FRMO Corporation Q2 2013 Conference Call

Tuesday, January 22, 2013 4:15 PM ET

Operator

Good day everyone and welcome to FRMO Corporation's second quarter 2013 earnings conference call. As a reminder, this call is being recorded. At this time, I'd like to turn the conference over to Ms. Thérèse Byars for opening remarks. Go ahead, ma'am.

Thérèse Byars – Corporate Secretary of FRMO Corp.

Thank you, Farrah. Good afternoon, everyone. My name is Thérèse Byars. I'm the Corporate Secretary of FRMO Corporation. We appreciate all of you joining us for today's discussion of FRMO's earnings during the second quarter of the fiscal year 2013. The statements made on this call apply only as of today. The information on this call should not be construed as a recommendation to purchase or sell any particular security or investment fund. The opinions referenced on this call today are not intended to be a forecast of future events or a guarantee of future results. It should not be assumed that any of the security transactions referenced today have been or will prove to be profitable, or that future investment decisions will be profitable or will equal or exceed the past performance of the investments.

For additional information, you may visit FRMO Corporation's website at www.frmocorp.com. Today's discussion will be led by Murray Stahl, Chairman and Chief Executive Officer of FRMO Corp and Steven Bregman, President and Chief Financial Officer. They will review key points related to the quarter's earnings. Once Murray and Steven complete their remarks, we will move to Q&A. A summary transcript of this call will be posted on the FRMO Corp. website, which again is www.frmocorp.com. With that, I'll turn the discussion over to Steven.

Steven Bregman – President & Chief Financial Officer of FRMO Corp.

Good afternoon, all. Thank you for joining us. I was thinking just now that as the voice of FRMO Corp it might be possible for shareholders to get the voice of Ms. Thérèse Byars on their home answering machine. Anyway, to review the most recent quarterly financial information, in terms of the numbers you see there on the balance sheet and on the income statement, I think there is not a lot of information I can add to what you see.

We have a certain amount of income from the existing programs, we have a certain amount of dividend and interest income, we have a certain amount of returns on our capital, and that all filters nicely through our income statement and balance sheet to our shareholders' equity, which is up another few percent. All that is easily observable and calculable. Book value per share, fully diluted, I calculate now at roughly \$1.49. It was \$1.43 in the prior quarter, and \$1.38 in fiscal 2012.

I would say one thing that occurred to me—I'll discuss it briefly—and it really couldn't have occurred to me earlier than last Friday, because one of the significant operating assets we've got in FRMO Corp. is a hedge fund we advise for an entity called Horizon Global Advisors, and we get management fees from that. If there were ever to be any performance fees, we would get performance fees as well. I don't know how many of you follow that at all or can follow it, but this particular hedge fund, which we've been managing on behalf of Horizon Asset Management LLC, the subadviser since 2007 has had—at least for those involved in it—a somewhat storied history.

It was started in 2007, not that long before the 2008-2009 financial crisis and, I hesitate to say this—on the other hand, I suppose, in full disclosure you should know who it is who's involved in helping to manage the capital of the firm in which you hold stock—but that particular fund in 2008 was down over 70%. Seven-zero. That's a strange thing to say. For those of you who are familiar with professional investing and hedge fund managers as a class, I dare say it would be very unusual to conceive of a hedge fund being down well over 70% and staying open. Because for most managers, they're very much focused upon and enthused about the performance fees that they can get and there are high water marks. So for that particular fund, for instance, it would have to have been up subsequently almost four times in order to get to breakeven or the high water mark, in order to perhaps earn some incentive fees. Who in his right mind would think that could be done if the focus is to generate incentive fees?

In any event, we didn't close it and we continue to manage it without incentive fees. We have quite a bit of our own capital in it. I think for us, as of December 31, the figure is about $5.2 million of limited partner capital of FRMO's in there. By my estimation, as of Friday night, we probably crossed the breakeven mark. So, that fund has about $80-plus million of limited partner capital in it, other than FRMO's. If we were to work out just one scenario, let us say that the fund were to be up 20% on a gross basis this coming year, that could easily add in excess of $1 million of incentive fee income to FRMO Corp, which is not insignificant. That doesn't include the base fee, it doesn't include another million dollars or so of increase on limited partner valuation, but that's something that we haven't been able to enjoy yet, but we might be able to enjoy it fairly shortly.

Much the same could be said of all the various hedge fund assets that exist at Horizon Kinetics. There's a not unsizable fund at Horizon Kinetics, which is in a very similar circumstance. I just thought I'd add that because that's something I *can* add. The rest of what I might tell you is fairly observable. The assets under management at Horizon Kinetics are marginally higher than they were last quarter, no obvious changes there. So, in terms of information you might want to have that'll be helpful to you, most important will be about things that we might be able to do in the future, as opposed to what you see in this past quarter.

In terms of being able to add anything of value, maybe like the old promotional saying from *The New York Times*, "All the news that's fit to print," that's really all that I've got to say that's fit to say. Now, I'll defer to my colleague, Murray Stahl.

Murray Stahl – Chairman & Chief Executive Officer of FRMO Corp.

Thank you, Steve. First I'll provide a few highlights from the balance sheet. The way I like to look at it is to compare the most recent quarter end, which is November 30, 2012, to one year ago, November 30, 2011. I think you'll find these figures interesting in a comparative sense. Cash and equivalents in November 2012 were up to $21.7 million, a not inconsiderable amount of money by any standards. A year ago at November 30, 2011, that figure was $13.6 million. So that's a fairly substantial increase. Our investments on a mark to market basis were $42.7 million on November 30, 2012 and $37 million on

November 30, 2011. That's a $5 million increase. Going down to shareholders' equity, you'll see that now we're at, I believe, the record amount we've ever had: $58.3 million of shareholders' equity, and we were at a little bit less than $50 million a year ago. So, that's a fairly substantial increase as well.

It's also worth observing that when our assets increase in value, we're required to provide for taxes. So if we were to buy any asset that's a publicly traded security—XYZ Corporation, for instance—if I put $100 in XYZ Corporation and we were fortunate enough that it doubled, in an accounting sense we wouldn't enjoy the full doubling at once, but would have to provide for taxes that would be payable if we were to sell that investment. Towards that end, you will observe that the deferred tax liability as of the most recent quarter is up to $4.3 million. But, of course, we haven't sold those securities, so you need to think of it, at least at the moment, as a tax-free loan from the government. Unless we intend to liquidate those positions, we actually have more money working on our behalf than you might think from merely looking at shareholders' equity.

In that regard, it's worth noting not just the difference between the available for sale investments and their cost basis, which is not inconsiderable, but you should also pay very close attention, I think, to securities sold, not yet purchased, because those are our shorts. With net proceeds of roughly $3.7 million, we have a market value, at least as of November 30, 2013, of $1.7 million and we continue to hold essentially all of those positions. There are many interesting things going on in that sense and I think it merits close scrutiny. Obviously, it's our objective to continue to increase the shareholders' equity.

Another pathway for increasing shareholders' equity is what might be happening in Horizon Kinetics. I think last time we talked about a new hedge fund that's involved in index arbitrage. We also have a mutual fund that, while not new, has had its investment objective changed from investing in water-related securities to being a fund meant to simulate a bond rate of return using out-of-the money options. The fund's name is now the Kinetics Alternative Income Fund. The idea is to generate a 3-plus percent rate of return with minimal variability in unit value. We only changed the fund on December 31, so it's very early to say whether or not we'll be successful. However, I think it's worth paying very close attention to how that fund behaves, and not merely to what the performance is. If we're right in our contention that the unit value won't fluctuate very much, if at all, and we can actually generate the returns that we expect, that could be a very successful investment product.

In the investment management sense, there's enormous opportunity in the world of bonds at the moment, because rates are low and the high coupon bonds that do exist are rapidly either maturing or being called for redemption. According to the Securities Industry and Financial Markets Association (SIFMA)[1], the size of the bond market is over $37 trillion. That's a lot bigger than the equity market. I would argue that there's currently a bond market panic going on in that bonds will always be an important part of everyone's asset allocation but, at the moment, they just don't earn a rate of return even equal to the presumptive inflation rate. So, the people who can solve that problem, I think, will be extraordinarily successful. We're paying a lot of attention to that segment of the marketplace.

[1]http://www.sifma.org/

I also think it's worth noting that in the last 10 or 15 years, a tremendous number of managers have made a lot of money in the bond market by essentially leveraging bonds to the degree that the beta on the leveraged bond portfolio, meaning the volatility, would actually be equivalent to that of an index like the S&P. As long as rates were in an exponentially smooth declining pathway, it was a very viable strategy. Open your newspaper and look at where rates are and you can clearly see that it's not a viable strategy anymore. At least going forward, the idea of leveraging bonds with a view to providing equity-like returns without equity-like risk is a strategy that can't possibly produce the successes that it has in the past two decades. I think the emphasis is going to shift to creating bond returns synthetically using equities, which very few people are doing.

The point is not that we started yet another product. The point is that you should not forget the objective of FRMO; you should not forget the objective of Horizon Kinetics. The idea is to use our research capability and use our so-called intellectual capital, to the degree that we have intellectual capital, to create revenues without the requirement of commensurate large capital investments. The difference between the cost of the products we create and the revenues that we receive, if we're right, should result in a reasonably robust return on equity. A lot of seedlings have been planted in the last year and in the next couple of months we will see whether or not they actually bear fruit.

That's essentially a *tour de raison*, so to speak, of what's going on in the various companies. Why don't we can open it up for questions and we can address whatever might be on your mind. Operator, if you can facilitate that, I'd appreciate it.

Operator

We have no questions from our telephone audience at this time.

Murray Stahl – Chairman & Chief Executive Officer of FRMO Corp.

Okay, well, in that case we thank the telephone audience for their attention, we hope we've addressed whatever is on your mind in the prepared remarks and, in roughly three months, we will reprise this and will give you an opportunity to ask questions again at that time. Thanks very much and good afternoon.

Operator

Ladies and gentlemen that concludes today's conference. Thank you all for your participation. You may now disconnect.

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