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New Rec: SLM Corporation (SLM: $9.74) July 15, 2015

Position: Sell **Target: $6.78**

	Q2 15e	Q3 15e	Q4 15e	Q1 16e	2015e	2016e
Revs $mm*	260.5	254.9	192.9	204.5	890.6	955.7
EPS (GAAP) $	0.196	0.177	0.097	0.118	0.569	0.639
Y/Y Gr	106.8%	(2.3%)	181.8%	19.4%	35.7%	12.3%
PE	n/a	n/a	n/a	n/a	17.1	15.2
Cnsns Rev*	258.7	263.7	196.3	204.5	900.7	1,038
Cnsns EPS	0.20	0.195	0.09	0.12	0.587	0.70

* Revenue is Net Interest Income plus Non-Interest Income, excluding Provision for Loan Losses

Shares Out: 432.3M **Market Cap: $4.21 B** **FYE: Dec 31**

Concept:

1. Major banks have exited the private student loan origination market, allowing remaining players, including SLM, to earn excessive returns.

2. New competition is entering the market, including venture-backed players such as SoFi, Earnest, and LendKey. Citizens Financial Group (CFG) and a product from NelNet (NNI) called U-Fi are additional competition.
3. Since it is illegal to have prepayment penalties on private student loans, well-funded new competition has been able to refinance (or “cherry pick”) the best credit quality borrowers post-graduation. This completely changes the unit economics of loans made by SLM.
4. Part of the existing demand for private student loans may not be sustainable if borrower awareness of federal student loan options is improved.
5. “Street” earnings estimates, which call for 19.2% and 20% EPS growth in 2016 and 2017, may be too high given the new competition. Moreover, SLM’s expected portfolio mix should shift to lower credit quality borrowers.

Summary: SLM Corporation (SLM) is the largest US originator of private student loans (PSLs), commonly referred to as “alternative student loans.” Issuance of PSLs, which are unsecured debt that are not federally guaranteed and are underwritten based on the borrower’s and/or co-signer’s credit, exploded in the decade prior to the financial crisis. This was largely due to the availability of cheap credit provided by the asset-backed security (ABS) market, rising college costs, and underwriting standards that allowed lending to students at for-profit colleges, as well as to borrowers with subprime credit profiles. After the financial crisis, the credit profile of borrowers in the PSL new loan origination market greatly improved, with SLM’s current average borrower having a FICO score of 748. Over 90% of loans are co-signed (typically by a parent or family member), and lending to students at for-profit schools is a very small portion of the portfolio. SLM management has characterized its post financial crisis PSL borrower as middle-class to upper- middle-class and has spoken of household incomes in the $80 K to $280 K range.

In 2010, the federal student loan market (which now has about $100B in annual originations vs. $8B to $9B in PSL annual originations), underwent a dramatic change after the US Treasury began to directly fund all federal student loans. Previously, private sector lenders such as SLM and other banks would directly originate federal student loans (known as Federal Family Education Loan Program loans, or “FFELP” loans) at government prescribed interest rates, would keep such loans on balance sheet or securitize them, and would receive a credit loss protection from the Department of Education covering 97% to 98% of principal. Past issuers and servicers of FFELP loans are now managing the runoff of these FFELP portfolios, and some banks have decided to sell off these legacy portfolios due to the diseconomies of scale caused as their portfolios amortize, and due to the increased regulatory scrutiny and negative public opinion associated with federal student loans and their high delinquency and default rates.

With these major changes occurring in the federal student loan market, on May 1, 2014, SLM took a good bank/bad bank and high growth/no growth

approach to corporate restructuring, and spun-off its legacy FFELP portfolio and its servicing business that was running off, as well as its pre-financial crisis PSLs (lower credit quality) that were originated outside its bank subsidiary into a separate company called Navient (NAVI). The higher credit quality PSL loans made post-financial crisis stayed with the SLM entity, as did the PSL origination platform, and a consumer spending rewards business called Upromise.

New competition has taken notice of the excessive risk-adjusted returns (500 bp + credit adjusted NIM, 2.3% ROAA, and 23% ROE if appropriately leveraged at 10% equity/assets) that can be earned in the PSL market by lending to mostly super-prime (FICO > 740) and prime (FICO 680 – 739) borrowers in the middle to upper-middle household income ranges. Very well-funded venture-backed companies such as Social Finance (SoFi) and CommonBond, both originally formed as peer-to-peer lending networks at highly ranked MBA programs, have funded rapid growth by tapping the securitization markets in order to expand their lending to students and graduates of other highly ranked universities. Given that prepayment penalties are illegal for all student loans (including PSLs) both companies saw the opportunity to initially focus on the refinancing of federal and private graduate student loans to graduates of top universities. They have since moved on to financing in-school and refinancing loans for undergraduates, which is SLM's core business. An earlier stage online lender called Earnest has generated significant fundraising momentum from top VCs with its unique underwriting approach that allows high credit quality student loan borrowers to refinance at very competitive rates by linking their bank accounts and other financial accounts to Earnest for use in the underwriting process. In April, 2015, LendKey, a venture-funded online PSL origination platform for credit unions and community banks, secured a $1B financing commitment from Apollo Investment Group to purchase refinanced PSLs to students who have graduated from lenders on the LendKey platform. And, finally on the physical side of the banking world, 1,200 branch Citizens Financial Group (CFG), spun-off from RBS in 2014, has targeted private student lending as a primary area for loan growth and has set the explicit goal of increasing its PSL market share to over 10% from 3% to 4% currently.

The high delinquency and default rates in the federal portion of the student loan market can at least partly be attributed to the fact that there is zero credit underwriting performed before the issuance of a federal student loan. Quite literally, all a borrower needs is a pulse and a high school diploma and he/she can be issued up to $31,000 in federal student loans ($5,500/yr for freshman year, $6,500/yr for sophomore year, and $7,500/yr for junior year and thereafter) for undergraduate studies. Despite the ease in obtaining a federal student loan, which usually has lower interest rates and better forbearance terms than a PSL, studies have found that 47% of PSL borrowers have untapped federal student loan

capacity, and 19% of PSL borrowers took out no federal student loans at all. The likely causes of this inefficient demand for PSLs is that student borrowers may not be aware of all of their federal student loan options. Organizations such as the Center for Responsible Lending have called for rules that would require universities to certify that there is a need for a student to take out a PSL in light of their available federal student loan borrowing capacity and inform students about the risks of taking a PSL versus a federal student loan, given interest rate differences (PSLs typically more expensive and variable rate) and stricter forbearance policies.

Following the spin-off of Navient in May, 2014, SLM has been marketed by its management team as a high growth consumer banking business with long-term earnings growth above 20%. The "street" appears to agree, with consensus GAAP EPS estimates show growth of 19.2% and 20% in FY16 and FY17. The "street" doesn't appear overly concerned about the threat from new competition. When asked about the competitive impact from the emerging refinancing lenders on its 1Q15 conference call, SLM management dismissed the risk, saying that 90% of its portfolio was originated with the co-signer's average FICO of 748, implying that the student couldn't improve his/her credit enough above a 748 to qualify for a lower interest rate. Citing the average is misleading. We note that 46% of SLM's PSL loan portfolio has a FICO above 750, and those are exactly the types of loans that other lenders are willing to refinance at a much lower rate. Citizens Financial Group (CFG), for example, has a PSL portfolio with approximately a 780 FICO and an average yield of ~5.5%, and states that it usually lowers a borrower's interest rates by 1.5% when he/she refinances.

As competition continues to expand in the PSL market, the impact on both SLM's existing portfolio from refinancings and on SLM's in-school originations should become clear. SLM's average life of loan (adjusted for prepayments) should shorten from its current seven years, leaving fewer years of NIM to recover the typical 3% upfront origination costs. After competitors are done cherry picking SLM's best loans for refinancing, the remaining loans in SLM's portfolio should be those borrowers unable to refinance (7% of loan balance had FICO < 670 at origination, 15% had 670 – 699, and 32% had 700 – 749) that likely make up an overwhelming percentage of defaults, and the resulting credit characteristics of SLM's loan portfolio will add volatility to SLM's earnings over the credit cycle. SLM currently trades at 13.9x consensus FY16 EPS of $0.70. We see competition impacting SLM's FY16 by $0.06, leading to an OWS EPS estimate of $0.64. SLM's earnings volatility and loan growth profile should begin to more closely resemble credit card lenders such as Capital One Financial Corp (COF) and Discover Financial Services (DFS), which trade at 11.06x and 10.21x consensus FY16 EPS. Applying a 10.6x P/E multiple (avg of COF & DFS) to our $0.64

FY16 estimate yields a price target for SLM of $6.78, 30.4% below SLM's current price of $9.74.

Shares Borrowable Information:

Supply Quantity	Quantity On Loan	Available to Borrow	Date
154.837 mm	3.746 mm	151.654 mm	7.15.2015

Source: Markit/Data Explorers

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Background:

SLM Corp. dates back to 1973, when the Student Loan Marketing Association (nicknamed "Sallie Mae") was formed as a Government-Sponsored Enterprise (GSE) to support guaranteed federal student loans. SLM went public in 1983. It benefitted from its GSE status by being able to issue GSE debt that was perceived as guaranteed by the U.S. government. SLM began its privatization process from a GSE in 1997, and completed its privatization in 2004.

During the credit boom in first part of the 2000s, SLM issued PSLs in addition to its primary business of issuing FFELP student loans that had 97% of their principal guaranteed by the government. At the height of the LBO boom in April, 2007, a consortium of J.C. Flowers, JPM and BAC offered to take SLM private in a $25 B transaction. The LBO of SLM fell apart in September, 2007 with the JC Flowers consortium claiming a Material Adverse Change (MAC) in SLM's business due to new regulations (the College Cost Reduction and Access Act) that adversely impacted the economics of federal student loans. The onset of the financial crisis and the disruption in the credit markets, although not cited as a reason for the LBO's termination, was likely also a contributing factor.

Once new issuance of FFELP loans was halted in 2010 and the US Treasury began directly funding all federal student loans, SLM's business model lost one of its primary income streams. While the FFELP portfolio and servicing business would be in runoff, the PSL business, although dramatically smaller than its pre-crisis levels, was profitable and growing, due to banks exiting the PSL market. In order to highlight the value of its PSL business, SLM spun-off the legacy FFELP business, its servicing business for US Treasury funded federal student loans, and its pre-crisis PSL loan portfolio into a company called Navient (NAVI) on May 1, 2014.

After the financial crisis, three major banks stopped originating PSLs, likely because the small size of the market ($8B to $9B in annual originations) wasn't

worth the headache associated with the regulatory scrutiny and negative public opinion about student loans. BAC stopped originating PSLs in 2009, Citi sold off its Student Loan Corp assets to SLM and DFS in 2010 and 2011, and JPM exited the PSL origination market in 2014. The remaining PSL origination market became an oligopoly, with SLM having ~50% market share, WFC having 25% market share and DFS having 10% to 15% share. This lack of competition has allowed SLM to earn a credit adjusted NIM over 500 bp, 2.3% ROAA, and 16% ROE (23% ROE if leveraged at 10% equity/assets) and has attracted new competition.

Recognizing the lack of competition in the PSL market, CFG entered the market in 2009, and multiple venture-backed online lenders launched products in order to exploit the attractive returns available in the PSL market. SLM management is dismissive of the refinancing threat from new competition. The impact that we expect hasn't fully appeared in SLM's on-balance sheet portfolio because it consists of mostly unseasoned loans to students still in school, with only 28% of loans in the post-graduation principal and repayment period when PSLs would likely be refinanced. Prepayment speeds in its two most recent securitizations since the spin-off are higher than historical levels, indicating the more seasoned loans that SLM is placing in the securitizations are seeing an impact from competitive refinancings.

Discussion:

1. Major banks have exited the private student loan origination market, allowing remaining players, including SLM, to earn excessive returns.

The private student loan market is still a relatively new asset class after emerging in the mid-1990s and after growing rapidly during the credit expansion and the for-profit school proliferation of the 2000s. PSL originations peaked in 2008 at over $20B, but, following the financial crisis and the shutdown of the PSL securitization market, PSL originations fell to below $6 B in 2011. As the delinquency and credit problems of the much larger federal student loan market began to make headlines and receive regulatory scrutiny, three of the country's largest banks began to exit the PSL origination business, as this was a niche asset class with only $8 B in originations, and not worth the associated regulatory and political headache. Bank of America ("BAC") exited the market in 2009, Citigroup ("C") exited the market by selling its Student Lending portfolio to Discover (DFS) and to SLM in 2010 and 2011, and JPM stopped making new loan originations in 2014.

The exodus of the big banks from the private student lending market led to an oligopoly with SLM, Wells Fargo (WFC), and Discover (DFS) funding over

90% of the new PSL originations. Table 1 below shows 2014 Estimated PSL Origination market share.

Table 1

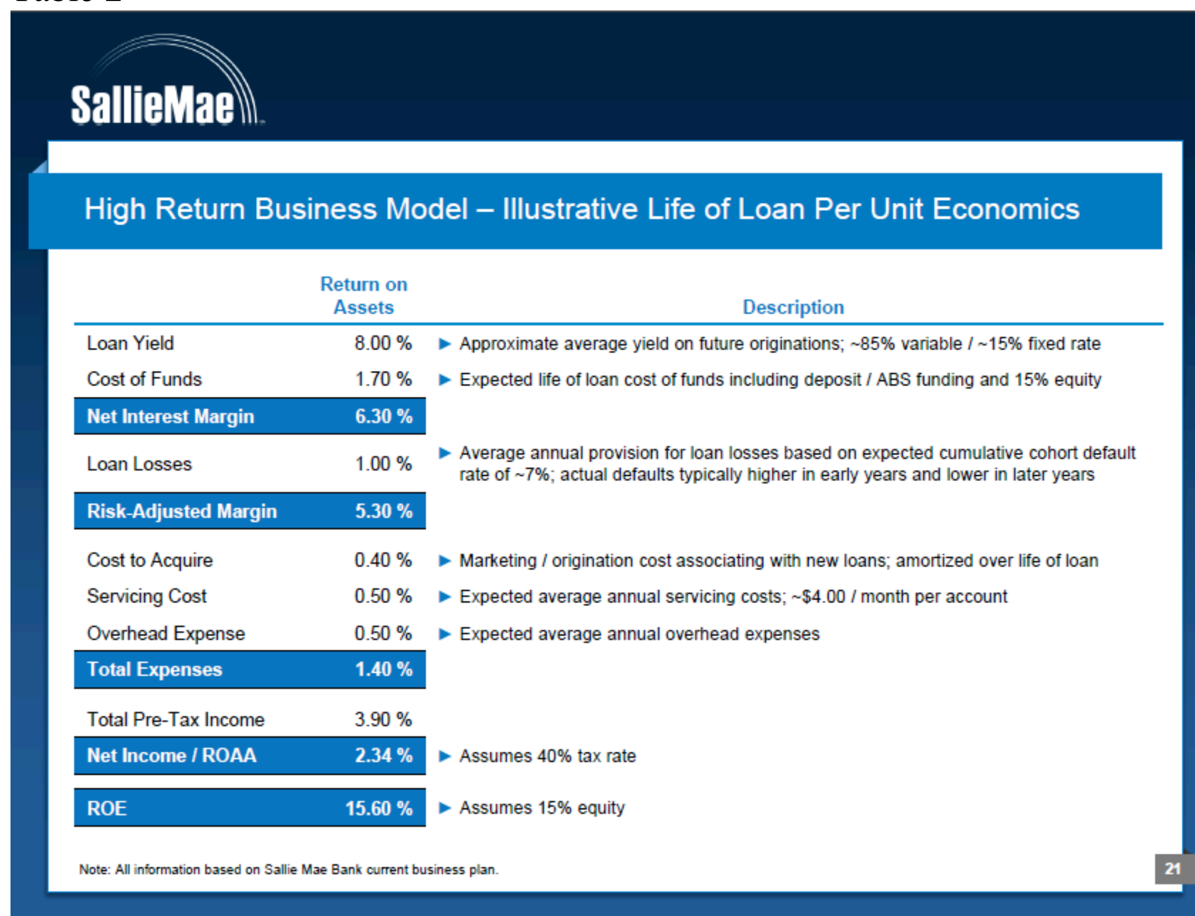
2014 Private Student Loans ("In-school" loans) Market Share
($ mils)

Company	Originations	Market Share
SLM Corporation	4,087	51.1%
Wells Fargo	2,000	25.0%
Discover Financial Services	1,200	15.0%
Citizens Financial Group	305	3.8%
Other (PNC, STI, Regions, LendKey)	408	5.1%
Total	8,000	100.0%

Source: SLM, DFS, OWS estimates.

Given the lack of competition, SLM and the remaining PSL lenders have been able to raise the credit quality of the their loans (SLM's avg FICO is 748 with 90% co-signors) while still maintaining attractive risk-adjusted returns. According to SLM in its April 2014 investor presentation in a slide titled "High Return Business Model" (shown below in Table 2), SLM's unit economics lead to a 530 bp Net Interest Margin (NIM) after a normalized 100 bp in credit charges which gives them a 2.34% ROAA and a 15.6% ROE assuming 15% equity/assets.

Table 2



SallieMae

High Return Business Model – Illustrative Life of Loan Per Unit Economics

	Return on Assets	Description
Loan Yield	8.00 %	► Approximate average yield on future originations; ~85% variable / ~15% fixed rate
Cost of Funds	1.70 %	► Expected life of loan cost of funds including deposit / ABS funding and 15% equity
Net Interest Margin	**6.30 %**	
Loan Losses	1.00 %	► Average annual provision for loan losses based on expected cumulative cohort default rate of ~7%; actual defaults typically higher in early years and lower in later years
Risk-Adjusted Margin	**5.30 %**	
Cost to Acquire	0.40 %	► Marketing / origination cost associating with new loans; amortized over life of loan
Servicing Cost	0.50 %	► Expected average annual servicing costs; ~$4.00 / month per account
Overhead Expense	0.50 %	► Expected average annual overhead expenses
Total Expenses	**1.40 %**	
Total Pre-Tax Income	3.90 %	
Net Income / ROAA	**2.34 %**	► Assumes 40% tax rate
ROE	15.60 %	► Assumes 15% equity

Note: All information based on Sallie Mae Bank current business plan.

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Source: April, 2014 SLM Investor Presentation, p 21.

Comments from SLM management and other participants in the private student loan business likewise praise the high risk-adjusted returns of the PSL business due to lack of competition. SLM's CEO, Ray Quinlan, discussed the lack of competition in the PSL market at Barclay's conference during the Q&A session on Sept 9, 2014:

> *So in a group [of PSL lenders] where it's really tight, there are some very few competitors in this, this specialized niche, do we want other people to figure out that this is an excellent product and an excellent prospect that is a growth industry? You know, we'd be happy if they never figured that out, Right? ...These are people who have above average incomes, the household income is $80 K to $280 K. These are upper middle class families. These are people [SLM's PSL borrowers] who have taken advantage of the federal grant, they've taken advantage of the discounts and policies. They've taken advantage of scholarships and they are filling in a gap [between the college's cost and the estimated family contribution].*

Another member of SLM's management team has likewise remarked on the attractive margins in the PSL business, noting, "There is a lot of spread in this

business…if they [WFC, DFS, or another PSL lender] lower price, there is no reason to believe we wouldn't follow."

Citizens Financial Group (CFG), which was spun-off from RBS in 2014 has earmarked private student lending as one of its growth areas for loans. CFG management referred to the PSL market on its 1Q15 conference call as follows: "very few people [PSL lenders] playing in the space, very attractive customer [780 FICO], very attractive returns, so just a good marketplace opportunity." Good marketplace opportunities usually don't remain unexploited for very long when capital is seeking attractive risk-adjusted returns. New competition from PSL lenders such as CFG as well as numerous, well funded venture-backed online lenders are poised to compete the risk-adjusted returns in the PSL market down to a more efficient level.

2. New competition is entering the market, including venture-backed players such as SoFi, Earnest, and LendKey. Citizens Financial Group (CFG) and a product from NelNet (NNI) called U-Fi are additional competition.

The high risk-adjusted returns (500 bp + NIM after credit costs) from high credit quality borrowers in the PSL in-school origination market has attracted several well-funded venture-backed companies such as SoFi and LendKey, traditional lenders such as CFG, as well as other competitors with established operations in the student lending market such as Nelnet (NNI).

Social Finance Inc. (SoFi) is a venture-backed PSL marketplace lender that has raised an enormous $360 mm in equity financing at a rumored billion dollar plus valuation and has been profitable since 2014, according to S&P reports on its securitizations (SoFi has already issued four PSL securitizations). SoFi was founded in 2011 by Stanford Business School students and was originally structured as a peer-to-peer lender where Stanford Alumni could make PSL loans to Stanford MBA students at lower than market rates, given the presumed low credit risk associated with lending to a Stanford MBA. SoFi's popularity quickly spread from Stanford's business school to other top schools such as those in the Ivy League, as well as MIT, Duke, Northwestern, Michigan, and Virginia to name a few. SoFi currently originates PSLs to graduate and undergraduate students at 79 top ranked schools in the country. After originating $1.75B in loans from 2011 to 2014, SoFi has moved beyond just student loans and into both mortgages and personal consumer loans. SoFi originated $1B in total loans in the 2Q 15 alone and has said it is on track to originate $4B in loans in 2015. An IPO of SoFi in 2015 has been rumored in the press, but the company has not yet filed an S-1 with the SEC. We expect such an IPO would not only accelerate SoFi's ability to scale its business through increased sales and marketing, but would also raise investor awareness of the competitive threat to SLM's business.

After originally focusing on graduate student in-school loans and on refinancing loans for both graduate and undergraduate students, SoFi launched its first undergraduate loan aimed at students still in school. SoFi's new undergraduate loan product, the SoFi Parent Loan, was launched at the end of April, 2015 and is a direct competitor to PSLs for undergraduates as well as Federal PLUS loans. For credit worthy parent borrowers (such as the 46% of SLM's portfolio with a FICO above 750), the rates on these loans can be meaningfully below the average 8% variable rate charged by SLM (Libor + over 750 bp). SoFi commented in a Jun 26, 2015 press release that it was seeing "increasing demand for parent loans."

Colleges typically are prohibited from the outright recommending of a PSL lender in exchange for any type of compensation, but colleges do often provide students with "preferred lender lists" of PSL lenders from whom other students at the university have successfully borrowed in the past. SLM estimates that 50% of its originations come from the "On-Campus" channel, where SLM is mentioned on a preferred lender list, so appearing on a preferred lender list is important not only for referrals, but also for brand building. The other 50% of SLM's originations comes from the "Direct-to-Consumer" channel (47%, paid search, affiliates, online display ads, direct mail, and e-mail campaigns), and the final 3% comes from the "Partnership" channel (banks and credit unions).

We researched the largest 50 universities in the US based on the number of federal student loan borrowers they had in 2011 (as disclosed in Department of Education data), which should be a decent proxy for students that also need or utilize PSLs. Despite recently launching its first PSL loan product focused on undergraduate students still in school (SoFi's Parent Loan) at the end of April, 2015, SoFi has made good progress in being named on the preferred lender lists at these 50 largest universities by number of borrowers. Universities that don't compile a list of preferred lenders themselves usually direct students to a list of PSL lenders recommended by FinAid.org. SoFi is listed on the PSL lender listed maintained by FinAid.org. Table 3 below shows the penetration of the major PSL lenders on the preferred lender lists of the 50 largest universities by the number of federal student loan borrowers.

Table 3

Preferred Private Lender Lists at Largest 50 Universities by # of Federal Student Borrowers

	Number	Percentage
# Universities with preferred lender list	26	52%
# Universities with no list, but FinAid.org (FA.org) link	3	6%
# Universities with no list, but studentlendinganalytics.com (SLA.com) link	1	2%
# Universities with no list, but link to both FA.org & SLA.com	1	2%
# Universities with no list and no links to lists	19	38%
Total	50	100%

Lender appearance rate on preferred lender lists (26 of 50 universities had lists)

	# Appearances on Lists	Appearance Rate on Lists	On FA.org List	On SLA.com List
Wells Fargo	26	100%	Yes	No
Discover	25	96%	Yes	Yes
Sallie Mae	25	96%	Yes	Yes
Citizens Bank	22	85%	Yes	Yes
PNC	19	73%	Yes	No
Union Federal (funded by SunTrust)	19	73%	Yes	No
SunTrust	18	69%	Yes	No
LendKey (CuScholar)	17	65%	Yes	Yes
IHELP Student Loan (funded by community banks)	7	27%	No	No
Credit Union Student Choice	5	19%	Yes	No
Regions Bank	4	15%	Yes	Yes
Fifth Third Bank	3	12%	No	Yes
SoFi	3	12%	Yes	No
Bank of North Dakota	2	8%	No	No
College Ave Student Loans (funded by Liberty Bank, NA)	2	8%	Yes	No
First Marblehead (funded by SunTrust)	2	8%	No	Yes
U-Fi	2	8%	No	No

Source: OWS research, university websites, www.finaid.org, www.studentlendinganalytics.com

As Table 3 shows, SoFi, after just launching its Parent Loan aimed at in-school undergraduate students only several months ago in April, 2015, is already listed on preferred lender lists at 3 of the 26 largest borrower schools (NYU, U of Pittsburgh, and USC) that have a preferred lender list. CFG has very high penetration (85%), appearing on 22 of the top largest 26 universities that have a preferred lender list, while LendKey also has high penetration (65%) appearing on 17 preferred lender lists.

Citizens Financial Group (CFG), a 1,200 branch regional bank with branches in the northeast and Midwest, opportunistically entered the PSL market in 2009 just as the major banks were starting to retrench from that market. CFG, which is majority-owned by the Royal Bank of Scotland (RBS), has designated student loans as one of its areas of loan growth following its spin-off from RBS in 2014 and its resulting renewed focus on growth. PSLs were CFG's fastest growing loan category in 2014, and they have grown from roughly $100mm in in-school originations in 2010 to $305mm in 2014, which equates to about 3% to 4% origination market share in 2014. CFG management has publicly established the goal of growing its PSL origination business to over 10% market share, noting that the lack of competition has created a "a good marketplace opportunity." To reach this goal, CFG has expanded the number of universities with which it has relationships from 1,100 at the end of 2013, to over 1,300 at the end of 2014,

resulting in very high penetration on the preferred lender lists (85%), as shown in Table 3 above. Given CFG's lower loan rates for high quality borrowers, advantaged low cost of retail deposit funding (relative to SLM's brokered deposits and securitization funding), strong brand awareness (#2 market share bank in New England), and renewed focus on growing its PSL business, we expect SLM to face an increasing competitive threat from CFG in in-school PSL originations in the coming years.

LendKey Technologies is a customer facing online origination platform for PSLs funded by partnering credit unions (CUs) and community banks (CBs). The LendKey platform allows borrowers to fill out an online application for either loans for students currently in school ("in-school loans") or for refinancing loans for students already graduated and then allows them to see a comparison of the actual rates and terms offered to them by LendKey member financial institutions. The participating CUs and CBs find value in the platform not only in the attractive risk-adjusted returns of the PSL market currently, but also because it enables them to acquire a college-educated borrower early in his/her financial life. LendKey, which was founded in 2007, has received backing from top VCs and is said to have originated over $750mm in loans since founding. Our research found that LendKey appeared on a high proportion (65%) of the top 50 universities by student borrowers that had a preferred lender list.

Following a $1B financing commitment announced in April, 2015 by Apollo Investment Group's MidCap Financial subsidiary to purchase PSL refinancing loans from LendKey participating financial institutions, we expect LendKey's market share to expand further. By selling PSL refinancing loans to Apollo's Midcap, LendKey CUs and CBs will free up capital to originate more PSLs while retaining the borrower relationship. This financing commitment with Apollo is essentially creating a secondary market for CU and CB originated PSL refinancing loans, whereas small CUs and CBs standing alone wouldn't have the scale to complete securitizations (which usually require aggregate loan pools in excess of $10mm) or have the resources to manage ongoing whole loan sales. Apollo was attracted to the PSL refinancing market opportunity given that SLM (with 50% to 55% market share in the undergraduate in-school PSL origination market) is getting an 8% yield on its mostly variable rate, high credit quality (748 FICO score) portfolio, leading to a 530 bp credit adjusted NIM and potentially over a 20% ROE. Given refinancing loans are made to students that have already graduated and are likely employed, the annual credit losses are expected to be significantly lower than the 1% level typically modeled by SLM for its predominantly in-school, unseasoned portfolio, so such refinancing loans could have attractive economics even if the yield is lower than the 8% currently charged by SLM.

Nelnet (ticker: NNI) is a $2B market cap publicly traded company whose primary business is owning and servicing legacy FFELP portfolios and servicing post-2010 federal loans directly funded by the US Treasury. NNI's FFELP loan portfolio and servicing business is obviously in run-off, given the underlying FFELP loans are amortizing (albeit slowing due to federal student loan delinquency and defaults). In an effort to replace the shrinking FFELP income stream, NNI has entered the PSL market through the formation of a partnership called U-Fi, and has also made an equity investment in CommonBond in conjunction with a $150mm commitment to purchase loans from CommonBond. CommonBond is a venture-backed online PSL lender initially focused on graduate students at top schools that will be discussed in the next section on refinancing loans.

The U-Fi partnership, formed with the Union Bank and Trust Company, owned by NNI's chairman, launched in 2015, and is already appearing on preferred lender lists at some of the top 50 universities by borrowers, likely due to NNI's existing relationships with universities as a major federal loan servicer. U-Fi makes both in-school and refinancing student loans, so we expect it to both compete against SLM for new in-school loans and to refinance the excessively yielding loans in SLM's portfolio in the coming years, as it diversifies away from its legacy FFELP business.

3. Since it is illegal to have prepayment penalties on private student loans, well-funded new competition has been able to refinance (or "cherry pick") the best credit quality borrowers in the student loan market post-graduation. This completely changes the unit economics of loans made by SLM.

In addition to new competition for in-school originations, SLM is also facing new competitors, both online and traditional lenders, offering refinancing loans for PSLs. New competitors have been able to enter the PSL refinancing market so easily partly because it is illegal to have prepayment penalties on all student loans, both federal and private student loans. As dictated by the 2008 Higher Education Opportunity Act, prepayment penalties on all student loans are forbidden, so when students graduate (a de-risking event for student loans), secure employment, and have several years of credit history, there is a natural reduction in credit risk that should enable them to borrow at a rate lower than the 8% (L + 750) that SLM charged them when they took the loans out as students. Additionally, like most student loans, SLM's loans typically have a six month grace period without any payments immediately following graduation, followed by a 10 year repayment period of both principal and interest, including interest capitalized while the student was in school.

As would be expected, much of the refinancing activity in private student loans has been focused on both students and/or their co-signer parents with high credit scores and on students that are graduates of top universities. Any lender looking to assess credit risk data for student loans has a trove of useful data available from the Department of Education (DOE) regarding cohort 3-year default rates on federal student loans based on the university the borrower attended and the year he/she entered the full principal and interest repayment phase of the loan. This university cohort 3-year default data is another input a lender can factor into its underwriting model in addition to traditional metrics such as credit scores, income, employment status, geography, etc. The cohort 3-year default data released by the DOE shows the 3-year cumulative default rate for graduates that entered repayment during a certain year. For example, the 2011 cohort 3-year default rate for Stanford (where SoFi began) is 1%, which means that, for the 3 years following 2011 (2012, 2013, and 2014), 1% of federal student loan borrowers from Stanford that entered repayment in 2011 defaulted on their loans. The weighted average 2011 cohort default rate for all non-profit public and non-profit private schools is 8.21%. The default rate can vary greatly between universities. For example, the 2011 default rates for Arizona State University and the University of North Texas are 8.5% and 10%. The default rates for borrowers from for-profit schools is much higher, but given that for-profit student borrowers are a very small portion SLM's portfolio, we excluded these from our analysis. Table 4 below shows the 2011 cohort default rates for various types of universities, including some of the top ranked universities on which SoFi initially focused.

Table 4

2011 Repayment Vintage 3-yr Cohort Default Rates for Federal Student Loans

4 year not-for-profit Universities	8.21%
4 year Private, not-for-profit Universities	6.91%
4 year Public, not-for-profit Universities	9.01%
Largest 50 not-for-profit 4 year Universities by # federal student loan borrowers	8.40%
SoFi - 20 Universities that SoFi filed P2P Alumni Funds with the SEC	2.90%
SoFi - 20 Universities above, excluding Purdue	2.31%

Note: The 20 Universities that SoFi had P2P funds filed with the SEC are: Columbia, Dartmouth, Duke, Georgetown, Harvard, MIT, NYU, Northwestern, Purdue, Rice, Stanford, UC - Berkeley, UCLA, U of Chicago, U of Michigan, UNC, Penn, U of Texas - Austin, UVA, and Yale.

Source: Department of Educaiton, OWS Analysis, SoFi filings with SEC.

It is quite easy to see how the new competitors offering refinancing loans have gained traction by first focusing on graduates of certain universities combined with their traditional underwriting metrics.

SLM currently does not have a refinancing loan product, which is logical because with 50% to 55% in-school loan origination market share ($4B + annual originations), it would essentially be refinancing portions of its own loan portfolio. SLM has said that, given that its portfolio has an average FICO of 748 (which is usually the FICO of the co-signer) and 90% of loans have a co-signer, it would be difficult for the student to improve their credit much beyond the 748 level to justify a lower interest rate. SLM management provided this same weak explanation to a question it received on the 1Q15 conference call regarding whether their portfolio was at risk of being refinanced by marketplace lenders such as SoFi.

The faulty logic in arguing that a loan portfolio with a weighted average FICO of 748 doesn't face refinancing risk is that 748 is only the *weighted average of the portfolio*. Thus, there are a meaningful percentage of loans in SLM's portfolio that have FICOs *above* 748. According to disclosures by SLM in the 2014 10-K (p F-30), 46% of its portfolio has FICOs above 750. These are exactly the types of loans that many lenders such as SoFi, LendKey, CFG, and U-FI are interested in refinancing at rates significantly below SLM's average rate of 8%. SoFi, for example, disclosed that the *average fixed rate* (not the variable rate loans SLM offers that expose borrowers to interest rate risk) on a student refinancing loan in its portfolio was 5.88% at 12/31/14. Additionally, if a co-signer is on the hook for co-signing a PSL for his/her child while in school, there is nothing to prevent him/her from co-signing a refinancing loan 2 years after the child graduates in order to save meaningfully on interest. Table 5 below shows the FICO mix of SLM's portfolio at 12/31/2014.

Table 5

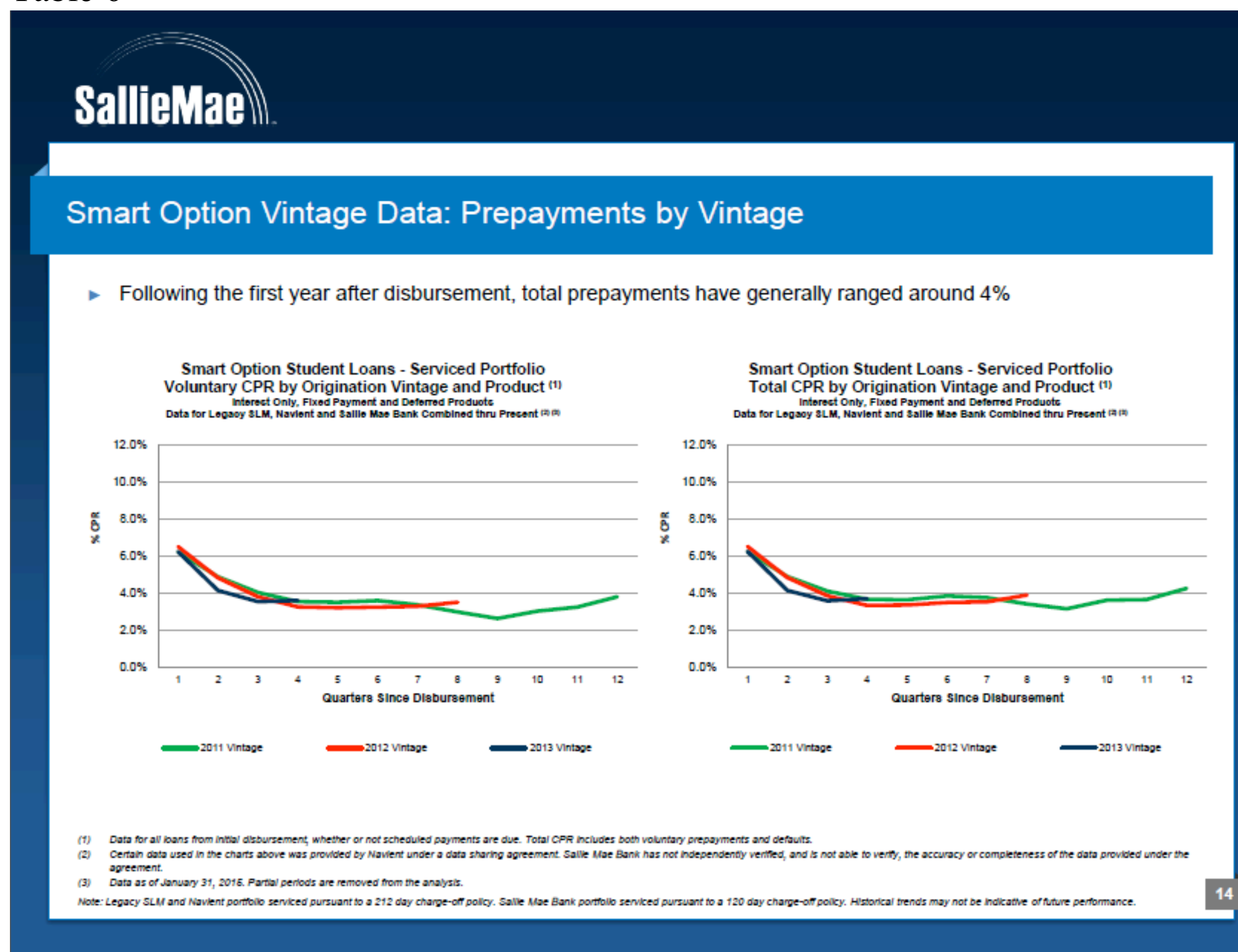
SLM On Balance Sheet PSLs - FICO Mix

Wght Avg FICO at Origination	On Bal Sht at 12/31/14 % Portfolio
750 +	46.00%
700 - 749	32.00%
670 - 699	15.00%
< 670	7.00%
Total	100.00%
Weighted Avg FICO	745

Source: SLM 2014 10-K, pp 2, F-30.

Prepayment speeds in the two securitizations SLM has issued since the May 2014 spinoff have also been running at higher than usual levels. Prepayments include both voluntary repayments of principal by borrowers in excess of what is contractually due (extra payments) and refinancings by third party lenders. SLM included a slide in its April 6, 2015 Investor Presentation (p 14) that shows that the Constant Prepayment Rate (CPR), which is annualized prepayments as a percentage of principal, typically ran at about 6% one quarter after the loan was disbursed and would usually drop down to a 4% or lower rate three quarters after disbursement for its 2011, 2012, and 2013 vintages of loan disbursements. The rationale given by SLM for this prepayment phenomenon is that some students take out loans for their senior year and are able to make extra payments once they graduate, get a job, and potentially receive a signing bonus. Table 6 below shows this SLM slide on CPR rates for the 2011 to 2013 vintages (from when the loan was disbursed). The left side chart shows the Voluntary CPR (excluding defaults), while the right side chart shows the Total CPR (including defaults)

Table 6



Source: SLM April 6, 2015 Investor Presentation, p 14

We analyzed data from SLM's first securitization after the spin-off, its 2014-A securitization completed in August, 2014. While the weighted average FICOs of the PSLs included in the 2014-A was similar to the that of SLM's on-balance sheet loans at 12/31/14 (746.6 vs. 745), the 2014-A securitization has a higher mix of very high FICO loans, with 53.3% of loans having a greater than 750 FICO versus only 46% for SLM's on-balance sheet portfolio. These high credit quality, 750 FICO plus loans are likely refinancing candidates. Similarly, the 2014-A securitization only has 5% of loans with FICOs less than 670, whereas the on-balance sheet portfolio has 7% of such loans. These lower FICO loans are less likely to be able to refinance to a lower rate. Table 7 below shows the different FICO mix for SLM's on-balance sheet portfolio at 12/31/14 versus the 2014-A securitization, despite SLM management maintaining the securitization is a cross-section of its on-balance sheet portfolio.

Table 7

SLM On Bal Sht PSL Portfolio vs. Securitization - FICO Mix

Wght Avg FICO at Origination	On Bal Sht at 12/31/14 % Portfolio	Securitization: 2014-A % Portfolio	Difference
750 +	46.00%	53.29%	7.29%
700 - 749	32.00%	26.99%	(5.01%)
670 - 699	15.00%	14.63%	(0.37%)
< 670	7.00%	5.08%	(1.92%)
Total	100.00%	100.00%	
Weighted Avg FICO	745	746.6	1.6

Source: SLM 2014 10-K, pp 2, F-30. SLM 2014-A Replines, available online:
https://www.salliemae.com/about/investors/asset-backed-securities/smb/2014-a/

While SLM maintains that its 2011 to 2013 vintages of loan originations typically had approximately 6% prepayment speeds one quarter after disbursement, dropping down to 4% three quarters after disbursement (as shown in Table 6), the loans in the 2014-A securitization had prepayment speeds running around 7% one quarter after issuance of the securitization, and remaining at the 6.25% level three quarters after issuance of the securitization. This is likely even underestimating the elevated prepayment speeds in the 2014-A securitization given that the loans in the securitization were disbursed some time before the issuance of the securitization, so they should be more seasoned and thus have a lower prepayment rate. SLM's more recent securitization, the 2015-A issued in April, 2015, while there is only one month of prepayment speed data, has a prepayment speed in that first month (June 2015 servicer report) of 8.67% vs. the 7.21% seen in the 2014-A securitization. Clearly higher FICO score loans are now subject to greater refinancing risk than SLM's 2011 to 2013 origination vintages due to the emergence of the online refinancing lenders as well as traditional lenders such as CFG, which only just introduced its refinancing product in January 2014.

SLM has attempted to provide data to investors relating to the refinancing activity for its on-balance sheet portfolio. The table titled "Education Loan Activity" disclosed in SLM's 2014 10-K on page 47 breaks out "Loan consolidation to third parties" so investors can track refinancings. While such a disclosure is clearly appreciated, its usefulness in tracking refinancing activity is diminished by SLM selling higher credit quality loans into its securitizations that have same weighted average FICO (2014-A securitization had 53.3% loans > 750

FICO while on-balance sheet loans > 750 FICO is only 46%) but with higher standard deviations (as discussed above) and by the fact that SLM's on-balance sheet portfolio is unseasoned, as it has only 28% of loans in the full principal and interest repayment phase (begins after 6 month grace period following graduation) as of 12/31/2014. Loans are likely to be refinanced after a student graduates and secures employment, not while he/she is still in school. It is also important to note that SLM's unseasoned portfolio is not experiencing normalized credit losses, given that approximately 66% of charge-offs typically occur within three years of the start of the repayment phase, according to SLM, and 72% of SLM's on-balance sheet portfolio has not entered the repayment phase.

As competition in the PSL refinancing market continues to cherry pick the best credits from SLM's portfolio for refinancing, the remaining loans in SLM's portfolio will be those borrowers that are unable to refinance and that collectively should make up a large amount of defaults. We expect that SLM's delinquency and default metrics will increase when measured as a percentage of SLM's portfolio that is losing high credit quality loans in the denominator. The competitors that we expect to have the biggest impact in the PSL refinancing market are SoFi, Earnest, CommonBond, U-Fi, CFG, and LendKey. We'll give a brief overview of each competitor's traction in the PSL refinancing market below.

SoFi has moved beyond its Stanford roots to now being a lender to students at 79 top universities. SoFi's initial success in both in-school and refinancing loans was aided by not only its word-of-mouth popularity for being able to save borrowers interest on their loans, but also by its $100 referral fee program. SoFi has begun marketing its refinancing loans to companies to be offered as a benefit for their employees. According to several LinkedIn profiles for Directors of Business Development at SoFi, current companies that have signed up to offer or inform their employees about SoFi refinancing loans include Facebook, Intel, Amazon, Goldman Sachs, DLA Piper, Bain & Co, Bloomberg, Deloitte, and Barclays. Given that one of the key credit risks for student loans is that students are unable to find a well-paying job post-graduation, we view this as a brilliant marketing move on SoFi's part, in that it targets a large number of eligible and employed student loan borrowers that are prime refinancing candidates. SoFi has also begun marketing through some of the alumni associations of the 79 top universities where it focuses its lending.

Earnest, Inc. is a venture-backed online student refinancing lender that allows potential borrowers to provide non-transactional access to their financial accounts to Earnest to demonstrate financial responsibility and allow Earnest to verify balances in order to qualify for lower interest rates. Potential borrowers can link their bank accounts, credit cards accounts, home loans, student loans, and asset accounts to Earnest so that, in its underwriting process, Earnest can view

direct deposit payroll transactions and verify balances. High credit quality borrowers will self-select providing the increased information disclosure to Earnest to receive lower interest rates similar to how car insurance customers agree to GPS (speed) tracking in exchange for a lower car insurance premium. Earnest has strong fundraising momentum, having raised $32mm in venture funding from top VCs in two rounds since May, 2014 after being founded in 2013. Earnest, which currently focuses only on refinancing student loans and personal loans, has stated that it is on track to hit an annual $1 B run-rate in loan originations by the end of 2015.

CommonBond, like SoFi, has its roots as a peer-to-peer lender for top MBA students, as it was founded by Wharton graduate students as a way for Wharton alumni to lend to Wharton MBA students at rates more favorable than in the marketplace. CommonBond has raised over $250mm in equity and debt financing and recently completed its first securitization for $100mm at the end of June, 2015. Nelnet (NNI) was an equity investor in CommonBond's last equity round and also committed to purchase at least $150mm in loans originated on the CommonBond platform. We view Nelnet's interest in CommonBond as potentially strategic given it needs growing revenue streams to offset the run-off of its FFELP loan portfolio and servicing business. While CommonBond's originations to date since its founding in late-2011 have only been about $200mm, as, originally, it narrowly focused on lending to students the top 20 MBA programs, following its last financing round and loan purchase commitment from NNI, CommonBond has said it will expand its lending to both undergraduate and graduate students from 700 universities. The interest rates advertised on CommonBond's website currently are 1.94% to 4.93% for variable loans and 3.74% to 6.49% for fixed loans, in both cases meaningfully below SLM's average 8% yield on its PSL portfolio.

While Nelnet's (NNI) U-Fi partnership only recently launched in 2015 in both the PSL in-school and refinancing markets, U-FI's market share could be meaningful given NNI's established presence and relationships in the student lending market as a major servicer. As we mentioned in the last section, our research found U-Fi already appearing on some preferred lender lists at universities despite only being just launched. When the U-Fi product launch is considered in conjunction with Nelnet's equity investment in and financing commitment to CommonBond, the PSL market appears to be where NNI is focusing its diversification efforts to offset the decline of its legacy FFELP loan business.

After launching its PSL refinancing product in January, 2014, CFG originated $230mm in refinancing loans in the product's first year during 2014. The $230mm in refinancing loans CFG originated in 2014 had a weighted average FICO of 786, which is slightly higher than the weighted average FICO of 779 for its in-school PSLs originated in 2014. In a September 16, 2014 press release

announcing a second student loan product that refinances both a federal and a private student loan into one loan, CFG commented that its PSL refinancing product had lowered borrowers monthly payments by $127 and lowered their APR by 1.5%. CFG management, when discussing the favorable conditions in the PSL market and its growth plans in the area, has commented that the yields on its PSLs are about 5.5%, so it's not difficult to see CFG saving PSL borrowers 1.5% on their rate given SLM is typically charging them 8% currently.

LendKey, the PSL origination platform for credit unions (CUs) and community banks (CBs), has a presence in both the PSL in-school and refinancing markets. LendKey's refinancing product is likely aided by the brand awareness it has generated from appearing on many preferred lender lists for its in-school PSL loan product (appeared on 65% of the top 50 universities by student borrowers that had preferred lender lists). The $1B financing commitment from Apollo's Midcap Financial is specifically earmarked for refinancing and consolidation loans. Having a secondary market to which to sell refinancing loans should enable LendKey member CUs and CBs to free up balance sheet capacity and increase the volume of their PSL refinancing originations.

4. Part of the existing demand for private student loans is suboptimal and may not be sustainable if borrower awareness of federal student loan options is improved.

As there are no underwriting requirements to receive a federal student loan, student borrowers should be strongly encouraged to utilize all of their available federal student loan borrowing capacity before taking out a PSL, since federal loans are at a fixed interest rate that is likely to be meaningfully lower than a PSL (4.29% fixed for a Federal Direct Loan for the 2015/16 academic year vs. ~ 8% average yield on SLM's PSL portfolio), and federal loans have more lenient forbearance options than PSLs. A study by The Institute for College Access & Success found that 47% of PSL borrowers have untapped federal student loan borrowing capacity available. This suggests that some of the demand for PSLs, including those originated by SLM, which has over 50% market share, is suboptimal, and could decline if student borrowers were better informed of their federal student loan borrowing options.

The specifics of the analysis by the Institute for College Access & Success on PSL borrowers' untapped federal borrowing capacity found that 19% of PSL borrowers had no federal student loans at all, and 28% had federal loans, but they didn't fully reach the federal loan limits before they decided to take out a private student loan. Of the 19% that took out no federal student loans, 8% did not apply for financial aid and 11% did apply for financial aid, but didn't take out a federal loan. Research on the topic suggests that students and their families that apply for

PSLs without fully utilizing federal student loans do so because they are unaware or misinformed about the differences between federal and private student loans.

Legislation known as "Know Before you Owe Private Student Loan Act of 2013" has been introduced in both the House (HR 3612) and the Senate (S. 113) that would require colleges and universities to certify the amount needed by a student borrower when factoring in the difference between the cost of attendance and the student's estimated financial assistance (scholarships, grants, federal student loans, and work study). More importantly, before a college provides a PSL lender with such certification, the proposed legislation requires the college to analyze whether the student has fully tapped his/her federal student loan availability and to notify the student if there is any such availability left. The legislation also mandates borrower protections such as giving the borrower 30 days to accept or reject a loan after the initial loan approval and another 3 business days to cancel the loan after it is signed. The legislation was referred to the House Subcommittee on Higher Education and Workforce Training on January 22, 2014. While it is difficult to assess the timing of when such legislation will be passed, it is clear that there is at least legislative awareness that some student borrowers are being sold loan products that are not in their best interest.

Some colleges and universities have taken it upon themselves to educate students of the disadvantages of PSLs relative to federal student loans, and, while such efforts can be deemed effective in certain cases, they are not yet widespread, so there could be a reduction in PSL demand as more colleges internally address the issue. Barnard College is said to have reduced its private student loan volume by 75% ($1.6 mm 2005/06 to $0.4 mm in 2006/07 by requiring student borrowers to have a counseling session about their federal student loan availability before the college would complete a certification request from a PSL lender. San Diego State University initiated in 2010 a requirement that student borrowers complete an online counseling session on PSLs and complete a Free Application for Federal Student Aid (FAFSA) before they will certify a PSL. Additionally, San Diego State will only certify PSLs based on whether the student maxed out his/her federal student loan availability. Results from the initiative show that the university was able to reduce by 50% the number of students that move forward with a PSL after requesting certification. As similar efforts by other colleges and universities are either adopted voluntarily or are mandated by legislation, we expect that some of the existing demand for PSLs will be eliminated.

5. "Street" earnings estimates, which call for 19.2% and 20% EPS growth in 2016 and 2017 may be too high, given the new competition. Moreover, SLM's expected portfolio mix should shift to lower credit quality borrowers.

Following the spin-off of its loan management and servicing company, Navient, on May 1, 2014, SLM management has positioned SLM as a high growth consumer banking business with long-term earnings growth in excess of 20% and an ROE greater than 15%. The "street" seems to agree, and doesn't appear to be factoring in the threat from new competition. Consensus earnings estimates show EPS growth of 19.2% and 20% in FY16 and FY17. The one question that has been asked of SLM management on its conference calls (1Q15) regarding new competition was dismissed by management using the rationale that their borrowers couldn't improve their credit profile above their 748 weighted average FICO to justify a lower rate through refinancing. We discussed earlier why this *weighted average* FICO rationale is flawed, given that 46% of SLM's portfolio has a FICO greater than 750.

Given the increase in competition from multiple well-financed competitors in both the in-school and refinancing portions of the PSL market, we expect SLM's originations to come in at $4.281 B for 2015, just shy of management guidance of $4.3 B, but then to decline by (6.26%) in 2016 to $4.013 B. Competition from refinancing lenders, which is further along, should have a larger impact than competition in in-school originations. We estimate that $132.7mm of SLM's portfolio could be refinanced by third parties in 2015 (5.18% of loans in full principal and interest repayment phase), increasing to $403.3mm in 2016 (13.8% of loans in repayment phase). The average yield on the portfolio should gradually drift down on SLM's portfolio from 8.07% in 1Q15 to 7.99% 4Q16 as SLM is forced to lower its rates on its loans to stave off competition. The estimated earnings impact from this new competition would result in 2015 GAAP EPS of $0.569, which is (3.06%) lower than consensus of $0.587 and 2016 GAAP EPS of $0.64, (8.57%) lower than consensus of $0.70.

We expect that as SLM management sees increasing competitive pressures mount they may try to offset its market share losses in the high credit quality segment of the market by lowering credit standards and by approving lower credit quality applicants. SLM management states in its investor presentations that it rejects 65% of applicants, which suggests it could try to mask the market share losses by lending to applicants that previously would have been rejected. Due to the payment mechanics of PSLs, where a borrower doesn't start paying back the principal and interest of the loan until 6 months after he/she graduates or starts to attend school less than half-time, SLM could increase its lending to less credit worthy borrowers without having to reserve for credit losses for as long as 4 or 5 years after the initial loan disbursement. SLM's credit reserving policy is to build its Allowance for Loan Losses to cover expected credit losses in the next twelve months, and delinquent loans are charged off once they are 120 days past due. So, a loan to a lower credit quality borrower at the beginning of his/her freshman year wouldn't need a Provision for Loan Loss run through the income statement until

4.5 years later when the borrower graduates and exits the 6 month grace period for repayment. While we are not suggesting SLM management will use a low credit quality, unseasoned loan growth approach to maintain market share, we do point out the risk that it could do so, and we will be monitoring the overall FICO of the portfolio for insight into the stability of the lending standards.

Whether due to competitors cherry picking SLM's best quality loans for refinancing and/or due to SLM management is originating more lower credit quality loans to combat market share losses, we expect the overall portfolio credit loss quality of SLM's loan portfolio to decline and to start to more closely resemble that of a credit card lender, leading to increased earnings volatility. SLM currently trades at 13.9x consensus 2016 GAAP EPS of $0.70 (OWS est. $0.64), while credit card lenders such as Capital One Financial (COF), and Discover (DFS, which has 12.5% of its loan portfolio in student loans) trade at 11.06x and 10.21x consensus 2016 GAAP EPS. If we were to apply a 10.6x multiple (avg of COF & DFS) to our FY16 GAAP EPS estimate of $0.64 to SLM, that results in our price target of $6.78, which is 30.4% lower than SLM's current price of $9.74. On a tangible book value basis, SLM is also much more expensive than COF and DFS, since it is currently trading at 3.25x its tangible book value of $3.00 (after accounting for $565 mm in preferred stock) versus 1.57x and 2.55x for COF and DFS. If SLM traded at 2.06x tangible book (avg of COF and DFS), that would yield a $6.18 value for SLM, which represents 36.6% downside for SLM shares.

6. Recent Results

SLM reported 1Q15 GAAP EPS of $0.10 that beat consensus estimates of $0.07. The beat was primarily driven by lower provision for loan losses, as credit trends proved better than the previous guidance. Following the improvement in credit trends, SLM management lowered its FY15 provision for loan loss guidance to $95 mm, down from $116mm to $130mm.

SLM also updated other elements of its guidance during the 1Q15 earnings release. While the 2015 PSL origination guidance for FY15 was unchanged at $4.3B (5.2% growth over FY14), SLM raised the gain-on-sale (GOS) margin on its planned $1.5B in loan sales to 10.5%, up from the 7.5% achieved on its single securitization in 2014. This is due to stronger than expected demand for its PSLs in the securitization market, including for the residuals or equity portion, which SLM has been selling. Apparently both credit and equity investors in the securitization market have not adjusted their models for higher prepayment speeds that we expect given the new competition that is refinancing PSLs. As we noted previously, the prepayment speeds in SLM's first securitization, 2014-A, issued last August have been running higher than the what SLM says is typical in its 2011 to 2013 vintage loan disbursements. Of the $1.5B in securitizations planned for

2015, a $753mm securitization was priced in the 2Q15 with a 10.5% GOS and another securitization for a similar amount is expected to take place in the 3Q15, also with a 10.5% GOS. As the trend of refinancing PSLs continues, we expect the GOS margins on SLM's first securitization in 2016 to be 9.5%, and dropping further to 9% for the second securitization in 2016.

The final item in SLM's updated guidance was FY15 operating expenses of $340mm and restructuring charges related to the spin-off of $7mm, up from previous guidance for operating expenses of $325mm. Overall, the lower provision for loan losses and higher GOS margins guided were more than enough to offset the higher operating expenses, so SLM management raised guidance for FY2015 "CORE" EPS to $0.57 to $0.59, up from $0.48 to $0.50. SLM's definition of "CORE" EPS takes GAAP EPS and factors in the net impact of derivative accounting (on interest rate derivatives) and its associated net tax effects.

7. OWS Financial Assumptions

1. SLM's Private Education Loan Y/Y origination growth projected to be 4%, 2%, and 0% in the 2Q15, 3Q15, and 4Q15, resulting in total FY15 originations of $4.281B, which is 4.75% Y/Y growth for FY15, and is just shy of SLM management guidance of $4.3B. FY16 Private Education Loan origination growth is (5%), (6%), (7%), and (8%) for 1Q16, 2Q16, 3Q16, 4Q16, resulting in total FY16 originations of $4.013B, which is (6.26%) decline from 2015.
2. Private Education Loans – Sales (includes both whole loan sales and securitizations) are modeled to be: 2Q15 – $753.3mm (securitization), 3Q15 - $749.6mm (securitization), 4Q15 - $7.9mm (whole loan sale), for a full year FY15 total of $1.517B. For FY16, sales are modeled to be: 1Q16 - $7mm (whole loan sale), 2Q16 - $750mm (securitization), 3Q16 - $750mm (securitization), and 4Q16 - $8.7mm (whole loan sale), for full year FY16 total sales of $1.519B
3. Private Education Loans - Loan consolidations to third parties is a line item disclosed in SLM's 10-K (2014 10-K, p 47) and 10-Q (1Q15 10-Q, p 42) in a table titled Education Loan Activity. It represents third party loan refinancings that are separate from contractual repayments and voluntary prepayments by borrowers for the on-balance sheet portfolio. Loan consolidations to third parties is modeled to be $29.1mm, $40.9mm, and $58.3mm in 2Q15, 3Q15, and 4Q15, for a FY15 total of $132.8mm. For FY16, loan consolidations to third parties are modeled to be $79.6mm, $100.6mm, $104.1mm, and $118.9mm in 1Q16, 2Q16, 3Q16, and 4Q16, for a full year FY16 total of $403.3mm.

4. Private Education Loans - Repayments & Other is a line item disclosed in SLM's 10-K (2014 10-K, p 47) and 10-Q (1Q15 10-Q, p 42) in a table titled Education Loan Activity. Repayments & other is modeled to be $291mm, $277.1mm, and $301mm in 2Q15, 3Q15, and 4Q15, for a FY15 total of $1.105B. For FY16, repayments & other are modeled to be $313.4mm, $357.9mm, $338.5mm, and $356.7mm in 1Q16, 2Q16, 3Q16, and 4Q16, for a full year FY16 total of $1.366B.
5. The FFELP loan portfolio continues to amortize and there are no acquisitions of FFELP loans. The period end FFELP loan balances for the 2Q15, 3Q15, 4Q15, 1Q16, 2Q16, 3Q16 and 4Q16 are $1.152B, $1.1B, $1.05B, $1.004B, $960.4mm, $919.6mm, and $880.2mm.
6. The yields on the Private Education Loan portfolio for 2Q15, 3Q15, 4Q15, 1Q16, 2Q16, 3Q16, and 4Q16 are estimated to be 8.05%, 8.04%, 8.03%, 8.02%, 8.01%, 8%, and 7.99%. The yield on the FFELP loan portfolio, taxable securities, and cash and short term investments stays constant from 2Q15 to the 4Q16 at 3.19%, 2.71%, and 0.25%, respectively.
7. The interest rates paid on Brokered Deposits go up 1 bp per quarter from 1.19% in the 2Q15 to 1.25% in the 4Q16. The interest rates paid on Retail & Other deposits also goes up 1 bp per quarter from 0.94% in the 2Q15 to 1.00% in the 4Q16. The interest rate paid on Other interest-bearing liabilities stays constant at 0.60% from 2Q15 to 4Q16.
8. Provision for Loan Losses are $23mm , $33mm, and $25mm for the 2Q15, 3Q15, 4Q15, and $97.618mm for full year FY15. For FY16, Provision for Loan Losses are $34mm, $23mm, $35mm, and $25mm in the 1Q16, 2Q16, 3Q16, and 4Q16, for full year FY16 of $117mm.
9. Gains on sales of loans, net are $78mm (10.5% GOS margin), $78.7mm (10.5% GOS margin), and zero in the 2Q15, 3Q15, and 4Q15, for full year FY15 Gain on sale on sale of loans of $156.7mm. For FY16, the gain on sale is zero, $71.6mm (9.5% GOS margin), $67.5mm (9% GOS margin), and zero in the 1Q16, 2Q16, 3Q16, and 4Q16, for a full year FY16 of $138.7mm.
10. Other Income, which is primarily Upromise, is modeled to be $9mm, $6mm, and $11.5mm for 2Q15, 3Q15, and the 4Q15, for a full year FY15 of $34.5mm. For FY16, Other Income is modeled to be $8.25mm, $9.27mm, $6.18mm, and $11.85mm for 1Q16, 2Q16, 3Q16, and 4Q16, for full year FY16 of $35.5mm.
11. Total operating expense are modeled to be $85mm, $86mm, and $89.5mm for the 2Q15, 3Q15, and 4Q15, for a full year FY15 total of $341.7mm. For FY16, total operating expenses are modeled to be $83.5mm, $85mm, $86mm, and $89.5mm for 1Q16, 2Q16, 3Q16, and 4Q16, for a full year FY16 total of $344mm.
12. There are projected to be $2.5mm of restructuring charges in the 2Q15.
13. The tax rate is assumed to be 40%, in-line with management guidance.

14. $4.85mm of preferred dividends are paid per quarter.
15. The diluted share count stays at 432.3mm shares. SLM is unlikely to launch a stock buyback ahead of its July, 2016 stress test, so any change in share count would come from option issuance.

8. Risks

Although most of the big banks (BAC, C, and JPM) exited the PSL market from 2009, there is the risk that another bank views the current high returns of the PSL market favorably and acquires SLM. A bank with a decent size branch network and a retail deposit base could potentially sell PSLs into its customer base and lower SLM's cost of funding. Given the proliferation of online lending competition in the PSL market and given that there are no significant barriers to entry in the Direct-to-Consumer channel of the PSL market, this risk should be mitigated by SLM's high multiple to tangible book value (over 3.25x) and the long-term impact from new competition.

Given that SLM is arguably overcapitalized, having a Tier 1 Capital to Risk Weighted Assets (RWA) of 13.6% at March 31, 2015 versus the 8% level required to be deemed "Well Capitalized" by its regulators, there is the chance that SLM returns capital to shareholders. If SLM were to go to 10% Tier 1 Capital to RWA, it could return $390mm to shareholders (9.27% of its current market cap), while at 8% Tier 1 Capital to RWA (the regulatory minimum for "Well Capitalized"), it could return $608mm to shareholders (14.45% of market cap). SLM currently does not pay a dividend and does not have a stock buyback authorized. SLM has been trying to abide by an FDIC annual asset growth limit of 20% by securitizing its excess loan origination growth to stay under that limit. In order to grow its balance sheet so that the 20% asset growth limit is based on a larger starting asset number, SLM has said it will retain all capital from earnings so that it can support a higher asset base longer term. In the near term, the risk of a return of cash to shareholder is also likely mitigated by the fact that SLM will be undergoing its first regulatory "Stress Test" in July, 2016, given its asset size, and has indicated that it would be unlikely to ask regulators to return capital to shareholders prior to completing the stress test.

As PSL demand is tied to the availability of other financing alternatives, such as more advantageously priced federal student loans, if federal student loan limits were to decline or grow slower than college tuition costs, there could be increased demand for PSLs.

Likewise, if college tuition costs were to grow faster than federal student loan limits, scholarships, grants, and work-study limits, the residual funding needs could result in increased demand for PSLs. College price inflation has been a

widely discussed national issue, since, according to The College Board, average published tuition and fees (excluding room and board) at four-year public and private not-for-profit institutions increased at a CAGR of 6% and 4.5% between academic years 2004/05 and 2014/05. Growth in college tuition costs more recently in the last two academic years has slowed to 2.8% (public) and 3.9% (private) in 2013/14 and to 2.9% (public) and 3.7% (private) in 2014/15. Due to the high amounts of student debt and the difficulty some students have had in obtaining employment after they graduate, there is heightened sensitivity to college price inflation that has helped to moderate tuition increases.

9. Financial Projections

Qtrly Income Statement ($ mils)	1Q15a	2Q15e	3Q15e	4Q15e	1Q16e	2Q16e
Total Interest Income	201.4	201.5	198.8	212.9	237.5	230.0
Total Interest Expense	30.4	27.9	28.6	31.5	34.3	33.6
Net Interest Income (NII)	171.0	173.5	170.2	181.4	203.2	196.4
Provision for Loan Losses (PLL)	16.6	23.0	33.0	25.0	34.0	23.0
Net Interest Income after PLL	154.3	150.5	137.2	156.4	169.2	173.4
Gains on sales of loans, net	0.0	78.0	78.7	0.0	0.0	71.6
Gains (losses) on derivs & hedges	3.3	0.0	0.0	0.0	0.0	0.0
Other non-interest income	8.0	9.0	6.0	11.5	8.2	9.3
Total non-interest income	11.3	87.0	84.7	11.5	8.2	80.8
Compensation & benefits	41.2	43.0	43.5	45.5	43.5	43.0
Other operating expenses	40.0	42.0	42.5	44.0	40.0	42.0
Total operating expenses	81.2	85.0	86.0	89.5	83.5	85.0
Acq intangible asset amortization	0.4	0.5	0.5	0.5	0.5	0.5
Restructuring & reorg expense	4.7	2.5	0.0	0.0	0.0	0.0
Pre-tax income	79.4	149.5	135.4	77.9	93.4	168.7
Income taxes	31.7	59.8	54.1	31.2	37.4	67.5
Net income attributable to SLM	47.7	89.7	81.2	46.8	56.0	101.2
Preferred stock dividends	4.8	4.9	4.9	4.9	4.9	4.9
Net income attrib. to SLM common	42.9	84.9	76.4	41.9	51.2	96.4
Diluted EPS	0.099	0.196	0.177	0.097	0.118	0.223
F.D. Shares	432.3	432.3	432.3	432.3	432.3	432.3

Y/Y % Change	1Q15a	2Q15e	3Q15e	4Q15e	1Q16e	2Q16e
Total Interest Income	24.4%	21.7%	18.2%	19.2%	17.9%	14.2%
Total Interest Expense	34.3%	32.8%	18.4%	12.6%	12.8%	20.4%
Net Interest Income	22.8%	20.1%	18.2%	20.4%	18.8%	13.1%
Provision for Loan Losses (PLL)	(57.6%)	2168.2%	121.5%	(17.9%)	104.6%	0.0%
Total non-interest income	(72.6%)	1030.0%	(11.8%)	(6.6%)	(27.0%)	(7.1%)
Total operating expenses	27.5%	40.5%	19.3%	16.7%	2.8%	0.0%
Net income attrib. to SLM common	(9.6%)	107.5%	(2.2%)	181.9%	19.4%	13.5%
Diluted EPS	(9.1%)	106.8%	(2.3%)	181.8%	19.4%	13.5%

As a % of Revenue*	1Q15a	2Q15e	3Q15e	4Q15e	1Q16e	2Q16e
Revenue (NII + Non-interest income)*	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Net Interest Income	93.8%	66.6%	66.8%	94.0%	96.1%	70.8%
Non-interest Income	6.2%	33.4%	33.2%	6.0%	3.9%	29.2%
Provision for Loan Losses (PLL)	9.1%	8.8%	12.9%	13.0%	16.1%	8.3%
Total Operating Expenses	44.5%	32.6%	33.7%	46.4%	39.5%	30.7%
Pre-tax income	43.6%	57.4%	53.1%	40.4%	44.2%	60.9%
Tax Rate	39.9%	40.0%	40.0%	40.0%	40.0%	40.0%
Net income attributable to SLM	26.2%	34.4%	31.9%	24.2%	26.5%	36.5%
Preferred stock dividends	2.6%	1.9%	1.9%	2.5%	2.3%	1.7%
Net income attrib. to SLM common	23.5%	32.6%	30.0%	21.7%	24.2%	34.8%

* Revenue is net interest income plus non-intereset income, excluding provision for loan losses.

Annual Income Statement ($ mils)	FY14a	FY15e	FY16e
Total Interest Income	674.3	814.6	920.5
Total Interest Expense	95.8	118.5	139.4
Net Interest Income (NII)	578.5	696.1	781.1
Provision for Loan Losses (PLL)	85.5	97.6	117.0
Net Interest Income after PLL	493.0	598.5	664.1
Gains on sales of loans, net	121.4	156.7	139.0
Gains (losses) on derivs & hedges	(4.0)	3.3	0.0
Other non-interest income	39.9	34.5	35.5
Total non-interest income	157.3	194.5	174.6
Compensation & benefits	129.7	173.2	175.5
Other operating expenses	143.2	168.5	168.5
Total operating expenses	273.0	341.7	344.0
Acq intangible asset amortization	5.2	1.9	2.0
Restructuring & reorg expense	38.3	7.2	0.0
Pre-tax income	333.8	442.2	492.7
Income taxes	140.0	176.9	197.1
Net income attributable to SLM	194.2	265.4	295.6
Preferred stock dividends	12.9	19.4	19.4
Net income attrib. to SLM common	181.3	246.0	276.2
Diluted EPS	0.419	0.569	0.639
F.D. Shares	432.2	432.3	432.3

Y/Y % Change*	FY14a	FY15e	FY16e
Total Interest Income	NA	20.8%	13.0%
Total Interest Expense	NA	23.7%	17.7%
Net Interest Income	NA	20.3%	12.2%
Provision for Loan Losses (PLL)	NA	14.1%	19.9%
Total non-interest income	NA	23.7%	(10.3%)
Total operating expenses	NA	25.2%	0.7%
Net income attrib. to SLM common	NA	35.7%	12.3%
Diluted EPS	NA	35.7%	12.3%

* N/A due to spin-off of NAVI

As a % of Revenue*	FY14a	FY15e	FY16e
Revenue (NII + Non-interest income)*	100.0%	100.0%	100.0%
Net Interest Income	78.6%	78.2%	81.7%
Non-interest Income	21.4%	21.8%	18.3%
Provision for Loan Losses (PLL)	11.6%	11.0%	12.2%
Total Operating Expenses	37.1%	38.4%	36.0%
Pre-tax income	45.4%	49.7%	51.6%
Tax Rate	41.9%	40.0%	40.0%
Net income attributable to SLM	26.4%	29.8%	30.9%
Preferred stock dividends	1.8%	2.2%	2.0%
Net income attrib. to SLM common	24.6%	27.6%	28.9%

* Revenue is NII plus non-intereset income, excluding PLL.

10. Financial Metrics

($ mils)	At 3/31/15
Total Assets	12,993.5
Available for sale investments	170.8
Loans held for investment, net of 89.8 ALL	10,909.0
Accrued interest receivable	541.4
Deposits	10,467.8
Book Value	1,865.9
Series A Preferred Stock	165.0
Series B Preferred Stock	400.0
Book Value available to Common	1,300.9
Acquired intangible assets, net	2.9
Tangible Book Value avail to Common	1,298.1
Tangible Book Value - Common - Per share	*3.00*
Price/Tangible Book Value	3.2x
Share Price	9.74
FD Shares	432.3
Equity Market Capitalization	4,210.6
OWS 2015 EPS	0.569
OWS 2016 EPS	0.639
2015 P/E - OWS Est.	17.1x
2016 P/E - OWS Est.	15.2x
Consensus 2015 EPS	0.587
Consensus 2016 EPS	0.700
2015 P/E - Consensus	16.6x
2016 P/E - Consensus	13.9x