)	(0.41)
Student loan net yield	6.71	6.78	6.80	6.74	6.72
Student loan cost of funds (a)	(5.65)	(5.50)	(5.32)	(5.54)	(4.99)
Student loan spread	1.06	1.28	1.48	1.20	1.73
Variable-rate floor income	(0.01)	—	—	—	—
Special allowance yield adjustments, net of settlements on derivatives (b)	—	—	(0.14)	—	(0.28)
Core student loan spread	1.05 %	1.28 %	1.34 %	1.20 %	1.45 %
Average balance of student loans (in thousands)	\$ 25,866,660	24,687,280	22,170,118	24,799,585	21,268,972
Average balance of debt outstanding (in thousands)	27,321,874	26,158,525	23,881,928	26,293,342	22,984,011

- (a) The student loan cost of funds includes the effects of net settlement costs on the Company's derivative instruments used to hedge the Company's student loan portfolio.
- (b) The special allowance yield adjustments represent the impact on net spread had loans earned at statutorily defined rates under a taxable financing. The special allowance yield adjustments include net settlements on derivative instruments that were used to hedge this loan portfolio earning the excess yield. On January 19, 2007, the Company entered into a Settlement Agreement with the Department to resolve the audit by the OIG of the Company's portfolio of student loans receiving 9.5% special allowance payments. Under the terms of the Agreement, all 9.5% special allowance payments were eliminated for periods on and after July 1, 2006. The Company had been deferring recognition of 9.5% special allowance payments related to those loans subject to the OIG audit effective July 1, 2006 pending satisfactory resolution of this issue.

Interest Rate Sensitivity

A portion of the Company's student loan assets earn a fixed rate. As a result, management has historically used fixed-rate debt and interest rate swaps to reduce the economic effect of interest rate volatility. The following table shows the Company's student loan assets currently earning at a fixed rate as of September 30, 2007:

Fixed interest rate range	Borrower/ lender weighted average yield	Estimated variable conversion rate (a)	Balance of fixed rate assets (dollars in thousands)
8.0-9.0 %	8.24 %	5.60 %	\$ 357,752
>9.0	9.05	6.41	<u>381,866</u>
			<u>\$ 739,618</u>

(a) The estimated variable conversion rate is the estimated short-term interest rate at which loans would convert to variable rate.

As of September 30, 2007, the Company had \$217.8 million of fixed-rate debt (excluding the Company's fixed-rate unsecured debt of \$475.0 million) that was used by the Company to hedge fixed-rate student loan assets.

During the 4th quarter 2006, in consideration of not receiving 9.5% special allowance payments on a prospective basis, the Company entered into a series of off-setting interest rate swaps that mirrored the \$2.45 billion in pre-existing interest rate swaps that the Company had utilized to hedge its loan portfolio receiving 9.5% special allowance payments against increases in interest rates.

During the 2nd quarter 2007, the Company entered into a series of off-setting interest rate swaps that mirrored the remaining interest rate swaps utilized to hedge the Company's student loan portfolio against increases in interest rates.

The net effect of the offsetting derivatives discussed above was to lock in a series of future income streams on underlying trades through their respective maturity dates. A summary of these interest rate swaps follow (notional amount in thousands):

<u>Maturity</u>	<u>Notional Amount</u>	<u>Weighted average fixed rate paid by the Company</u>	<u>Notional Amount</u>	<u>Weighted average fixed rate received by the Company</u>
2007	\$ 512,500	3.42 %	\$ 512,500	5.25 %
2008	462,500	3.76	462,500	5.34
2009	312,500	4.01	312,500	5.37
2010	1,137,500	4.25	1,137,500	4.75
2011	—	—	—	—
2012	275,000	4.31	275,000	4.76
2013	525,000	4.36	525,000	4.80
	<u>\$ 3,225,000</u>	<u>4.05 %</u>	<u>\$ 3,225,000</u>	<u>4.98 %</u>

In August 2007, the Company terminated all interest rate swaps summarized above for net proceeds of \$50.8 million.

Derivative Settlements

The following table summarizes the components of derivative settlements.

	<u>Three months ended</u>			<u>Nine months ended</u>	
	<u>September 30, 2007</u>	<u>June 30, 2007</u>	<u>September 30, 2006</u>	<u>September 30, 2007</u>	<u>September 2006</u>
	<u>(dollars in thousands)</u>				
Interest rate swaps - loan portfolio	\$ —	1,919	4,317	4,753	9,357
Basis swaps - loan portfolio	(2,608)	58	(145)	(2,489)	(656)
Interest rate swaps - other (a)	1,729	5,657	—	12,050	—
Special allowance yield adjustment derivatives (a)	—	—	7,909	—	19,794
Cross currency interest rate swaps	(1,457)	(2,438)	(5,115)	(7,214)	(10,083)
Other (b)	—	—	(1,993)	—	(1,993)
Derivative settlements, net	<u>\$ (2,336)</u>	<u>5,196</u>	<u>4,973</u>	<u>7,100</u>	<u>16,419</u>

- (a) Derivative settlements for interest rate swaps “other” include settlements on the portfolio of derivatives that the Company had used to hedge 9.5% special allowance payments and the portfolio of off-setting interest rate swaps the Company entered into during the fourth quarter 2006. Settlements on the 9.5% special allowance derivatives were classified in the special allowance yield adjustment derivatives line item through September 30, 2006. Also included in derivative settlements for interest rate swaps “other” are the off-setting derivatives entered into in the 2nd quarter 2007.
- (b) During 2006, the Company issued junior subordinated hybrid securities and entered into a derivative instrument to economically lock into a fixed interest rate prior to the actual pricing of the transaction. Upon pricing of these notes, the Company terminated this derivative instrument. The consideration paid by the Company to terminate this derivative was \$2.0 million.

Student Loan Servicing

The Company performs servicing activities for its own portfolio and third parties. The following table summarizes the Company's loan servicing volumes for FFELP and private loans. Loan servicing volumes for the Company's discontinued operations are excluded from the table.

	<u>As of</u> <u>September 30, 2007</u>	<u>As of</u> <u>December 31, 2006</u> (dollars in millions)	<u>As of</u> <u>September 30, 2006</u>
Company	\$ 25,491	21,869	20,772
Third Party	<u>8,026</u>	<u>8,725</u>	<u>9,097</u>
Total	<u>\$ 33,517</u>	<u>30,594</u>	<u>29,869</u>