

From: Jeffrey Epstein <jeevacation@gmail.com>
To: "Barrett, Paul S" <paul.s.barrett@jpmorgan.com>
Subject: Re: To Do -
Date: Tue, 02 Oct 2012 17:42:16 +0000

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On Tue, Oct 2, 2012 at 1:21 PM, Barrett, Paul S <[REDACTED]> wrote:

Jeffrey

For Haze, we have \$5MM in the JPM High Yield Bond Fund. The SEC yield on that fund has come down to 5.60%. I think we should sell \$1.5MM of that position and:

- Buy \$1MM of the Kindred Healthcare bond from yesterday (ytm 8.25%)
- Buy \$500K of the iPayment 10.25% 2018 (yield 12.70%)

Let me know

Paul

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- iPayment, Inc. provides financial transaction processing services. The company's payment processing services enable merchants to accept credit cards, debit cards, checks, and gift cards as forms of payment for swipe transactions as well as card-not-present transactions that are conducted over the internet or phone. The Company offers credit and debit card-based payment processing services, including, card authorization, data capture, settlement, merchant accounting, risk management, fraud detection, merchant assistance, support, and charge-back services. iPayment serves merchants throughout the United States.

- The company focuses on small businesses, which results in a higher failure rate, but acquiring new customers remains a priority and their business is very scalable

- They have 190,000 customers (130,000 of which are considered very active)
- No single merchant accounts for >1% of their revenues
- High margin business
- High barriers to entry in this market that should offer some protection against competition

- For the first half of 2012, the company processed 169.1M transactions for a total charge volume of \$11.3B.

- iPayment derives close to 90% of its revenues from the merchant discount fee it charges to its customers for services. The fee is based on the size of the transaction and is typically 2.8% for a credit card transaction, with some variation related to merchant type, card type, and in-person versus internet transaction.
- Chairman/CEO owns 100% of the company – we like this as he thus has a large vested interest to see the business succeed
- 7.0x leverage (this is fairly high – so the bonds are CCC+ and around a 12.7% yield)

We believe iPayment's bonds offer very attractive relative value, with the iPayment, Inc. 10.25% notes due 2018 offering a yield of ~12.7%.

Given industry trends, the company's competitive positioning, and these yields, we recommend these bonds.

IPMT 10.25% 05/15/18

- Cusip 46262EAE5
- Senior Unsecured
- Rating: B3/CCC+
 - This is their only bond (the others are Pay in Kind notes due Nov 2018)
 - Trades around a 12.7% yield to maturity
 - Please see the JPM Research attached

iPayment: Attractive Business with Strong Relative Value; Initiating with Overweight

We are initiating coverage of iPayment with an Overweight rating. The company is a leading merchant acquirer serving small businesses and has benefitted from increasing electronic payments by consumers. iPayment has generated higher margins given the challenging nature of the small business space. While attrition has been a concern, the company generally uses excess cash flow to make acquisitions and maintain its portfolio.

Targets small businesses. iPayment's customer base consists of small merchants, which typically pay higher transaction fees than large merchants due to greater business risk, lower volumes, and difficulty in identifying them. Thus, iPayment can generate better margins by collecting the higher fees, while still receiving lower processing costs by aggregating small merchant transactions to receive larger volume discounts from their primary payment processor, First Data.

Acquisitive focus. iPayment has typically used excess cash flow to make acquisitions to grow its portfolio and mitigate attrition, which can be meaningful given the higher failure rate in the small business market. We believe they have been successful with their acquisition strategy, having completed numerous transactions in recent years.

Unconventional ownership. Carl Grimstad, iPayment's Chairman and CEO, and his affiliations own all of iPayment Holdings. However, he also has a vested interest in ensuring the success of the business and is likely to carefully consider how his potential actions may impact the company and his stake.

Regulatory impact. Since the implementation of the Durbin legislation in October 2011, margins for processors and merchant acquirers have benefitted from lower interchange fee expenses. However, as they continue to pass the savings onto more merchants, merchant discount fees will continue to decline, closing the gap between the top-line and lower interchange expenses.

Industry competition. There are a number of companies looking to get into the payments business using new technology including digital wallets, near field communications, and mobile card readers. However, we believe there will be little in the way of change for merchant acquirers such as iPayment in the medium term.

Bottom line. We expect iPayment to continue to maintain its top line and generate healthy margins with total leverage levels of ~7.2x. Although the ownership structure is unconventional, we believe the company has a good management team, focused on controlling attrition and growing the portfolio with acquisitions. iPayment's bonds offer very attractive relative value, with the iPayment, Inc. 10.25% notes due 2018 offering a yield of 13.34% and the iPayment Holdings 15% PIK notes due 2018 offering a yield of 20.91%. Given industry trends, the company's competitive positioning, and these yields, we recommend that investors buy iPayment bonds.

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