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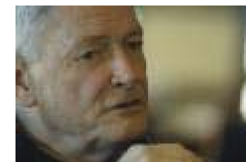
John Malone talks of his past and future: Part One

Denver Business Journal - by Greg Avery

MEDIA



Cable and media mogul John Malone sat for a lengthy interview at **Liberty Media Corp.** headquarters in Douglas County to talk about his roots in the cable industry, the economy and his vision for the various holdings of Liberty Media.

The 68-year-old Connecticut native is founder and chairman of Liberty Media (NASDAQ: LCAPA), which owns outright or has the largest shareholder stake in satellite broadcaster DirecTV, **Expedia Inc.**, **Home Shopping Network**, **QVC** home shopping channel, **Starz** Entertainment movie channel, **Ticketmaster Inc.** and several other businesses.

In this portion of the interview, Malone talks of his roots in cable TV, and Tele-Communications Inc.'s approach to building a new industry.

Part One

DBJ: How did TCI founder Bob Magness pursuade you to come out here?

Malone: I was at General Instruments. I was running their systems group, which was Jerrold Electronics: cable TV, R&D, manufacturing and financing and installation. Jerrold was kind of the biggest thing in the cable industry from a hardware and financing perspective at that time … I was running the largest division of General Instruments, but — that would've been 1972, so I was 31 years old — and they thought I was too young to be the CEO of GI. And my mentor there at GI was retiring because he was too old.

I decided it was time for me to make a career change. From the role I was playing there, I got to know the entrepreneurs in the cable industry quite well because I was their principal vendor as well as financing them. So I knew them from various perspectives.

There were really three companies I considered joining at the time, one of which was TelePrompTer, which was then the largest in the industry. The second, at the time, was really **Warner Bros.**, and that would've been Steve Roth. And the third was TCI out here in Denver, and it was really a small company then. I decided it would be better to bring up a young family here than it would in New York with all that commuting.

DBJ: What did you think you were getting yourself into?

Malone: Of course, I knew the operating business because when I was at General Instruments; GI was the third-largest cable operator. … So I understood the cable operating business reasonably well. What I thought I was getting into was, I believed, a growing industry with evolving technology and, you know, boot-strapping its financial position.

I had no idea that in the summer of 1973 that financial scandal would wrack the industry. TelePrompTer would be accused of everything from financial fraud to bribery and extortion – all kinds of problems. It was also a time when [former president Richard] Nixon, who'd been re-elected in a landslide, was now being pursued on the Watergate issue. The whole equity market collapsed that summer.

So, TCI with a lot of commitments and a lot of prospects, but very little in the way of financial strength, was caught in that downdraft in the summer of '73. I'd joined a company that I knew was small, thought was rapidly growing and thought was financable along with an industry I thought was financable. And I found myself for the next five years in an industry that was not financable because of both the general economic conditions and the specific problems related to TelePrompTer's scandal. … It really dried up financing for the industry for a number of years. The first five years out here were really a financial struggle.

DBJ: What did that teach you?

Malone: Well, a lot. To not expose yourself to one financial source, diversification of every kind, isolation of financial risk, and how to bootstrap. It taught us a lot of things. It taught us survival skills, I think that is the No. 1 thing. We were able to keep TCI independent and viable despite the fact there was no external financing available for an extended period of time. It certainly toughened up the financial team and made us all battlefield buddies, you might say.

DBJ: Is that when the model of operating a business for cash flow and aggressive growth came about, or had that idea been established?

Malone: The concept that cable television looked more like real estate than it did manufacturing was always obvious, … to me, anyway. And I think the financial markets really didn't have a model for cable, because the industry was a small, startup industry with no real following. Coming out of that period of the '70s, the industry needed some model, some metric how the market could value us.

We decided out here in Colorado — not just us, but the other companies out here — to go on a cash flow metric very much like real estate. Levered cash flow growth became the mantra out here. A number of our eastern competitors early on were still large industrial companies — **Westinghouse**, GE, — and they were on an earnings metric.

It became obvious to us that if you were going to be measured on earnings, it would be real tough to stay in the cable industry and grow. We needed to be measured much more like real estate as an industry.

DBJ: How hard was it to get Wall Street to adopt that view?

Malone: It was not easy. It was almost like building one brick at a time. We found one institutional investor at a time who would hear that and start to believe it. Slowly, over time, that became the metric. I can still remember **Comcast**, which was much smaller than we were at that time, at a conference. I kept kidding (Comcast co-founder) Julian Brodsky, "Listen, Julian, it's not about

earnings, it's about wealth creation and levered cash-flow growth. Tell them you don't care about earnings."

Through that period into the '80s, those who were in cable and got measured by earnings because they were part of some industrial company — whether it Warner Amex, whether it was Westinghouse or it was GE — they all bailed out of the industry. They could sell these (cable) businesses and boost their earnings per share dramatically, and they were all induced to do so.

In the '80s into the '90s, the industry really became a cash-flow growth story. … It gave us great freedom to grow the business. The public companies that were earnings oriented were issuing equity to grow. They could avoid depreciation and amortization and so on, but they were diluting the value of their equity in the long term.

TCI and others were expanding by leverage; we were buying assets for cash, basically. It made our earnings look awful, but it meant were sheltered from income tax and we weren't diluting that common equity.

Over those years, we were shrinking our equity fairly dramatically and growing our company fairly aggressively. There's a study, a Harvard Business School study I believe, that shows TCI had the highest return on equity of any public company through that 20-year period. We had to do it by completely ignoring what they teach you in business school about earnings and all that.

I used to go to shareholder meetings and someone would ask about earnings, and I'd say, "I think you're in the wrong meeting." That's the wrong metric. In fact, in the cable industry, if you start generating earnings that means you've stopped growing and the government is now participating in what otherwise should be your growth metric.

DBJ: In 1980s, you had TCI and Magness, Bill Daniels, Monty Rifkin's operation in Denver, and …

Malone: Well, there were two centers: New York and Denver. And to an extent we were competing as centers. But the industry, other than sometimes competing for new franchises and, occasionally, for acquisitions, the industry was very fraternal. We had the cable association, where everybody was working together against common adversaries. And we were able to start Cable Labs (in Louisville) in that period. There were many deals we all put together as partners … It was a very collaborative industry and we were not really competitive with each other in most ways.

DBJ: I have the impression that TCI did more to try to shore up the availability of content for cable than many other companies. You helped Ted Turner's company survive … Why?

Malone: That was a decision I came to in the 1980s. The alarm bells really started going off for us, frankly, when MTV decided it was probably going to go public. Up until then, it had promoted itself as a free service — free to the cable operators and advertising supported. And as a result we carried MTV everywhere, promoted it and distributed it, and so on. We became aware of the fact, in trying to turn the company public (which at that time was owned by Warner Amex) that they were putting forth a business plan that had very aggressive charges to the cable industry in the future.

When we saw that, we said, "Uh-oh, look at what we're doing, we're creating something that will have leverage over us in the future to extract fees." If that's going to happen — [if] there's money flowing in to create programming that's going to differentiate cable from broadcast — we were 100 percent in favor of that. But the downside of that was these entities, be it ESPN or MTV, were going to develop

leverage over us and be able to extract large fees.

I said in a speech to the cable association, "Look, this is both good and bad." We definitely want to support unique content on cable because that's what would drive penetration and make cable independent of broadcasting, and superior to broadcasting. [But] while we're doing that, we have to be careful we don't create a monster that eats us out of house and home.

At that point, we decided at TCI that we wanted to own about as much in the programming industry — the cable network industry — as we did in the cable distribution industry. We set our targets on staying about 20 percent of the U.S. cable industry and we wanted to own roughly 20 percent of the programming networks that would supply us. That way we were hedged. If they were more profitable than the cable industry, we would share on that side.

We actually began a process of looking for investing opportunities where we could invest in and help develop new programming vehicles. We started with Black Entertainment Television, **Discovery Channel**; those were some of our earliest efforts … We were in Telemation Programming Services, which evolved into Hollywood Home Theater, and when HBO started, it was the only other premium movie service out there. It was a joint venture between us and some Hollywood guys. We had various efforts to participate.

When [TBS broadcasting founder Ted] Turner got in financial trouble it was an opportunity to take an investment stake in his channel as well as prevent him being taken over by adversaries. As time went on, we did more and more of that.

TCI had evolved into a philosophy of investment. On the one hand, we were an operating company in the cable business, but we also had a philosophy that, both in the cable business and in programming and in technology, that we were better off being a supportive, synergistic investor rather than thinking we had the management skills to run everything.

I think at one point we had something on the order of 40 to 50 partnerships. Through the '80s and into the '90s, it was a very fertile field. All kinds of new ideas were coming out. There were dozens of entrepreneurs who were finding cable systems we could invest with them in. People like Bill Bresnan, Jeff Marcus — dozens of deals where our standard was 80-20, we would put up 80 percent of the capital, they would get a 20 percent ownership and they would manage it. We did many deals like that, sometimes 50-50.

We were in a process then of investing, I'd call it, venture capital investing in technologies. We actually later on sort of focused that by creating Liberty Media, which was focused more on the content business. We created TCI Tech Ventures, which was focused on technology. We still had within TCI this collection of partnerships and investments in all different sizes, including one with Scripps Howard, which was a 50-50, Knight Ridder was a 50-50 … There were literally dozens of these ventures and they all represented an ability to broaden out the company's portfolio, bring in creative managers and keep our own headquarters staff relatively small.

We stayed at, like, 85 employees for many years as we grew and acquired. We probably grew 20-fold and didn't grow our headquarters at all … until we finally had to expand when we merged in Daniels, United Cable and United Artists … That was our method of growing: looking at every which way we could to grow our portfolio and create synergies between our operating business and all these other, related elements.

DBJ: By the time you came to talk to AT&T about selling TCI, how had the cable industry changed in Denver?

Malone: There'd been a lot of consolidation, and we'd been a major consolidator. Through a series of transactions we'd bought United Artists, United Cable, which had merged and brought Daniels in, and that all was brought into TCI … We brought everything into TCI. We had already spun off Liberty Media. The first Liberty Media was a ragtag collection of minority interests in both technology and cable. Then subsequently, in 1992, when we were discussing a merger with Bell Atlantic — now Verizon — they wanted us to make life simpler for them. So we sucked everything back in into new TCI, if you want to call it that.

Then, when the Bell Atlantic deal blew up because of the FCC and a new regulatory environment, we then decided to split two entities off what had been Liberty Media, which at that point became much more programming focused and [TCI] Tech Venture which focused more on technology. And we spun those off as tracking stocks, not as independent companies at that point. We built those three companies separately until the AT&T merger idea came along.

In Part Two of this interview, to be posted Tuesday at DenverBusinessJournal.com, Malone talks about the 1990s mega-mergers TCI pursued with telecom giants. And in Part Three, to be posted Wednesday, Malone talks about the future of telecommunications, Liberty Media's financial rescue of Sirius satellite radio, the credit crisis and the strategy for Liberty Media's holdings. This week's print edition of the Denver Business Journal includes more on cable's Denver roots.

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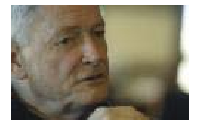
John Malone talks of his past and future: Part Two

Denver Business Journal - by Greg Avery

MEDIA



Cable and media mogul John Malone sat for a lengthy interview at **Liberty Media Corp.** headquarters in Douglas County to talk about his roots in the cable industry, the economy and his vision for the various holdings of Liberty Media.

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In Part One of the interview, posted Monday, Malone talks of his roots in cable TV, and Tele-Communications Inc.'s approach to building a new industry.

Now, in Part Two, Malone talks about the 1990s mega-mergers TCI pursued with telecom giants. The first, with Bell Atlantic in 1993, fell apart. The second, with AT&T, closed in 1999 and saw Malone become a board member for the fabled phone company.

Shortly after buying TCI for $46 billion, AT&T outbid **Comcast** and paid $58 billion for U.S. West's cable spinoff, MediaOne, before ultimately collapsing under the weight of its cable acquisitions.

Part Three will be posted Wednesday.

Part Two

DBJ: The Bell Atlantic deal and the AT&T deal: Was the ultimate goal of both of those the same?

Malone: Not really, no. At the time of the Bell Atlantic deal, we thought there was an opportunity to essentially increase our footprint dramatically across the country by trading out of the cable systems that we had in the Bell Atlantic area — trading those to other cable operators — for systems in the rest of the country.

It was kind of interesting because most people thought Bell Atlantic was acquiring us when we were acquiring Bell Atlantic because in the deal we were taking over the board, in effect. We were getting to name the board of directors. It got a little complicated, but the theory was that the old POTS business — the plain old telephone service business — would really be isolated off as a dividend-paying, stodgy business literally with a tracking stock. The wireless cellular business and what would become the data business, and then the video business, they would become the growth areas. Maybe at one point they could be separated as businesses. That was the theory.

And that was with a great, very far-thinking CEO at Bell Atlantic, Ray Smith, who saw that the telephone industry had limits and thought that the grass was greener on our side of the fence. He was kind of coming over to us in a sense.

DBJ: In the AT&T deal in 1999, was it an opportunity for them to get last-mile connection to homes and transform its core business of consumer long distance?

Malone: The AT&T deal, conceptually, was a fabulous strategic deal. The original thesis was that they were going to combine the consumer businesses. We were going to take the cable business and put it together with the consumer part of the telephone business and the consumer part of the cellular business, plus this emerging [Internet] data business called @Home and a new technology, ... voice over Internet, which was something we thought we had a big lead in technologically because of a company, Net2Phone, that AT&T was acquiring at that point.

The whole thesis was that we were going to create this triple-play business that would be run by Leo Hindrey, our guy from TCI, and would be represented by an AT&T tracking stock that would separate it from the more industrial part of their company, which was the business-to-business [telecom services]. That was the theory.

The reason I supported it was because of the AT&T cash flow, which at the time, I believe, was $16 billion a year ... and no net debt. AT&T was a very powerful financial company that had no growth and no real solution to the last mile because their former subsidiaries [the regional Baby Bell telephone companies] were going to be released by the FCC to compete for long distance with AT&T. A lot of [AT&T's] cash flow was the long-distance business, and they were a wholesaler of that to their former affiliates.

So it was struggling with a strategic problem of what do they do to protect this huge cash-flow stream they were getting out of the long distance business. ... They were really struggling to find some bundle, something that would give them sustainability in their business.

Strategically, this combination [with TCI] made all the sense in the world — their cash flow accelerating the growth and deployment of the cable business, the technology, the broadband and the voice over broadband. AT&T would be coming into the cable industry as a leader, getting all the cable companies to look at AT&T as a one-stop shop at least for telephony, and perhaps for broadband because TCI had @Home, and that had exclusive agreements in North America with most cable operators.

For a while there, it looked like that strategy was going to be a slam dunk. The AT&T stock rose on the announcement of the deal. Obviously that dragged TCI along with it. It was the biggest merger in business history in the U.S. to that time. We thought it made all kinds of industrial logic to do it. And that's why I was an enthusiastic supporter of it — on paper it looked like a great deal.

And it should've been a great deal. It fell apart on execution.

DBJ: On AT&T's decision not to have a tracking stock for the cable business?

Malone: First thing was that they didn't do a tracker for the cable thing. So right up front, because [of] internal politics inside AT&T, they couldn't get to it. They thought they could live without it. As a result, when the telephone business started to go to hell, they didn't have a currency other than cash. They wanted to keep growing but they didn't have a currency, so their deals — like the MediaOne deal ... that was the Rubicon that they crossed that they shouldn't have crossed — they didn't have a currency to buy MediaOne and to out-compete Comcast, so they did it with a very cash-heavy guaranteed deal: guaranteed their stock price, put too much cash in it and financed all of it with short-term money, all of which was a disaster and led them to have to, basically, liquidate all of AT&T.

Great strategy and terrible execution led to what I would regard, personally, as a fiasco.

DBJ: It destroyed one of the most storied brands in U.S. business.

Malone: It destroyed a lot of things. It blew up @Home. @Home was a collaborative way for the cable industry to have a branded national, or even North American, data service. Imagine if that was still in tact. Something like 65 percent of cable subscribers are now paying something like $50 a month for broadband. The numbers would have been astronomical had AT&T been able to work with the cable operators and kept @Home in tact.

Unfortunately, a lot hubris at AT&T blew up any chance they had at being the lead partner in a collaborative industry. They just couldn't get a long with other cable guys.

DBJ: Was that because of a different culture at AT&T — the phone industry is not collaborative historically but cable is?

Malone: Exactly, amongst other things. Just fundamentally I would call it hubris, and to some degree incompetence, led to the whole strategy unwinding. At one point, the scene was Jerry Levine, representing **Time Warner**, and [AT&T CEO] Mike Armstrong on stage shaking hands about a big collaborative deal to unify the cable industry with AT&T to supply America with the greatest communications technologies on a national or North American footprint. I mean, bingo — that's the strategy.

Then the whole thing blew up. They couldn't collaborate, they couldn't agree. The whole thing turned into a dogfight instead of a collaborative exercise. ... Unfortunately, that inability to execute on the strategy plus the way they'd financed the MediaOne purchase was really the undoing of the company.

DBJ: How did that consolidation period through the late 1990s — culminating in the AT&T deal and MediaOne — change cable TV?

Malone: It was necessary. You couldn't have such a balkanized business with no standards, no consistency and no ability to participate in advertising or to use advertising. The industry was too small and too balkanized. It had to be consolidated. If it hadn't been, I don't see how cable could possibly compete with the telephone industry and the satellite industry. I think it would've been toast.

To the degree we were able to consolidate a fair amount of it, it created the Comcasts and Time Warners that were big enough to compete. ... If you still had a bunch of mom-and-pop cable systems, they would all be toast today — no common technology, no standards, no leverage with vendors, no leverage with programming networks. They would've been completely eaten alive by that balkanization and taken over by technologies, like satellite, that are ubiquitous.

I think consolidation was an absolutely necessary evolution in the business. You hate to see the entrepreneurs disappear because they were fun guys. But they all made a lot of money, and a lot of them are still around playing at the periphery of the game. ... But without it there would have been no way for the cable industry to compete with the big guys. You had to have Cable Labs, you had to have standards, you had to have size to be able to buy programming from Disney without being completely raped by **ESPN**.

It's been pretty ugly as it is, but there's been a big shift in the economics of the business to the programming conglomerates. Once the government passed retransmission consent, there was this huge sucking sound, and it wasn't Ross Perot's jobs going to Mexico. It was wealth going from the cable industry to the programming conglomerates, whether it was Disney or News Corp.

When all of a sudden, Fox News costs a cable operator a buck a month [per subscriber] and you used to think it was free, all of that is size driven. It's the law of nature. Big bubbles get bigger, small bubbles disappear — it's surface tension, the law of physics; and in business it's scale economics. It had to happen.

In Part Three of this interview, to be posted Wednesday at DenverBusinessJournal.com, Malone talks about the future of

telecommunications, Liberty Media's financial rescue of Sirius satellite radio, the credit crisis and the strategy for Liberty Media's holdings. This week's print edition of the Denver Business Journal includes more on cable's Denver roots.

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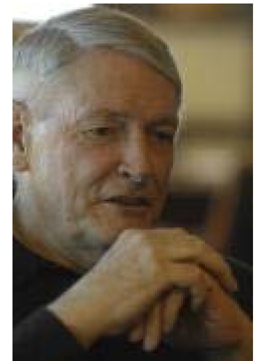
John Malone talks of his past and future: Part Three

Denver Business Journal - by Greg Avery

MEDIA



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In **Part One of the interview**, posted Monday, Malone talks of his roots in cable TV, and Tele-Communications Inc.'s approach to building a new industry. In **Part Two**, Malone discusses the 1990s mega-mergers TCI pursued with telecom giants Bell Atlantic and AT&T.

Now, in Part Three, the final portion of the interview, Malone looks ahead, talking about the future of telecommunications, Liberty Media's financial rescue of Sirius satellite radio, the credit crisis and the strategy for Liberty Media's holdings.

Part Three

DBJ: In some ways the country doesn't have that triple-play synergy [of one company selling voice, video and Internet] to the degree it seemed like we should have by now.

Malone: Well, the cable guys would argue with you. What's evolved now is you really have two competitors in the space with the triple play. One is the cable companies, collectively, who, for practical purposes, are all supplying a triple play of their own. There's no national brand for the cable guys, and each cable guy in their own area has a version of this.

Then, you currently have [Liberty Media-controlled satellite broadcaster] DirecTV in bundling deals with all the major terrestrial telcos nationally. So, anywhere in the U.S., you can get DSL, voice, VoIP and video in a bundle because of the DirecTV relationship.

DirecTV has that national footprint now, which is a huge advantage for DirecTV relative to any cable company, ... even in the case of **Comcast**, which covers only 22 percent of the country.

This is a story yet to play out, because, as 4G, or wireless broadband, comes in and becomes more potent in terms of its data-rate capacities and its ubiquitousness, the bundle of 4G services with satellite and DSL or an enhanced DSL starts to become a very competitive service relative to cable.

And the ubiquity is its No. 1 advantage — one national offering, one national brand, one national price. Cable suffers, as it always did, from the balkanization that was its birthright from the franchising process.

DBJ: One big advantage that cable has — Liberty Global is a great example of this — is the ability to roll out unbelievably fast speeds compared to what the telcos have generally been willing to do.

Malone: One can take data speeds up and become competitive. If speed is the killer, than speed will be a cable asset, ... unless the telco choses to overbuild the way Verizon is doing in their FIOS footprint. Only in Japan have the telcos gotten that aggressive outside the U.S. Otherwise, they're trying to make DSL be sufficient. There is a middle ground. How fast is fast enough really becomes the engineering catch phrase. If you're AT&T ... and you upgrade your DSL but you don't have to put video on it because you have satellite for video, you can take data rates up to be very competitive with what cable will offer in the near term. ... That's a relatively cost-effective thing for the telcos to do without having to spend immense amounts of money to overbuild their networks with fiber.

The question really is, now, as the world turns to mobility being important to consumers, will a consumer regard mobility of connectivity as important a phenomenon as speed? In other words, would you sacrifice speed for mobility, or will you buy both? Obviously, in high-income households, folks will buy both. You can afford it; why not? You can have extremely high speed from your terrestrial connection, but when you travel you have reasonably high-speed portability.

That's the next shoe to drop in the competitive race. How important in that environment is the bundle? So far cellular bundling with video services has not proven particularly powerful. And it may not prove that wireless broadband bundled with video turns out to be a dominant thing.

There are those who believe that we're entering a national branding and marketing game as much as we are a technology game. The argument the two dominant cellular carriers would make is that, "Hey, we're national, we're ubiquitous; our services will be promoted nationally, and that's cost-effective. We'll have stores everywhere that you can go in and sign up for it." It's one brand, one national offering, and that's something the cable industry has to worry about, because the cable industry's fragmented.

The cable industry's counter-move has been to back the Sprint WiMax deployment, which may or may not technologically be a meaningful competitor to 4G. You can take money on that bet, but for the moment, at least, that's the cable industry's counter-play.

And Charlie Ergen over here at **EchoStar**, he went out and bought some frequencies on the theory that he might be able to put something together, and he even went after Sirius radio. Nobody's really put Charlie on the couch to figure out why, but the theory is that there may be some applications there for mobile video.

They have their terrestrial repeating network, which is 800 sites now, and the frequencies they have.

The question is: can you blend that all together? And obviously we're now deeply involved in the Sirius thing, and we think we're going to win. We'll see.

DBJ: What does winning look like from a DirecTV standpoint? Or, I mean, a Liberty standpoint?

Malone: This is not a DirecTV play. This is a Liberty play on Sirius. It may evolve into some involvement by DirecTV. It could mean some involvement by Charlie. Right at the moment, we just saw something we were interested in and decided we should get involved.

DBJ: The favorable financial aspects of the assistance Liberty gave to Sirius are clear, but the strategic aspects for Liberty … ?

Malone: Initially it's a financial play, but it's also strategic. Obviously we have a large stake in DirecTV, and how Sirius could play into that is an important consideration, but it's not on the table today. What's on the table today is, let's understand Sirius and its assets. Let's help it avoid either bankruptcy or a takeover by somebody they didn't want to be taken over by, and let's study it for a while and then decide what the right moves forward are.

Whether that involves something with DirecTV, something with Charlie or it's entirely inside Liberty Capital, … we really haven't gotten a clear perspective on that, but we thought it was a very interesting asset and one we should get involved in.

DBJ: What would've been the danger of letting Charlie play out his hand?

Malone: Well, it's just one possible strategic asset we wouldn't be able to influence. It's as simple as that. If we got our involvement in it, we keep open whatever that strategic direction is. Whether that involves DirecTV or not, I don't have a clue today. And if Charlie has a great idea on how to exploit the asset, we may end up doing something with Charlie.

Our skills here, internally, are very much in financial engineering. We thought it was an opportunity to use our financial engineering skills to help keep a company alive and independent and see where it goes.

DBJ: Have you talked to Charlie?

Malone: I have not. I didn't think it was appropriate since we were bidding against each other. The government might look askance at two bidders talking with one another. And I'm sure the Sirius folks wouldn't like two potential acquirers or investors to be conspiring with each other.

DBJ: The recession, the capital market freeze-up and everything that's been going on for the past year or more — how do those things change Liberty's strategy?

Malone: The first thing you do is make sure you have enough juice to survive and you don't have any credit issues that are going to bite you in the near term, and that you've thought about how you manage your way through those issues. And once you're comfortable in that regard, you start looking for what opportunities exist that you can take advantage of in what is essentially a very tight credit environment.

Since we have a fair amount of capital, we look for opportunities to use the capital in ways that have real leverage and real synergies. You've got to play both offense and defense. Equities would appear at the moment to be very cheap, but that's on a historic basis, and who knows how big the hole is that

we're drifting into as a national economy, as a global economy?

DBJ: Do you see valuations coming back significantly? There are those who see the paradigm as shifted, and what we're seeing now is the new reality.

Malone: You tell me. We're talking about governments around the world taking their lending rates to zero to be stimulative, and you're talking about banks charging incredibly high interest rates because there's a shortage and they think they can take advantage of the situation. So, I think we're in a completely unstable environment at the moment.

Long-term valuations are going to be a function of long-term interest rates. Certainly, in our businesses, you value a business at the present value of its cash flow. And to the degree that present value is based on an interest discount factor, you've got to look at it that way. Also, the ability to use leverage to enhance debt equity returns is another way to do present valuation of cash flow.

I used to say in the cable industry that if your interest rate was lower than your growth rate, your present value is infinite. That's why the cable industry created so many rich guys. It was the combination of tax-sheltered cash-flow growth that was, in effect, growing faster than the interest rate under which you could borrow money. If you do any arithmetic at all, the present value calculation tends toward infinity under that thesis.

Obviously, the world doesn't keep going on forever that way, but, you know, 20 years for the cable industry in that scenario wasn't bad. The cable industry was growing faster that the prevailing interest rate, and that's why you had guys like Chuck Dolan ending up rich. It's just arithmetic, if you could borrow the money. Lots of entrepreneurs did. A lot them went out and effectively borrowed 100 percent to buy a cable system and then did a good job of growing it, and their returns on their equity were infinite.

In businesses that are valued by present-day cash generation, it's entirely a function of what you believe long-term interest rates are going to be. If you think long-term interest rates are going to be high because of inflation, that's always been kind to our type of industry, because our cost structure is largely fixed. Inflation lets you raise your rates and devalue your liabilities. Historically, inflation has been a growth builder for our kinds of industries.

If you think interest rates are going to be high in the long term because of capital shortage — there just won't be savings in the world that needs to be invested — that's a whole different view of the world. In that view of the world, who knows? If I've got to pay a 20 percent interest rate to attract Middle Eastern surplus cash, that's a whole different world than we've been in. That probably means the U.S. government is going to be paying 18 percent for the same money, right? That is a world view that is devastating to America, because we are so deep in debt and we have so much liability to role over or create in the future.

I'm a believer that — and this becomes philosophical as opposed to mathematical — that we will end up monetizing our deficit and monetizing our future commitments as a country. There's just no available source of funding. The administration can talk about raising taxes on rich people, but the rich people just aren't very rich any more, in case anybody's looked.

I think we're either going to have curtail spending in our welfare state or we're going to be inflating our currency substantially, which then argues for high interest rates but higher growth rates in nominal terms, in dollar terms — and therefore favorable for fixed-asset type businesses.

I don't know; you can speculate whether values will come back. The simplistic thing is if interest rates come back, and cash availability — leverage availability — comes back, then multiples will come back. Entrepreneurs will always be able to take an asset, leverage it up, operate it tightly and make it worth money to them and get good equity returns. If you see debt capacity return, you'll see private equity come in and swallow these businesses that are trading at low multiples because they can generate very high returns. Even if you don't postulate high growth rates, you can generate high equity returns if you can leverage them up. That's why the past four or five years had been huge for private equity.

If there is credit availability in the future, you're going to see private equity and entrepreneurs driving these multiples back up. If there isn't, they won't be.

It's largely a bet on what you think global savings and global financial moves will be. If China can, in effect, absorb all the world's savings in order to grow — if Asia becomes Asia-centric and finds ways to reinvest all the savings they're generating … Look, our boom, the Bush-era boom, was all generated by Asian savings being recirculated back into the U.S. without a lot of credit analysis. That's why we had the bubble, and that's why things have blown up.

I've got to believe that the Asians will return to a world where they have excess capital and where they're going to want to invest it. And if they're going to invest it back in the West, then interest rates will be reasonable, credit will be available. Good businesses with good life expectancies will find credit, and therefore multiples will go back up.

DBJ: How is Liberty hedging itself not knowing what that future will be?

Malone: Well, most of Liberty's liabilities are very long term and fixed, and those represent a pretty darned good bet on inflation. Our cash is basically all very liquid, very short term, very safe. We're sitting with cash looking for opportunity and with liabilities looking to be devalued by government policy. That's our philosophical view of how we sit right at the moment. Where we are using cash, we're using it both strategically and with high yields. The Sirius deal is a great example. We're sitting in a senior position in a business that's clearly worth more than the senior liabilities, and [we're] yielding quite attractive current interest rates. So, high yield, senior secured and strategic.

DBJ: Are you seeing many other deals like that out there?

Malone: Not yet. It's kind of interesting. Stocks are cheap; companies aren't. We can look out at a lot of things we wouldn't mind owning, that would make sense to own, and we could buy some stock in them at very low valuations. But to buy the company? No board of directors right now is waving the white flag and saying, "Take me out at my current stock price."

And I think that'll continue until credit changes. If credit softens up, we won't see those opportunities [like Sirius] very much. If the credit markets stay really, really tight and people face refinancing risks or there are cash-flow shortfalls and things like that, that's when the boards will start waving their white flags and saying, "Make us a proposal."

But we haven't seen a lot of that yet. We haven't seen a lot business bankruptcies in our space. Charter's a good example, but that's not really a bankruptcy as much as it is a restructuring managed by private equity guys.

Really, Sirius XM's the only example of someone that's in our space that's waving the white flag and willing to take in substantial capital at market rates. We'll keep looking for opportunities like that

where our capital can make a big difference in the success trajectory of a business. But so far there really haven't been many.

I look at the ones that [IAC/InterActive Corp. CEO Barry] Diller spun off, and the timing couldn't have been worse. You're creating low-cap type businesses that original shareholders couldn't continue to own, so there was a lot of redistribution going on. Those companies are all in a space where the economy is hurting their current results, and their stocks are trading at ridiculously cheap multiples. But you can't buy the company. You can buy some shares.

DBJ: Hasn't Liberty been selling IAC shares?

Malone: We're selling a little IAC stock right now primarily because we have a high tax basis in the shares we're selling. So we're triggering capital loss which we can use on our tax return, and we're monetizing a little of our position in the company. We can always buy back in, and in the short run we don't see big turn around coming in IAC primarily because 80 percent of their balance sheet is cash. So there's not a lot of downside risk in IAC because the shares are trading pretty close to cash. Even if their operating business turns around, it'll have relatively small effect on their stock value.

The real issue in IAC is, what does Barry spend the cash on? If he finds something really terrific, watch us pile back into the stock. If he just sits on the cash, there's no particular reason for us to own the stock. We might as well own the cash ourselves as own a pro rata share of his cash, which is where it trades right now. As Greg [Maffie, Liberty Media's CEO] has said, it really no longer has much strategic element for us. The businesses inside IAC — which are principally Ask.com, which really needs to combine with other search engines; and then there's Match.com, unless we all want dates ... and most of us are married, so Match.com's not really strategic for us — there's really not much in IAC that would be strategic with our businesses. The businesses that [Diller] spun off, on average, are really more synergistic with us than the ones that he kept.

DBJ: Liberty's e-commerce companies, what's the strategy with those? Is it just the cash flow they provide?

Malone: Two things. There's a long history of [Liberty Media] involvement with [television shopping channels] QVC and HSN. We like the businesses. We think that the absence of bricks and mortar makes them unique retail businesses. We thought that, as the Internet grows in importance for shoppers, it was a way to play that growth. We've acquired a series of businesses that are coming at it from the Internet side, while QVC is coming it from the video side and evolving to have greater involvement with the Internet. Strategically, we thought it was an interesting place to be. We were cofounder of QVC as a video channel way early, so obviously it's a very large asset for us.

Yes, it has very attractive cash flow, free cash flow and earnings characteristics. But it also has this very interesting Internet involvement, which clearly is going to be a growth driver in retail. It's just an interesting space that has very attractive financial attributes.

DBJ: Does the Ticketmaster-Live Nation merger deal mean much to you?

Malone: That could be very interesting to DirecTV. Here you're going to have unique relationships with talent and venues, and the ability to do pay-per-view events that are unique and the ability to promote events. So, there could be a very warm and fuzzy relationship. I don't think it makes any sense in putting [DirecTV and a merged Ticketmaster-LiveNation] together, but there could be a lot of synergy in them working together. If DirecTV says it's ready to promote a new talent and you want

to take it on tour, you know, it kind of works. And the ubiquity of DirecTV makes it kind of unique. You don't want to put it on broadcast TV because then everyone gets to see it for free, right? What you really want to do is promote something, increase it's economic value by having an element of scarcity, a uniqueness, but still be able to monetize it effectively.

So, DirecTV is potentially a very interesting relationship with Live Nation-Ticketmaster. I kind of like that one, myself. We'll hold onto that one for the foreseeable future.

We have a big stake in [travel-booking website] Expedia, and I think ultimately [time-share vacation services company] Interval Leisure Group, which is one of the spinoffs of IAC, should relate to each other.

Obviously, Home Shopping Network [another IAC spinoff] relates to QVC somewhere down the road. There should be synergies between those two that should be realizable.

You know, that's kind of the collection right there.

DBJ: And the **Atlanta Braves**?

Malone: The Atlanta Braves ... Unfortunately, had we been able to get the southeast Regional Sports Network — we were just a little late on that — but if the Braves had come with that regional TV network, the Braves would've made more strategic sense for us. We believe they're a good storer of value, a good asset for us. They obviously had good tax implications for us when we did the transaction with **Time Warner**. There's a lot of guys around who think that they're sports geniuses, and so it creates a little interest. But it's hard to see how they're strategic to us.

DBJ: There's no interest in getting involved in the operation of the team?

Malone: I long ago decided I know nothing about that, and someone should shoot me if I start to show an interest. That's a great way to lose money. We have it professionally managed by some extremely talented people. Our guys can kibitz, but they shouldn't start to think they know which pitcher to waive and which one to hire. We can help financially, as far as managing the finances of the team, and we can be a sounding board for the professional management that does run the team. But, like anything else, it is a skill set, and we have no pretensions to it.

Just like making movies. God help us if we think we can pick winners and losers when it comes to making movies. Even the good guys don't know how to do that. There are certain fields, in my experience, that it's good to stay out of. One can be a good investor in them, if one's prudent, but one shouldn't fool oneself into thinking one knows how it really works.

DBJ: There are, occasionally, observers of Liberty Media, and of you personally, who think you've been reassembling a coherent media empire like you had before.

Malone: Well, we've been going in a different direction. We've spun off Discovery, it's a separate, autonomous business; Liberty Global, a separate autonomous business unit. Pretty soon DirecTV — what I would call DirecTV Holdings — is being spun into a separate, distinct business entity with its own management. I suspect, somewhere down the road, we should have a retail business that is separate and distinct, so our investors can either own it or not, distinct from Liberty Capital and what have you.

We've been going in the direction of smaller, more focused and more independent as opposed to

more conglomerated, consolidated and combined. I've personally been a major driver of that because I think you get better valuations and more sustainability that way. Those entities have got to live their own lives, and they've got to compete. And, really, the way our tax system works, there's a huge negative to keeping everything in one statement, because if you ever sell anything you'd have double taxation. This way, our shareholders can benefit through their direct ownership of units, and if there is a transaction it's one tax at the shareholder level and its tax advantaged by capital gains differential.

It doesn't mean the businesses can't work with each other, and there should be some synergies. But I've personally put more emphasis on focus and independence and a management team that really controls the business and has a lot to gain by its success as opposed to a more conglomerated structure.

Yeah, you could put all these things back together, and it'd be a big company. But so what? Other than bragging rights, what the hell good does that do for anybody?

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