

Paul Allen's NEW RIFF

The Microsoft co-founder and guitar aficionado, stung by losses in technology and cable holdings, has brought in Wall Street veterans—and his sister—to retune his investments.

By Peter Robison

◀ It's June 1999, and a one-time record store manager has just phoned in a winning bid to Christie's International in New York, using \$497,500 of Paul Allen's money. The target: a Fender Stratocaster guitar used by Eric Clapton to record his 1970 rock anthem "Layla." After ignoring his billionaire boss's order to spend no more than \$200,000, Peter Blecha sits dazed in a Seattle warehouse. The price is the highest ever paid for an electric guitar. He expects to be fired or reprimanded. Instead, an e-mail arrives from Allen. "Congratulations!" it reads. "Exciting that we got it."

Those were the trophy-hunting days of Paul Allen, who co-founded a small software company with his Seattle high school buddy Bill Gates in the 1970s. Microsoft Corp.'s soaring growth delivered unimagined wealth to Allen, allowing him to indulge his tastes for mansions, French impressionist art, Jimi Hendrix memorabilia and helipad-equipped yachts and make high-profile investments in technology companies and the Seattle Seahawks pro football team. Today, though, razzle-dazzle is out.

Allen's holdings now feature pipelines and insurance.

After enduring scathing losses early this decade that shrank his \$30 billion fortune by more than half, Allen, 53, has embraced the mundane. His Seattle-based Vulcan Inc. has been reinvented as a diversified investment firm with real estate, oil pipeline and insurance holdings. The man who once boasted of running his business by "ad-hocracy" presides over what now resembles a Wall Street investment firm. A team of seasoned managers is playing down Allen's one-time vision of a "wired world," where Internet and cable companies work seamlessly to deliver a cornucopia of data to living-room TV sets. Instead, Vulcan is trying to maximize returns for Allen through investments in everything from currencies, stocks and bonds to distressed debt and leveraged buyouts.

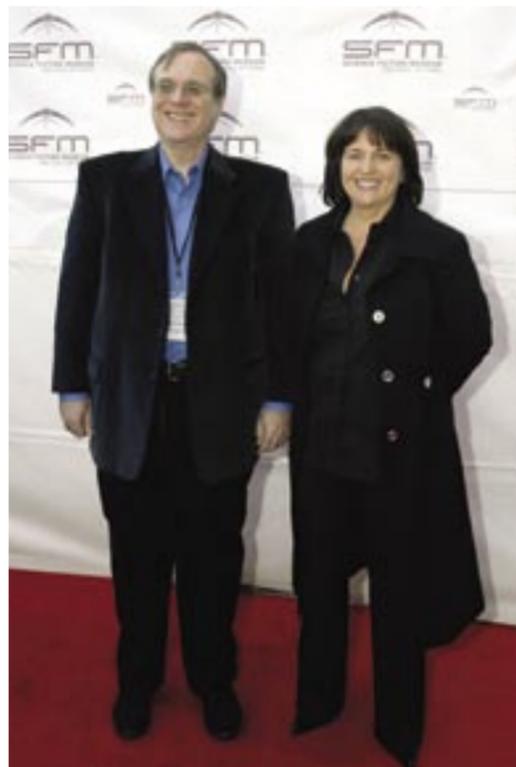
"There was clearly some turmoil in the office," says David Barrett, 47, an executive recruiter in New York who was hired by Vulcan last year to help find a new asset-allocation specialist. "Paul realized that he needed to hire the best possible talent and let them do what they're best at doing."

At its nadir in 2003, the value of Allen's holdings stood at \$12.4 billion, including \$4 billion in debt, according to a person familiar with the investments who asked for anonymity because Vulcan doesn't release such figures. If Allen had simply kept the 28 percent stake he held in Redmond, Washington-based Microsoft in 1986, the year the world's largest software maker offered shares to the public, his fortune would be worth about \$78 billion today. Allen left

Microsoft's board in November 2000 and sold almost half of his stake that year. He shed about 106 million Microsoft shares, worth \$6 billion as of Dec. 14, 2000, according to the Washington Service, which tracks insider sales. That left him with 144 million shares worth \$7.5 billion on the same date. He doesn't need to disclose his current stake because he now holds less than 5 percent of Microsoft stock and is no longer a company director.

Vulcan spokesmen declined to comment on any of the figures or to make Allen or other executives available to be interviewed for this story.

"He's a brilliant guy as a technologist and a programmer, but as a businessman, he probably isn't Bill Gates," says Matthew Harrigan, an analyst at Greenwood Village, Colorado-based



Allen turned to his younger sister, Jody Patton, a drama major, to stage a comeback at Vulcan.

Janco Partners Inc. Harrigan, who covers the cable TV industry, has watched the share price of Allen's St. Louis-based Charter Communications Inc., the No. 4 U.S. cable operator, sink from \$12.50 when Harrigan initiated coverage in November 2001 to \$1.17 as of March 3.

Allen's tarnished investment record may explain why Vulcan's staff now numbers about 500, double its size of five years ago. Led by Lance Conn, 37, a former senior vice president at America Online Inc., the 22 most-senior investment managers at Vulcan include eight graduates of Harvard Business School in Boston and four from the University of Pennsylvania's Wharton School in Philadelphia. Others were hired away from Hicks, Muse, Tate & Furst Inc., a buyout firm based in Dallas that changed its name on March 1 to HM Capital Partners LLC, and from New York-based investment banks JPMorgan Chase & Co. and Lehman Brothers Holdings Inc. What best describes the new team? "Traditional

Wall Street pedigrees," says Vanessa Bailey, founder of Cressida Partners LLC, a New York executive search firm that helped recruit them. "These are classically trained investment bankers who learned the ropes working 120 hours a week at Morgan Stanley, followed by blue-chip private equity experience."

Vulcan's sports trophy case may get smaller. While the Seahawks made it to the National Football League's Super Bowl this year, losing to the Pittsburgh Steelers 21-10, Allen hasn't ruled out selling or moving his beloved Trail Blazers, the Portland,

Oregon-based National Basketball Association team he bought in 1988. The Trail Blazers approached Portland city officials for public aid in February, when Vulcan forecast \$100 million in team losses over three years. "All options are on

the table," says Steve Crosby, a Vulcan spokesman. *The Sporting News* might also go. The magazine, a weekly that Allen acquired for \$100 million six years ago, said in a news release on Feb. 22 that it was examining offers from several potential buyers.

Allen's sister, Jody Patton, has presided over the shake-up at Vulcan. She had managed construction at his 6.85-acre (2.77-hectare) estate on suburban Seattle's Mercer Island and supervised the building of a new basketball arena in Portland before Allen elevated her to become Vulcan's chief executive officer in 2001. Under Patton, 48, who also declined to be

interviewed for this story, Vulcan replaced 100 managers, including investment chief William Savoy, who was 39 when he left in 2003. He had worked for Allen since 1988, when he was chief financial officer of an accounting software maker in which Allen had invested. One ex-Vulcan employee, Jim Fricke, says the firm had begun to reflect Patton's tough, detail-oriented personality by the time he left in mid-2004.

Patton, who majored in drama at Whitman College in Walla Walla, Washington, and worked in fund raising for the Pacific Northwest Ballet in Seattle before joining Vulcan, has a reputation for being a taskmaster. "A lot of people are absolutely terrified of her," says Blecha, 49, the former record store manager who worked on Allen's music projects in the 1990s. Blecha wrote about bidding on Clapton's guitar in his book *Rock & Roll Archaeologist* (Sasquatch Books, 2005) and provided details in an interview for this story. "Jody was tough, but she was fun," Blecha says, remembering Patton's fondness for grilling people in meetings about the precise meaning of a word, even calling for a dictionary. One term that got under Patton's skin: *brain trust*. "Is that a word?" she asked. (It's two words—first used together in 1933 to refer to a group of advisers to President Franklin Roosevelt, according to the Oxford English Dictionary.)

"She's not the kind of person you can bluff," says James Poulson, 50, the Kansas City, Missouri-based architect who designed the Seahawks' stadium, Qwest Field. "I think she's very

protective of Paul. She just didn't want him to get ripped off."

Patton, who's married with three children, and Allen's 83-year-old mother, Faye, live in separate homes inside his Mercer Island compound, which was valued at \$129.7 million in this year's county tax assessment.

As the new Vulcan took shape, Allen sought to assure his latest recruits that he wouldn't micromanage investment strategy, says Barrett, the headhunter. About 20 candidates were considered for the asset-allocation job before the post went to Dan Kingston, chief investment officer of the Ewing Marion Kauffman Foundation, which is based in Kansas City, Missouri, and named for the late founder of Marion Laboratories Inc. "What people had to be sold on was that Paul really was going to take a hands-off approach," Barrett says.

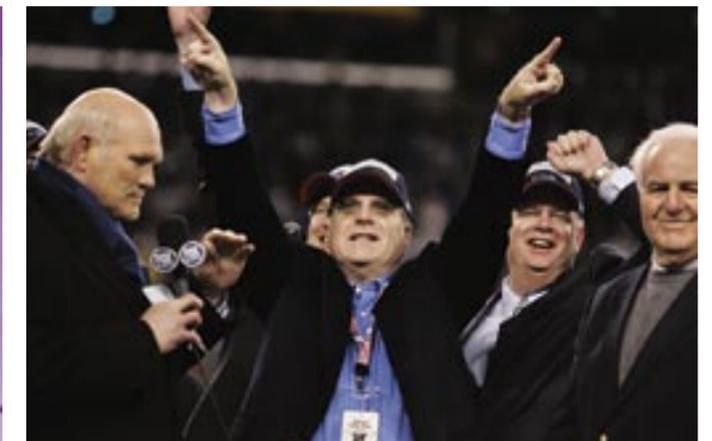
So far, Allen likes what he sees, according to Tim Bueneman, senior vice president of McAdams Wright Ragen Inc., a Seattle-based brokerage. Bueneman sent a note on Feb. 8 to institutional clients after meeting with a Vulcan official whom he declined to name. "Paul has never been in a better mood," Bueneman wrote, adding that Patton "is now credited, by Paul and others close to him, as 'saving Vulcan' when it was going downhill very rapidly."

The new specialists have made their presence felt. David Capobianco, who had worked at New York buyout firm Greenhill Capital Partners LLC, brought the expertise in

'As a businessman, he probably isn't Bill Gates,' Janco Partners analyst Matthew Harrigan says of Allen.



Among Allen's pastimes: memorializing Jimi Hendrix, winning football games and bringing commerce to spaceflight.





Mike Fidler, CEO of Allen's Digeo, is pushing TV set-top boxes.

energy that led to Vulcan's \$460 million purchase of Plains Resources Inc. in 2004, Bailey says. The Houston-based oil transporter's main asset was a stake in Plains All American Pipeline LP, a publicly traded partnership that operates 14,000 miles (22,530 kilometers) of crude oil pipelines. As of March 3, the value of Plains All American partnership units had gained 34 percent since the purchase. Capobianco was added to the Plains All American board.

In a deal brokered by Hoon Cho, a former Hicks Muse principal, Vulcan agreed in December to buy underwriter International Catastrophe Insurance Managers LLC for an undisclosed price. The purchase of the closely held insurer, based in Boulder, Colorado, makes sense at a time when disaster premiums are only likely to increase, fueled by the risks of hurricanes and terrorism, says Andrew Barile, an insurance consultant in Rancho Santa Fe, California. "Anybody writing catastrophe covers is about to make great deals of profit," Barile says.

A breakup of Hollywood studio DreamWorks SKG, which failed to produce many hits beyond the *Shrek* animated films, has given Allen an opportunity to recoup his investment there, too. He put in \$500 million in 1995 when the studio was formed by Steven Spielberg, Jeffrey Katzenberg and David Geffen. Since DreamWorks spun off its animated-film division in 2004, Allen has sold 4.9 million shares, valued at \$137 million. He retained another 29.7 million, worth \$801 million as of March 3. Allen likely got another payday in February, when the live-action portion of the studio was sold to New York-based Viacom Inc.'s Paramount Pictures for \$774 million, excluding debt. Based on Allen's initial stake of at least 16 percent, that sale may have generated \$124 million for him.

Allen hasn't given up his pet projects. On his Web site, www.paulallen.com, he says, "The varied possibilities of the universe have dazzled me since I was a child, and they continue to drive my

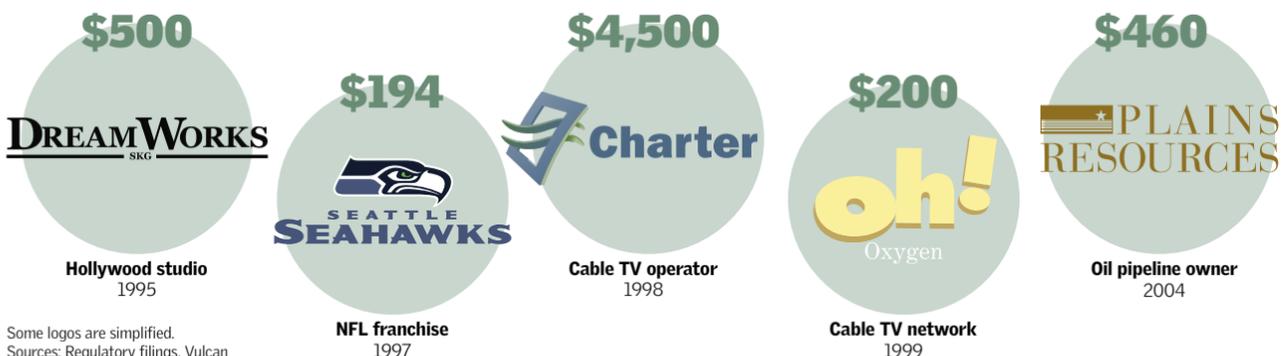
work, my investments and my philanthropy." The way Allen put it, according to Barrett, getting the most out of his holdings lets him spend time "doing good."

Never married, the newly trim, bespectacled Allen pours considerable time into philanthropy, civic projects and scientific exploration. He spent \$240 million to found the Experience Music Project, a swooping, Frank Gehry-designed museum in Seattle inspired by Allen's rock idol, Hendrix, who was born in the city and died in London in 1970 at the age of 27. Allen funded aircraft designer Burt Rutan's SpaceShipOne with \$20 million, leading to the world's first commercial spaceflight in 2004. Vulcan's real estate arm, whose payroll has increased to 35 people from three in 2001, is redeveloping an industrial section of downtown Seattle with a 17-story hotel and retail complex. Allen invested \$100 million in 2003 to create the Allen Institute for Brain Science, a lab in

Vulcan's reach

Paul Allen's holding company has invested in everything from sports teams to movie studios and oil pipelines.

Investment, in millions



Some logos are simplified. Sources: Regulatory filings, Vulcan

REX RYSTEDT

Seattle where researchers are trying to determine which genes are most important in influencing the workings of the brain.

And there's nothing mundane about his expensive toys. Allen travels in his own Boeing 757 jetliner, outfitted with a bedroom and polished-wood dining table, according to one guest. He owns the chair used by William Shatner as Captain Kirk to command the starship *Enterprise* on the *Star Trek* television show; it's on display at Allen's music museum. His art collection includes works by Monet and Degas that were to be shown at the museum in April. He splits time among homes in Beverly Hills, California; Cannes, France; and Seattle. And he owns a 413-foot (126-meter) yacht, the *Octopus*, which docked in New Orleans for the 2004 convention of the National Cable & Telecommunications Association. The yacht boasts two helipads.

Allen spends weeks overseas, scuba diving in Papua New Guinea or attending events such as the Cannes Film Festival.

Film and television are among his preoccupations. Allen has a stake in Oxygen Media, which runs a U.S. cable channel geared toward women. In 2002, a Vulcan unit brought out the movie *Far From Heaven*, a drama about race and sexuality in suburban Connecticut. Allen took the *Octopus* in May 2005 to the Cannes Film Festival, where actress Laura Harring, who appeared in the film *Mulholland Drive*, was on his arm at one screening. The yacht was mentioned in a Los Angeles County Superior Court defamation suit filed in 2005 against hotel heiress Paris Hilton by Zeta Graff, an actress who was the ex-girlfriend of a man Hilton was then dating. In a deposition, Hilton mentioned bumping into actor Val Kilmer in the lobby of Allen's yacht when it was docked in Cannes last May. Lawyer Paul Berra was startled. "The boat has a lobby?" he asked. "It's like a 500-foot yacht; it's insane," Hilton replied.

'He honestly tried to cultivate anonymity,' says Jim Fricke, a former Vulcan employee.

Few people peg Allen as a full-fledged jet-setter, though. His most-prominent feature used to be his beard, which he shaved because, as he told the *Seattle Times* in 1998, he was tired of being recognized. "He honestly tried to cultivate anonymity," says Fricke, the former Vulcan employee, describing Allen as a "genuinely nice guy" who often made his jet plane available to employees for trips to Portland for Trail Blazers games.

In February, a global TV audience saw Allen rooting at the Super Bowl for his other team, the Seahawks. He bought the franchise as a favor to the community for \$194 million in 1997, when the Seahawks were close to moving to California. It turned into a good investment: The team was worth \$725 million as of 2002,

according to an estimate by Kagan Research LLC in Monterey, California. Leery of the public spotlight, Allen skipped media events before the Feb. 5 championship game in Detroit. He was visible behind the scenes and flew 100 friends in for the

game on the Seahawks' jet. At a postgame party, he tried to liven up a disappointed crowd by playing electric guitar with an impromptu band that included comedian Dan Aykroyd on harmonica, says Ric Weiland, 52, a high school friend who was there. "Not so shy," he says, a reference to Allen's reputed reclusiveness.

Allen does guard his privacy. Employees of Vulcan typically sign confidentiality agreements promising not to disclose any personal details about him or his family, according to several people contacted for this story. There are ample former Allen employees; turnover has been an issue at some of his companies. Digeo Inc., a set-top-box maker in Kirkland, Washington, that Allen owns, and Charter Communications have each had three CEOs since 2004. Many of Allen's closest advisers are people he's known since childhood. They include Bert Kolde, a former classmate at Washington State



Allen escorted actress Laura Harring at the Cannes Film Festival in 2005. His yacht *Octopus*, docked in Venice

GARETH CATTERMOLE/GETTY IMAGES (LEFT); CHRIS HELGREN/REUTERS/CORBIS

University who's now senior vice president of Digeo. Like Gates at Harvard, Allen never graduated from college.

Some people wonder how two decades in the shadow of Gates—whose Microsoft shares were worth \$26.3 billion as of March 3 and whose charitable foundation has a \$29 billion endowment—may have influenced Allen. In a January radio interview, Allen noted that he had introduced Gates, Microsoft's chairman, to Bono, the lead singer of U2. Bono and Gates, who have both made the relief of suffering in Africa a philanthropic cause, appeared on stage together at the Live 8 concert in London in July and were named *Time* magazine's 2005 Persons of the Year, along with Gates's wife, Melinda. Gates and Allen built their lakefront estates within a few miles of each other in the 1990s. "There was always this speculation that there was a little bit of competition or house envy going on there," Poulson says. Microsoft spokesman Tom Pilla says Gates declined to comment.

By some accounts, Allen's early relationship with Gates was contentious as well as productive. The son of librarians, Allen met Gates at the Lakeside School, a prep school where they wrote their first computer programs. Gates would tease Allen about his taste for the science fiction of writers Arthur C. Clarke and Robert Heinlein—"what Bill used to call trash," says their Lakeside classmate Weiland, who was also an early Microsoft employee. The two eventually stopped playing chess because the games became too heated. "I remember Paul saying even several years ago that they have kind of a prickly relationship," Weiland says. "I think that was good for both of them: They stimulated each other with verbal dialogue that was pretty intense."

The two formed Microsoft in 1975. According to accounts by both men, it was Allen, then working in Boston as a programmer for Honeywell Inc., who pushed for the creation of a software company after he spotted a magazine article about the world's first microcomputer kit. Allen left Microsoft in 1983 amid treatments for Hodgkin's disease, which can be cured if found and treated early. "Bill really twisted Paul's arm to come back," says Steve Wood, 53, the sixth employee at Microsoft. Instead, Allen decided to pursue his own interests, pressing into such fields as artificial intelligence and satellite TV. "He would recognize opportunities where he thought he could push technology forward faster than Microsoft could," Wood says.

Allen's first post-Microsoft venture was Asymetrix Corp., a software maker in Bellevue, Washington, that experimented with artificial intelligence. Asymetrix was renamed Click2learn.com Inc. and sold in 2002. Allen founded Vulcan in 1986. The

wired world notion began to take shape in 1990, when Vulcan invested \$10 million in SkyPix Corp., a satellite TV operator in Kent, Washington, that broadcast pay-per-view movies into people's homes. SkyPix eventually landed in bankruptcy. In 1998, Allen took the plunge into cable, overruling Savoy, his investment

chief. Savoy said in a 2000 interview with BLOOMBERG MARKETS that he had counseled against the investment because prices were too high and the costs of upgrading to digital systems were too great.

Charter Communications, where Allen is chairman and the controlling shareholder, has been a disastrous investment, sinking by March 3 to less than one-sixth of its \$3.2 billion value at its 1999 initial public offering. The shares fell another 15 percent over the next week after analysts said the proposed acquisition of Atlanta-based BellSouth Corp. by San Antonio-based AT&T Inc., announced on March 5, would mean stiffer price competition on Charter's cable turf. Charter has recorded net losses in all but two of its 28 quarters and is carrying

\$19.4 billion of long-term debt, according to company filings. Even so, the irony of the wired world concept is that Allen may have had the right idea at the wrong time, overestimating how quickly people would become comfortable with a digital living room, says Gary Schultz, president of MRG Inc., a Sunnyvale, California-based market research firm. "Vision is one thing; implementation is another," he says.

Competition in media, Internet and technology has led to a profusion of choices for consumers, not the wired world's integrated delivery system. Craig Moffett, a Sanford C. Bernstein & Co. analyst in New York, ticks off the reasons investors have avoided cable stocks: Some say telephone or wireless networks will pick off cable's customers, and others envision dire scenarios in

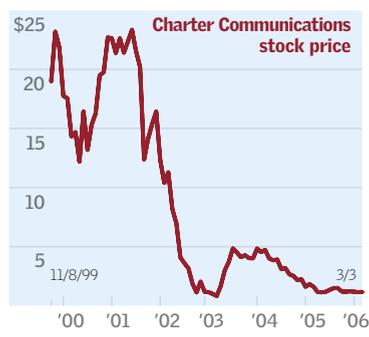
which people go straight to the Internet for movies or TV shows. Already, Cupertino, California-based Apple Computer Inc. is selling \$1.99 downloads of TV programs such as *Battlestar Galactica* and *Lost*.

"Every one of those things makes for a terrifying sound bite," Moffett says. "If you do rigorous analysis, none of them are all that scary," he adds, noting that the average family's monthly TV bill would come to \$653 if they bought all of their shows for viewing on an iPod.

While Vulcan no longer touts the wired world, Allen may not be abandoning the idea entirely. He spent a day in early January at the Consumer Electronics Show in Las Vegas, looking at Samsung Electronics Co.'s 102-inch (2.59-meter) plasma displays and the latest set-top TV boxes from Matsushita Electric Industrial Co.'s Panasonic with Comcast CEO Brian Roberts and other cable executives, according to one

Cable slump

Shares of Allen's cable company are down 94 percent since its IPO.



Source: Bloomberg

'You take that pain and let it motivate you,' Allen told his Seattle Seahawks team after the Super Bowl loss.

participant on the tour. Allen stopped by the booth of Digeo, his own set-top-box maker. It supplies a TiVo-like device called the Moxi Media Center that can record broadcast television and store it for later use, as well as pull up music and photos.

Digeo, which was founded in 1999, is one of the few holdovers from Allen's wired world. Until now, its biggest customer has been Charter, which sells the Digeo devices to cable customers. Digeo formed a partnership in 2005 with Samsung, which plans to market a version of the set-top box under its own name later this year.

It's too early to call the digital living room a failure, says Mike Fidler, 59, a former Sony Corp. executive hired as Digeo's CEO in August 2005. "At one point, they called DVD 'dead, very dead,'" he says. "Over the next two to three years, you're going to see a dramatic explosion in the digital lifestyle."

If anyone is shaping up as a rival, it's Gates. Microsoft had its own stumbles on digital convergence, taking a loss of \$2.6 billion in 2001 on stakes in cable operators it had acquired in the hopes of selling them set-top-box technology. Now, Gates's company has a more focused strategy. Its Media Center software lets people operate computers with a remote control like a TV's, making it easier to access music, photos and video from any screen in the house. For the long term, Microsoft is pushing a technology called Internet protocol TV, which Schultz, the MRG analyst, says can transmit information over the Internet for half the cost of cable TV. Microsoft's dozen customers for Internet protocol TV, including

London-based BT Group Plc and AT&T, represent 26 percent of the world's phone lines. "Moxi's biggest competition is in their own backyard with Microsoft," says Bijan Sabet, a general partner at Spark Capital, a \$260 million media fund firm based in Boston.

Allen has taken notice. Fidler says he hears from Allen by e-mail almost every day and sits down with him at Vulcan every two weeks. After the Las Vegas show, Fidler says his boss sent an e-mail asking how the capabilities of Digeo's set-top box compared with the functions Microsoft was planning in the latest version of its Media Center software. "Can we bring some of these capabilities into our platforms?" Allen asked.

Allen's trials as an investor and competitor in tough markets such as cable and the Internet may have taken a financial toll. Yet his determination to set Vulcan on a new course suggests he's unbowed. After the Seahawks' Super Bowl loss, Allen made his way into the locker room to address the players. A crisp Seahawks polo shirt and jacket hung from a hook in a locker labeled *P. Allen*. Meeting reporters afterward, with reddened eyes, Allen said he had told his players that the important thing was how they responded to adversity. "You take that pain and let it motivate you for next year," he said. That same lesson might apply to his investments. ▶

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BLOOMBERG TOOLS

Digging Into Charter Communications

To list the largest shareholders of cable television company Charter Communications, type `CHTR US <Equity> PHDC <Go> 1 <Go>`. The latest available filings as of March 3 showed that Chairman Paul Allen owned 6.7 percent of Charter's outstanding shares. To download a copy of the Form 4 filed with the U.S. Securities and Exchange Commission regarding Allen's holding in Charter, click on his name on the Holdings Search screen and then on XML Form 4.

Type `DDIS <Go>` for the Syndicated Bank Loan & Debt Distribution function to graph the scheduled maturities of Charter's outstanding bonds and syndicated loans by year. As of March 3, the company had \$24.2 billion in bonds and loans outstanding. Of that total, \$5.7 billion was scheduled to mature in 2010 alone. Press `<Page Fwd>` to list Charter's individual debt issues and their coupon rates, issue and maturity dates, amounts outstanding and maturity types, when available. To find more information

about a particular bond issue, click on its line on `DDIS` and select a function from the pop-up menu that appears.

To see Charter's current credit ratings, type `CRPR <Go>`, as shown below. As of March 3, Moody's Investors Service rated the cable company's senior unsecured debt `Ca`, one step above the lowest possible grade. Standard & Poor's rated Charter's long-term debt `CCC+`, near the middle of its range of non-investment grade credit ratings. Type `RATD <Go>` to access rating scale definitions from various credit rating companies.

JOHN DIXON



To run the Issuer Information function on Charter Communications, type `CHTR US <Equity> ISSD <Go>`.