Operator

Good day everyone, and welcome to the FRMO Quarterly Conference Call. As a reminder, today's call is being recorded. At this time, I would like to turn the conference over to Thérèse Byars. Please go ahead.

Thérèse Byars – Corporate Secretary

Thank you. Good afternoon, everyone. This is Thérèse Byars; I'm the Corporate Secretary of FRMO Corp. We appreciate all of you joining us for today's call.

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Today's discussion will be led by Murray Stahl, Chairman and Chief Executive Officer, and Steven Bregman, President and Chief Financial Officer. They will review key points related to the 2018 third quarter earnings.

A summary transcript of this call will be posted on the FRMO website in the coming weeks. And now I'll turn the discussion over to Mr. Stahl.

Murray Stahl – Chairman & Chief Executive Officer

Thanks Thérèse, and thanks to all of you for joining us. Today, I thought I would begin with a few questions that I posed to my colleague, Mr. Bregman, while waiting for this call to commence. You all can try it, and we'll see who gets the answers first. Will it be someone in the telephone audience or will it be Steve Bregman?

Here is the context of the questions. In looking at our current balance sheet and considering the companies in the Russell 2000—of which, oddly enough, there actually are fewer than 2,000 companies—how many companies in the Russell 2000 have the following:

1. Less total assets than FRMO's total assets of almost $162 million?
2. Less shareholders' equity than FRMO's shareholders' equity attributable to the company, which is a little more than $122 million?
3. Less cash on the balance sheet than FRMO's approximately $52.6 million?

I don't know the answer to these questions, because I didn't do the computation. But, as I mentioned to Steve, I think he will find quite a few companies. He will calculate it, and perhaps some of you will calculate it. I think the answer will be illuminating.

Steven Bregman – President & Chief Financial Officer

I would add a slight refinement. Glancing at our balance sheet—of course, here, it becomes a little less well-defined when you put in your search terms or your filter ranking terms—but in addition to the $52-plus million in cash and equivalents on FRMO's balance sheet, there are also the bond and equity securities available for sale. Of course, we don't know what's in some other firm's equity securities for sale, so that becomes a little less certain. But for FRMO, that's another $33 million.

Murray Stahl – Chairman & Chief Executive Officer

Well, true. I think you'll find that most of the companies in the Russell 2000 don't have liquid investment securities in their current assets. If you want to look at it that way, I guess the difference would be a higher number. Anyway, you can add it to the list of questions, if you like. I'm interested in what the answers will be.

I bring it up as an introduction to what we'll talk about today, which is to give you some historical context once again. On the FRMO website, you can see all the quarterly financial statements. If you go way back, you'll see a period of time when we had almost no investments; all we really had on the balance sheet was cash. Yes, we made some investments, but they were fairly tangential and, if they went to zero, it wouldn't have really mattered one way or another. It would've been a non-material rounding error.

From the start, our whole idea was to build up a corpus of reserves, such that, when we reached a point when we were ready to make an investment, we wouldn't have to start over if, sooner or later, something didn't work out. We wanted to build enough so that we could make a meaningful investment and, in the event that it fails—which is always possible—we'd live to fight another day. There's an element of risk control here that is hard to see unless you reflect on it.

I'll start with the balance sheet because everything we do really comes from there. The idea of FRMO is to grow out of merely being a proxy for Horizon Kinetics ("HK") and to engage in other investments and operating activities. The cash is one item and, of course, we will talk about the exchanges and the cryptocurrency. The idea is that we have a lot of initiatives going on, some of which pertain to Horizon Kinetics, and some of which are quite independent of Horizon Kinetics.

Let's continue with a question that I promised to answer in this presentation every quarter. Many of you want to know what FRMO's cryptocurrency exposure is on a look-through basis. Of course, we don't want to be known as "Cryptocurrency Corp.," but a lot of the exposure is from our investment in the partnerships which, as you can see on the balance sheet, amounts to about $40 million of market value.

About a week and a half ago, when I saw this balance sheet for the first time, we calculated FRMO's look-through cryptocurrency exposure. At that time, it was roughly $5.7 million. As of now, it might be almost 20% higher than that. That $5.7 million did not include the following balance sheet items: FRMO's investment in Digital Currency Group; the investment in HK Cryptocurrency Mining; nor the computer equipment, net of depreciation, of $82,000. The computer equipment is comprised entirely of the servers that we're using for cryptocurrency mining.

Also not counted in the $5.7 million figure is the roughly $70,000 of cryptocurrency balances, including bitcoin, ethereum classic, Zcash, and whatever cryptocurrency that we have mined and are holding on FRMO's behalf. We haven't broken that figure out yet, although maybe we should. So, the exposure is $5.7 million plus the appreciation since that date, plus the various items that I just mentioned, almost all of which you can see on the balance sheet, except for the cryptocurrency, which then was worth about $70,000, and is now worth maybe 20% more.

The reason we bring that up is to illustrate a couple of things. The first is that if you take the cryptocurrency we've mined, at market value, and divide it by the computer equipment we have on our balance sheet net of depreciation, and you add back the depreciation, you'd get roughly $95,000. That gives you an idea of the return on capital. The first servers for FRMO began mining in September of 2017, but we hadn't put the entire $95,000 to work in 2017. That figure includes the servers we've been buying all along. And, of course, we've been depreciating all along. I haven't gotten to the point of actually formalistically calculating the true internal rate of return on the investment in a time-weighted fashion, because I don’t think it’s really all that important. I think that all we have to say is that it’s a very high rate of return.

It’s also worthwhile saying that inside Horizon Kinetics, we have similar investments. FRMO owns a piece of Horizon Kinetics, and the reason for bringing it up is that we intend to gradually expand that mining business. If it stays where it is in terms of return on capital, it will actually create a meaningful revenue stream for us, if we do decide to expand it.

You could argue—and many people do—that such a rate of return is unsustainable. We’ll go through in a minute some insights into that view, because the revenue stream doesn’t work the way you might think it works in ordinary businesses.

In January, HK Cryptocurrency Mining LLC paid a cash dividend equal to about 5% of the cost basis of our investment. In a couple days, we will receive another dividend that will be slightly less than 10% of the cost basis, or 10% of the $68,000 you see on the balance sheet. When you look inside the fund, even that amount is not fully invested. Horizon Kinetics intends to create a much larger fund in the next couple of months. That plays an important role in investing and in asset allocation in general. More about that in a second.

The important point is that we’re evolving in this manner because the opportunity set in traditional investments of bonds and stocks is narrowing. We haven’t stopped that type of investing, as you can see from our balance sheet, but the opportunity set is narrowing. I’ll give you one simple statistic, although I could give you many more. The market capitalization-to-GDP ratio of equities is about 1.5x. Since the GDP statistic was adopted in 1938, I think that’s the highest that ratio has ever been. If it turns out I’m wrong and it’s not the highest, then it’s virtually the highest. But I actually think it’s the highest it’s ever been.

Therefore, it’s only reasonable to say the opportunity set is much narrower than it’s ever been. That situation doesn’t mean we’re never going to buy a stock again. It just means we have to be cognizant that the range of opportunities is not what it was. In the bond market, I think it’s pretty much self-evident that the interest rates worldwide are so low that it’s hard to imagine they’ll go materially lower. It’s a big problem, so you have to be creative and do interesting things.

For us, and for asset allocation in general, the way I would compare these two elements of mining—the HK Cryptocurrency Mining LLC and the computer equipment—is as follows. In the HK Cryptocurrency Mining LLC, the idea is to mine the cryptocurrency, then sell it that day. We accumulate the cash for a quarter, and then we pay it out as a dividend. Internally, we refer to that dividend as seigniorage, meaning we’re actually creating money—if you accept the idea that cryptocurrency is going to be money—and earning a margin on that.

The reason it's important in asset allocation is that the people who practice modern asset allocation want or expect it to create historical rates of return without the historical valuation parameters. On the bond side of an asset allocation problem, how do you create the historical yield when the bonds and the equities are not at their historical yields?

In modern asset allocation models, there are many ways of mixing and matching all these different funds, indexes and securities together. The idea is to find indexes and/or securities whose volatility characteristics, at least historically, offset one another and to thereby control volatility. But all you know is the historical volatility; you don't know the future volatility. Nor do we know if they really will offset each other simultaneously. Moreover, that doesn't solve the return problem.

The reason I gave you the numbers for the HK Cryptocurrency Mining LLC is so you can make a much more reasoned assertion about what the net asset value would be, because there's a certain amount of depreciation of the equipment and a certain amount of cash we hold back to buy new equipment when this equipment inevitably wears out. But the idea is to try to keep the net asset value stable, and we're keeping it stable by basically applying nothing other than generally accepted accounting principles. There's a certain amount of non-cash depreciation expense. Reasonable minds may differ about what the depreciation rate should be, but we think we've applied it very conservatively. Whatever the depreciation is, we just hang onto that part of the cash flow; it stays in the bank. And we pay out the profits, give or take a couple of pennies.

The variability of that investment, assuming we've estimated the depreciation schedule accurately, is that cryptocurrency prices will fluctuate, and therefore the quarterly dividend yield will fluctuate. If I'm not mistaken, I believe people would much rather live with an uncertain dividend than with an uncertain net asset value. I would compare that to the bond part of a portfolio, and I told you what the dividends are, so you can see how robust it is.

On the equity side of the portfolio, you have the computer equipment utilized for cryptocurrency mining. The idea there is not to sell FRMO's cryptocurrency; it is to hang onto it. As you undoubtedly have noticed by now, the cryptocurrency fluctuates enormously in value. It's not a big deal from the point of view of this balance sheet, since the amount accumulated to date is so small. But, if we keep holding it, and we keep mining more, eventually it might be a big deal. Then, at some point in the future, we can make a decision as to whether we want to keep it or sell it. So, in that way, it is akin to an equity investment.

If you are an aficionado of modern portfolio theory, then you believe that risk, as expressed in price variability, is somehow related to expected return. Well, you can see what the cryptocurrency variability is, which you might think explains why the return is so high in a modern portfolio theory sense. I don't buy that for a minute. Looking at the cryptocurrency mining returns, it's worthwhile saying why I do not believe it represents a bubble.

Why do I think the returns were what they were? Consider the bitcoin market capitalization, which is roughly $140 billion. While we don't know what the future value will be, of course, we know that as long as the bitcoin protocol is followed, the maximum number of bitcoins will be 21 million in the year 2140, and that's it. A couple of days from now, the number of bitcoins will reach 17 million, so we know where we'll be in terms of remaining issuance. Compare that policy to that of a currency such as the Brazilian reais. The market value of the Brazilian reais, which on a cumulative percentage basis has been depreciated by debasement to virtually zero, is well below where it was decades ago, and now has a $750 billion market capitalization.

We recognize that cryptocurrency has its risks, that there is certainly a high risk of failure, but is the risk any greater than that of an inflationary currency like the Brazilian reais, knowing that Brazil is a serial debaser of its currency? Why should bitcoin be worth less than the Brazilian reais? I have no idea. And Brazil is not the only country that habitually debases its currency. All countries debase their currencies; it's just a question of how long it takes to destroy 99%-plus of the purchasing power.

I believe cryptocurrency, in its whole pattern of use—meaning you either buy it or you mine it with a view to holding it—is essentially a new set of asset classes. If you mine it and hold it, it is a new asset class on the equity side of the asset allocation spectrum. And the mining incarnation, in which you immediately sell the currency and distribute the cash in whatever fiat currency you want, that's analogous to conventional bonds. If you were to take a tiny portion of the de minimis yield that you get from conventional bonds, and invest it in cryptocurrency mining in its bond incarnation, with a view to selling the currency as soon as you get it, if you look at these numbers, I don't think you'd have to invest very much money before you would have a meaningful yield pickup. Given that, I think it's important that we expand this business in Horizon Kinetics.

Another interesting exercise would be to take those numbers and, for our own capital account, consider expanding the mining business—which we do want to do. You can calculate how much money we would need to invest in servers to more or less duplicate the entire investment management business. I won't tell you what that number is; that's part of your exercise and your homework, just like figuring out how many companies in the NASDAQ have more cash than we do. But you will see it's not a huge number.

In a risk sense, that does a lot for us because, if something unfortunate happens in the capital markets, we could expand our business greatly in extremis. Assuming this opportunity is available, we could replace lost opportunities from depreciating securities, if that scenario presents itself. It gives us a lot of flexibility.

Just for your information, as of the most recent reckoning, the liquid assets on the balance sheet of Horizon Kinetics are roughly $87 million; therefore, we have a fair amount of liquidity, and we don't consolidate Horizon Kinetics in FRMO's financials. When you calculate how much money we would have to put in to basically replace the investment management revenue, it won't make a very big impression on the $87 million—and we have more money on the way. So, there's that.

I should mention, in passing, something I note in each call, which is the line for "securities sold short, not yet repurchased." You can see what the proceeds are, and you can see what the market value is. As our total assets expand, we will expand this business as well. There was a time when we had never closed out a position, so you could look at this line and see the sum total of all of our position profits made up to date. We can't do that anymore because we've had to close out positions for tax and other reasons. But basically, the profits we've made here have actually paid for a lot of small investments. Consequently, that's a very robust business, and I'd like to expand it.

It's also noteworthy that we're now in a lower tax bracket, because we are a beneficiary of the tax reform that went into effect at year-end 2017. One of the reasons our total assets are higher is because there was a certain amount of deferred tax liability that was reversed when the new tax bill went into effect. But we also had some appreciation that, oddly enough, offset the tax benefits, meaning we had some appreciation, and contingent taxes on the unrealized gains were due, but at the lower rate.

That's kind of a statistical oddity, but charming as well. Even though we got a pretty big benefit from the tax bill, if you look at the deferred tax liability right above the total liabilities line, you'll see that it is $8.9-odd million at February 28, 2018, versus $8.8 million at May 31, 2017. Even though we had this big tax benefit, we still ended up with almost $9 million of deferred tax liability.

Steven Bregman – President & Chief Financial Officer

That deferred tax liability should've gone down by something like several million dollars, shouldn't it?

Murray Stahl – Chairman & Chief Executive Officer

And it did, but then we had appreciation of other assets, and it went up. A lot of the appreciation occurred in the limited partnerships, and taxes are due against it. Of course, we're not selling very much, if anything, in the partnerships, and we have no intention of pulling any money out of the partnerships. So, we're not likely to pay that number any time soon. But we do trade occasionally in the partnerships and, from time to time, taxes are due.

In sum, our financial position is as good as it's ever been, and we keep looking for more investments that are a diversification from the traditional or conventional securities markets. We do not intend to make FRMO into some version of a Cryptocorp USA. We will be engaging in other investing activities as well. But we do plan to expand these cryptocurrency operating businesses in some reasonable, prudent fashion.

Right now, we have what I believe to be the highest shareholders' equity we've ever had. If you go back to February of 2017, one year ago, we had $102 million of shareholders' equity and now we have over $122 million. One year ago in February, we had an $11.8 million deferred tax liability. Now it's $8.9 million, and we obviously paid some taxes in the interim as well. You can see that we stand in a comfortable position, but we're not complacent. If we can, we intend to build this a lot further.

On the Horizon Kinetics side, let's not forget that we are orienting our businesses much more to performance-fee oriented asset management. This approach creates a certain amount of earnings volatility, but it also greatly increases our return on capital. If you take Horizon Asset Management LLC, Kinetics Asset Management LLC and Kinetics Advisers LLC as combined companies—you will recall that, historically, they were separate companies—I think it's the best year we ever had in aggregate, with the exception of 2007.

On a firm-wide basis, Horizon Kinetics has $5.5 billion of assets under management, with 36% in the high net worth business, and 14% with intermediaries, which for the most part are asset allocators. We have 6% of the assets under management coming from sub-advisors; the institutional business is 11%, and the Kinetics Mutual Funds are 24%. Alternatives are 9% of the Horizon Kinetics AUM and include cryptocurrency, among other investments. We've done some one-off investments in high yield, including energy bonds. We've done some one-off investments in Fannie Mae and Freddie Mac preferreds, and we'll find out in the next year or two whether it has been a sensible undertaking or not. So, I think we're in pretty good shape as far as our AUM portfolio goes.

That's an overview of where we're at in all our major dimensions. I didn't go into the securities exchanges, because some of the questions refer to them, and I don't want to repeat myself. I'll just read the questions as they're presented to me, and then I'll give you my response.

Question 1

My theory of the case about the Bermuda Stock Exchange (BSX) strength in Insurance Linked Securities (ILS) is that it is the home market for considerable amounts of reinsurance, and that the "critical mass" of listings is provided by Bermuda domiciled reinsurers using the exchange to list. Absent that "home market" supply/need, Bermuda might decline in scale and ILS activity might move elsewhere. Something like 2/3 of all ILS are U.S. related catastrophes, indicating the dependence of the market on U.S. reinsurance, for which Bermuda is the primary offshore provider.

Murray Stahl – Chairman & Chief Executive Officer

So, that's a statement, not a question, but I interpret it to mean, "Is there not a heavy reliance on one aspect of insurance for ILS, which is United States reinsurance?" Yes, that is true. It's hard to keep two-thirds of the market but, so far, we have two-thirds of the market. There may come a day when it will be very difficult to keep that market share, but it's very possible that the market could have become a lot bigger.

There are new, smaller developments that are unique to what's happened historically in insurance and insurance-related securities. They may be just seedlings that go nowhere, or they might grow a lot. ILS represents an insignificant part of the insurance market and, in theory, there are many potential outcomes for ILS. For example, some people believe that there will be insurance futures one day. I don't know if that will ever happen, but it's possible. All sorts of developments are possible right now, and they don't necessarily have to be insurance-related. Bermuda is a great jurisdiction and a great place to list securities.

Ultimately, I believe that everything in the world of exchanges will evolve to the blockchain. What does that mean? In my reckoning, that means—and this was always our theory—that small exchanges with a very small market share are in a much better position than bigger exchanges. Why? Because, while they may have less capital, they also have less to lose. They don't have a lot of incumbent business, so they don't have to worry about doing something on a blockchain that might displace a lot of their existing activity. I think there's a certain amount of liberty of action that small exchanges in general have that big exchanges don't. It's just my opinion, and we'll find out one day if I'm right.

Question 2

The tax rules which, to my understanding, remove some of the tax deductibility of retrocession to offshore carriers, mean that Bermuda will now have to compete more aggressively with U.S. onshore reinsurance options. This might lower overall supply and, thereby, hurt the BSX.

Murray Stahl – Chairman & Chief Executive Officer

That's a true statement but, so far, we just haven't seen any meaningful diminution of business. That doesn't mean it won't happen, and I can't predict the future but, as of the most recent reckoning, I don't see any evidence of that.

Question 3

I guess the question is, how accurate is this view? To what extent does the BSX advantage in ILS depend on the size of the home market? What other competitive strengths does it offer in serving ILS?

Murray Stahl – Chairman & Chief Executive Officer

Well, I guess I answered a bit of this question earlier. Basically, ILS is a small market. The major securities exchanges have some interest in doing something with ILS, but we just haven't seen much happening. There are so many pressing issues in the world of exchanges that they have a lot more to focus on than insurance-linked securities. And I think everybody is thinking very carefully about the implications of the blockchain.

I believe that one day everything that trades—and, by the way, that includes real estate, insurance—everything—will trade on the blockchain. How long will that transition take? In my opinion, 5-6 years. It's just a guess, but I think it's an educated guess. I could be very wrong, so don't take this for more than what it is, which is merely conjectural. But the blockchain evolution is moving so fast that it would require several hours just to provide a lecture on it.

Here are a couple of developments to look at that are just facts, not predictions. I urge you to check out something called BitClave, which is one example of thousands that you could look at. What the heck is it? BitClave is just a search engine, kind of like Google. What's the idea behind it? It's not really different from Google, except in one meaningful respect. As you search for information on Google, Google maintains data on you and your searches. Ultimately, based on that data, advertisers might tailor their ads to you, or a group of people like you, or a group of people with whom you share characteristics, and so on. It's a great debate right now about who has a right to your private data. You know the answer to that.

Well, in BitClave, all that data will go on the blockchain instead of on big servers like Google's. People will be able to look at public keys associated with that data, but they won't know who the owners or subjects of that data are. One might see that somebody, let's say X, likes to buy certain kinds of consumer items. You might be X, and some sellers might be very interested in sending ads to you, but they don't know it's you, because they can only see a certain public key. They would contact you via your public key, not knowing who you are, and they would say, "I would like to advertise to you." If you say yes, you'll be able to set a parameter. You could say, "I don't mind a pop-up ad every 25 seconds, just pay me 10 cents for each ad. Or, you may not want to see ads at all. Or, you may want to see only ads that pertain to classical music, or musical instruments, or vacation resorts, or whatever your interest happens to be.

In short, everyone's data would be the property of the individuals who generate that data, and the revenue that flows from that data would go to the individuals who own it, rather than to the big technology companies. That's a big deal, and it's just one of many plans to recapture individuals' online browsing and purchasing data.

There's another site that may shock you to hear about—I don't use this myself—but it's in the news, so it's topical. People ask: "What happens to the Facebook data? Who has the right to use it?" This talk is obviously generated by the people who use the various Facebook applications, like WhatsApp. They ask: Who has the right to view that data? Who can use it? For what purposes can they use it? It's a big issue. I don't know the answers to these questions. I don't know if Facebook should be regulated or not and, if the answer is that it should be regulated, I don't know how it should be regulated. I personally don't have the slightest idea.

But I can tell you that there is an app available for free download that, as far as I can tell, is indistinguishable from WhatsApp. It's called Telegram. Telegram has the same features as WhatsApp; the only difference is that users have absolute control over any data associated with their activities. Therefore, the only people who will see that data are those who users allow to see it.

This is a relatively new phenomenon. I don't remember how many months it's been out, but it hasn't been out long. When I tell you the next number, you're going to say I made it up, but it's absolutely true. Telegram has 200 million users right now. I know you'll find that number unbelievable, but you can verify it very quickly. You might find it even more shocking that Telegram accumulates 350,000 new users every single calendar day. Obviously, it will make an impression.

The Telegram creators completed two private initial coin offerings so far, and they raised something like $1.7 billion to further expand its reach and to add applications.

That's just one example of products being developed. If you want more of a bird's-eye view of what's happening in general, I suggest you visit a website called GitHub. This one is basically a shared open source community of people who develop applications and programs. There you'll see that programmers from all over the world are collaborating on developing applications, software, and all sorts of just amazing things. How many people are on GitHub? Twenty million, and growing.

Think about it: yes, there are big technology companies that can put 2,000, 3,000, or 4,000 people on a project, and I realize they have deep balance sheets and a lot of cash. But how much can 3,000 or even 5,000 people do against 20 million? GitHub is a big deal, and I think people should reflect on that.

Question 4

This is a crypto follow up question. You described the difference between bitcoin and many other "coins," including the public nature of mining in bitcoin vs. the more owner/sponsor focused rewards in IPO-like alt-coins. That made sense. My question is, why do you then support XRP, which is controlled by Ripple and is essentially centrally owned and controlled? I get that it has tontine characteristics and is effectively a way to go short the fiat currencies en masse. But mostly it is benefitting the insiders who own 60 billion XRP, isn't it? Might they not change the operations to suit themselves? Also, if the need that it is solving is to lower transaction costs between currencies, how good an idea is it that it be deflationary, such that the cost of the system goes up with each use, instead of down as most systems do? Just the store of value, then?

Murray Stahl – Chairman & Chief Executive Officer

All right. First of all, maybe it's my mistake, but I didn't want to give people the idea that I am a huge supporter and believer in XRP or Ripple. I merely wanted to assert that it has some good features and some bad features. Let's just start with the features that I don't like.

Unlike the other cryptocurrencies, XRP is a permission based system. In other words, you could decide tomorrow to become a bitcoin miner if you want to, but to be an operator of the Ripple system requires permission from the people who own it. That is an important difference. They're both distributed ledgers, but one is distributed based on whoever wants to join it, and the other is a closed system. I think open distributed ledgers are better than closed distributed ledgers.

More importantly, there is no reward for operating Ripple. For a bank, the reward for operating Ripple is that the bank will be spending money. Why spend money to make life easier for its client base? Because the bank would be saving money on aspects of their operations like the SWIFT system, which is very cumbersome and, in some cases, error-prone. The idea is that the bank might end up getting less revenue but, in theory—and I don't know if the theory is valid—at least the bank would have a proportionately lower cost and would be better off at the end of the day.

Ripple poses some dangers for the banking system, because foreign currency trading, or the spread earned from converting from one currency to the another, is one of the biggest profit centers for all the global banks. Theoretically, if XRP becomes a truly accepted currency, that revenue would go away.

The deflationary aspect of it is what I find interesting. I don't want to make too big a deal out of it, though, because, at the moment, there's a charge imposed to prevent spamming. When XRP is used in a transaction, that coin is burned, so a certain amount of the currency disappears every day. Now, there are 99.99 billion XRP. So, if you look at how much currency is burned a day, at the current rate, it will take a very long time before you make money from the deflationary aspects of it. It is deflationary, and the unit issuance does decline, but it's not declining by much.

XRP does have the property that it is decreasing at an increasing rate, because as the denominator, or the number of units, goes down and the transaction volume stays the same, that volume becomes an ever greater proportion of the remaining units. But it will be many, many years, and perhaps, at the current rate, many centuries before its shrinking volume becomes a significant factor in its valuation character.

Of course, the velocity of transactions could increase. And, in my opinion, XRP does have some interesting properties, from the point of view of global multinational corporations, because they can keep all of their capital in one account and can use it interchangeably, instantaneously, across countries, assuming it's accepted as a means of payment. It would be a lot more cost efficient to monitor. So, it has some benefits.

Steven Bregman – President & Chief Financial Officer

May I ask a question? I hope this isn't excessively naïve. But if—and maybe it's an "if" that should be capitalized, italicized, and underlined—but ***<u>IF</u>*** bitcoin, for instance, does develop the transactional speed that the bitcoin lightning network seems to hold as a possibility, and if it comes to be sufficiently widely accepted amongst the global populace, so that there's enough of a network effect, why might one even need Ripple?

Murray Stahl – Chairman & Chief Executive Officer

Oh, that's not a naïve question; that's a good question. I understand the premise of your question. Basically, why would you need Ripple? Because Ripple is not designed for somebody who wants to send $50 across borders—although, in theory, it could be done—rather, Ripple is designed for extremely large transactions.

Steven Bregman – President & Chief Financial Officer

So, it is for large financial institutional transactions. It happens within their accounting systems, regulatory systems, and so forth.

Murray Stahl – Chairman & Chief Executive Officer

When you're transferring large amounts of money, apart from the fact that you want to make sure it happens, and the transfers might be bank-to-bank or corporation-to-corporation, and when you are moving large sums of money, governments have a responsibility, a duty, and certainly a desire to establish the provenance of the money. They need to determine if it is being used for nefarious purposes, like by drug dealers, terrorists, or for some other dangerous activities.

Steven Bregman – President & Chief Financial Officer

So, if Ripple is integrated into the banks' accounting and oversight systems, then they're tied to accounts and they're tied to other information.

Murray Stahl – Chairman & Chief Executive Officer

Every transaction would be on the blockchain. And, by the way—maybe I should've said this in the beginning—but whether its bitcoin or Ripple, there are people who say it's very bad for them, and it's true. But, for some people, it's really great. You can see why the advent of cryptocurrency might be not such a great development for banks.

For example, irrespective of whether it's bitcoin or some other cryptocurrency, if you could pay for an item with a cryptocurrency and the transaction were, in theory, as fast as Visa or MasterCard, from the point of view of the merchant receiving the currency, you're not paying Visa, MasterCard, and the banks all the processing fees.

Consider this as just a theoretical example. Let's say you're a merchant, and you have $1,000 of revenue, and your profit margin is 10%. You would have $100 of profit, but you have to pay at least 3% to the banks, card processors, and other merchant processors. What's 3% of $1,000? It's $30 and, in relation to your $100 profit, that $30 is 30% of your profit. You can see that there is an enormous incentive to disintermediate those costs. I don't think it's possible to overstate how enormous that is.

But it's not the only big deal. As I've mentioned before, just think about money in the bank, the interest you earn on it, and the manner in which it's being debased. That's another great incentive: just not to be debased, and to maintain a constant purchasing power. Or, the way I look at it, and I might be wrong, but let's say that cryptocurrencies replace the inflationary currencies and are just worth the market value that the inflationary currencies are worth right now—not the major currencies of the world, just the obviously inflationary currencies of the world. You know what they are and can look up their market capitalizations. If people in those nations were to adopt cryptocurrencies as an alternative to their nations' inflationary currencies, that could create a pretty big return for the cryptocurrency market right there.

However, even that is nothing. Let's look at it from the point of view of a government. In the United States, there are some states, including Arizona and Georgia, that have introduced legislation that would allow state taxes and license fees to be made in certain cryptocurrencies. It wouldn't surprise me if more states begin that process. Why in the world would a government want to encourage cryptocurrency, when everything you read in the paper and everything you see on the television media says the opposite?

Put yourself in the position of a government, and imagine, theoretically of course, that every transaction were on the blockchain. Everything you do, whether you're buying a pack of chewing gum or a house, is recorded on the blockchain. The government would make a tax law, and it matters not how complicated it is or how simple it is because, at the end of an accounting period, either a year or a quarter or however the government decides to do it, all that data will be fed into an algorithm. The tax, whatever it happens to be, would be automatically computed and deducted from your address on the blockchain. The government would get its money. I would imagine some people might not agree with the government's calculation, and there would probably be little boxes saying something like: "Check this box if you agree with the government's calculation." Or "Check this box if you don't agree with the government's calculation." And you'll go fight it out with them. But just think about it: no more K-1s, no more documentation for a K-1.

Steven Bregman – President & Chief Financial Officer

Not even a postage stamp? Not even a postcard?

Murray Stahl – Chairman & Chief Executive Officer

Not even a postcard. By the way, weren't we going to include a photograph of the FRMO tax return in one of these transcripts?

Steven Bregman – President & Chief Financial Officer

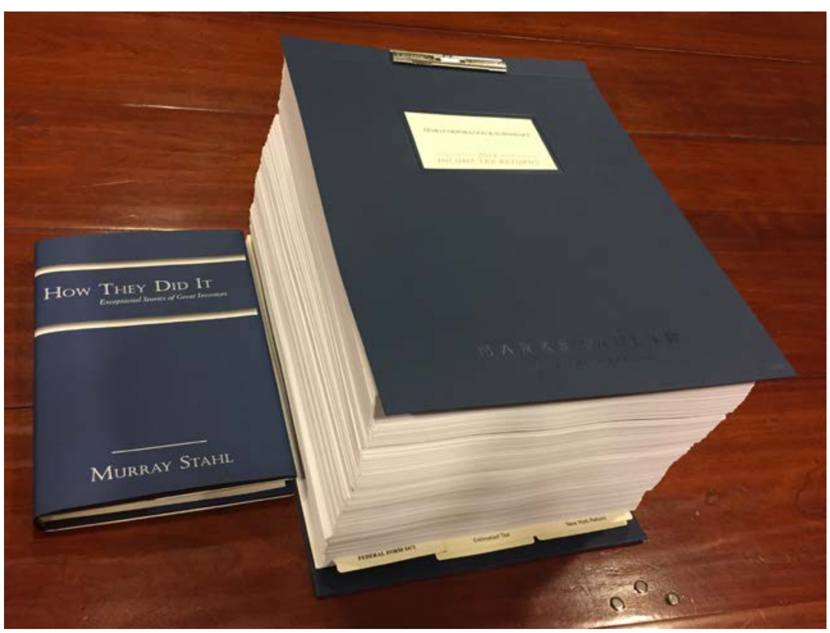
We have a photograph, and we can include it in this transcript.

Murray Stahl – Chairman & Chief Executive Officer

How tall would you say it is?

Steven Bregman – President & Chief Financial Officer

I would say, approximately eight inches tall. For context, the photo shows the tax return next to a copy of your book *How They Did It*, which is a slim volume compared to the tax return.



Murray Stahl – Chairman & Chief Executive Officer

The return is pretty heavy, so when we want to exercise, we use it to do a little weight-lifting. Joking aside, there are about one and a half million people in the United States who are involved, in one manner or another, in tax preparation. I don't mean just working on the returns; there's a lot of documentation that's provided, before even getting to the tax return. You can't begin to do the return until get you get the documents provided by those one and a half million people.

Talking about displacement, let's look at what's happened in society thus far. People used to work at various repetitive tasks in the textile industry, or auto manufacturing industry, and now a robot does many of those tasks. A robot can bolt parts together and do repetitive motions better than a human being. So, what happened? Those jobs involving repetitive motions were low-paid, low-skilled jobs. Perhaps the displacement of those individuals was an efficiency from the societal point of view, though certainly not for the people who lost their jobs.

Today, the people who perform higher-end work, of which taxes are just one example, those are higher skilled and higher paid jobs. From a societal point of view, if you want to consider it, maybe technological displacement of those jobs is not an efficiency; maybe it has a social cost. But, if you consider it an efficiency, then it's a big efficiency. Obviously, if you happen to be a member of that group of one and a half million people, you're not going to be very pleased.

I could go on and on with examples of higher-skill or white-collar tasks that theoretically could happen on the blockchain; for example, think of all the people involved in the closing documentation of a home purchase or sale, and how many pieces of paper are involved. That could be on the blockchain. Think about legal disputes versus smart contracts. How many legal disputes could be solved or actually prevented by a notice or words to this effect: "You signed on; there's a smart contract; it is what it is; there's no recourse to a court; the document is only as good as the two parties who created it, and that's it"? It's enforceable by the machine itself, by the algorithm of the blockchain.

You can go on and on about all these possible applications of blockchain. And, by the way, from the point of view of the government, at the end of the tax accounting period, the government would get its money—all of it—and it would have it sooner, and with far less effort, than it does right now. You can see why a government would be interested in these innovations. This is a revolution in society, and I don't think we're going back. I could be wrong; I've been wrong before, and I'm going to be wrong again. Maybe this is one of my mistakes but, at least as of this moment, I don't think so.

This technology is a big deal—a very big deal. It's a much bigger deal than even the internet was, and the internet was a big deal. This is a revolution in the way we're going to perform financial transactions. I spend a lot of time on it; I learn something new every day, not because I missed something but because, if I don't pay attention for 8-12 hours, something new comes out. It's incredible. Anyway, I invite you to look at some of these citations and be the judge for yourself.

Question 5

Texas Pacific Land Trust (TPL) is a large and long-term holding for Horizon Kinetics. You have previously discussed that some of the large energy companies plan to spend billions in the region where TPL's land is located. Why wouldn't one of these large energy companies try to buy TPL outright?

Murray Stahl – Chairman & Chief Executive Officer

Well, it's not as easy as you think, because Texas Pacific Land Trust (TPL) is a trust. The three trustees have a great deal of power, and they might not be interested in selling it. If it turns out that their posture is not to sell, I for one—because we own about 23% of the company, or the trust, I should say—we'd be right on board with that.

Why would we want to sell to a big energy company for the X% premium in return they would give us? All you have to do is look at the map and see where TPL's property is located, which is in the Delaware Basin, which itself is located in the western area of the Permian Basin. There's very little you can do in that area without either trying to exploit the Trust's hydrocarbons or crossing their land in some way and paying an easement, or drawing brackish water for fracking—they own the water rights—or using their sand, which is known as caliche. There's very little you can do without having to pay some kind of fee to TPL.

Look at what's happened in construction in that area so far. Look at the various large energy companies' websites and read how many billions they plan to spend. And the operative word there is "plan" to spend. They haven't spent it yet.

Steven Bregman – President & Chief Financial Officer

I looked at a satellite view today of portions of Texas where they have had oil wells for generations. If you start with a satellite view from afar, then zoom in, it looks like there are little white dots arranged in a square matrix. As you zoom in further and further, you see that those dots are concrete drilling pads. It looks like a pincushion in that area. Across whole areas, you have all these densely placed oil wells and the pipelines connecting the wells. Then zoom out and go westward to the counties in which TPL's properties lie, and you see there's nothing there.

Murray Stahl – Chairman & Chief Executive Officer

Like Reeves and Culberson and Lubbock.

Steven Bregman – President & Chief Financial Officer

Yes. And you can just imagine how much structural intensity there will be one day.

Murray Stahl – Chairman & Chief Executive Officer

That's right. So, I'll mention a couple things about it. You can't get a large amount hydrocarbon material out of that area yet, because they don't have gas-gathering and pipeline systems to speak of yet. There's a little bit, but it still has to be built. That's a very significant limitation on production volumes. And there are other issues, such as the issue of gas. If you fly over the area at night, you'll see that, to the extent they are producing, a lot of the gas is being flared, because there's no way to gather it. Even not considering what would happen if gas prices went up, just think of what would happen if they didn't flare it and could transport it. And, by the way, a lot of the gas is wet gas, the best kind.

I could go on and on but suffice it to say that I have no desire to accept a control premium of X% for selling it to anybody.

Here's a follow-up to that question.

Question 6

Horizon Kinetics owns approximately 23% of TPL. If for some reason you want to significantly reduce your TPL position, is that something that can be done in an efficient manner?

Murray Stahl – Chairman & Chief Executive Officer

I'm sure there are plenty of people who would buy it, but we don't have any intention of selling it.

Steven Bregman – President & Chief Financial Officer

Well, first of all, we'd have to change direction from increasing what we own before we would decide to sell it.

Murray Stahl – Chairman & Chief Executive Officer

Right. It has appreciated mightily. We buy shares on most days, and the proof of that is in our 13D filings. You can see all these back-and-forth transactions—both purchases and sales. For the most part, the sales come from people for whom the position size became too large, or because they want to gift some shares. They're selling some shares, and we, in one of our incarnations, are buying shares.

Like Steve said, we're increasing our holdings, not decreasing. That's our posture. I don't doubt that, if we had to, we could sell all of our shares but, thankfully, we have the money, and we're buyers, at least for the time being. Maybe we're wrong, but that's what we're doing.

That concludes our prepared remarks and the questions we received, which I thought were great questions. It remains only to thank you for your attention. We look forward, next time, to getting more questions and speaking more about what we're up to. We will reprise our review on the next call. So, thank you once again, good afternoon, and we'll see you soon.

OPERATOR: That concludes today's call. Thank you for your participation. You may now disconnect.

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