Operator

Ladies and gentlemen, good day 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 Ms. Thérèse Byars. Please go ahead, ma'am.

Thérèse Byars – Corporate Secretary

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

The statements made on this call apply only as of today. The information on this call should not be construed to be 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 the FRMO Corp. website at www.frmocorp.com.

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 2019 first 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

Thank you, Thérèse, and thank you everybody for joining us. I thought I'd commence today by reviewing the income statement and balance sheet, showing you how to read them, because there are some new accounting guidelines. If you don't know how to read them, I imagine it would look fairly bizarre.

Let's begin with the balance sheet. Cash is pretty straightforward. Accounts receivable is pretty straightforward. But, when you come to equity securities and fair value, it's a little less than straightforward. FRMO is an investor in an entity called Horizon Kinetics Hard Assets ("HK Hard Assets"), which is consolidated on FRMO's balance sheet. But FRMO doesn't own the entirety of that partnership.

The accounting practice is as follows: You take all of the assets, whatever they are—and many are equity securities—and you put them in the equity securities category on the balance sheet. Then, on the liabilities side, you back out non-controlling interests. You'll see, all the way down, right above shareholders' equity, the non-controlling interests. If someone doesn't pay attention to that, it would be very easy to get the idea that we really are sitting here with $52.6 million in equity securities, but we are not; the actual value is a lower number.

Why do we even consolidate this? Why not just be a limited partner, as we're a partner in the other funds? Because this is an entity that FRMO is actually running, so that is the appropriate accounting treatment. What you'll see in the future is the other partnerships that FRMO is actually running—meaning that we're not relying on any outside parties; we're running them entirely on our own. Why do we want to do that? Well, it really has to do with the idea of permanent capital, as opposed to fleeting capital.

Before I get to that, let me just turn to the income statement, because I'd like to make some comments about that, just in terms of how to read it, and then we'll go to more cerebral matters. If you look at the revenue number, under the newly adopted accounting guidelines, items like unrealized gains from securities or investments in a partnership, to the extent that we have them, we are required to report them as revenue.

It's really bizarre to think about them as revenue in one sense, because clearly what goes up can come down. Theoretically, if these numbers were negative, at least theoretically, we could actually have—and I hope it never happens—but we could actually have negative revenue, which is a bizarre concept. But that, my friends, is the accounting treatment. And we have no alternative but to live with it. I don't want you to get the idea that, in three months, we somehow obtained nearly $15 million in actual revenue. The revenue, in the commonly understood sense of the term, is less than that. Later on, we'll go into what constitutes the more commonly understood definition of revenue.

Why do we want to have these partnerships? Well, before we get to that question, how did we get the money to make these various investments? Some of it came from the Horizon Kinetics revenue share, and some came from the investment we made in Horizon Kinetics, meaning that we get dividends from Horizon Kinetics, and we get a revenue share off the top from Horizon Kinetics.

We also have the short-sale investments, which you'll see on the books. We have about $11.8 million on a cost basis, and about $6.5 million on a market value basis. Over the years, we have realized some profits. In some cases, these were option positions; we were actually short options. I think all of our funds for investments came from those three revenue sources. In addition, we generated a fair amount of cash, not merely from short selling activities. So, we didn't even spend all the money we made.

The short-sale positions are kind of interesting. We don't pay taxes until we cover them, so they're very tax-efficient. It is akin to getting a tax-free loan. Now that we've built up some positions in these funds, we'd like to reprise what we did in FRMO in the funds themselves. We'll use the security positions, to the extent that we can, as collateral, and have yet more short positions, and generate yet more cash. That cash, if and when we generate it, will be reflected on the balance sheet, because it will be consolidated.

The idea is to grow our investments, not to take this cash and spend it on security ideas. We would not spend it all in one fell swoop, unless there were some kind of economic crisis during which we could buy a business really cheap. That's what it's there for. And maybe we'll get that chance or maybe we won't, but that's our so-called elephant gun. When we have a really good target, we'll move. Until that time, we'll try to accumulate cash.

We've also used a small amount of cash—almost a rounding error—that you can see in the line item called "Computer Equipment." That item represents cryptocurrency mining equipment that we operate. Subsequent to quarter-end, we made another investment in mining equipment, so that number will increase next quarter. It won't be a big number, but the idea is to gradually grow the mining business, because it's actually a very high return on equity business. Ultimately, cryptocurrencies are something that's really important to us. We're looking for other ways to enter that business. A minor way is our small investment in Digital Currency Group. Another is our investment in various cryptocurrency mining entities. It's just the start of something that we hope will be successful and will grow.

Regarding the asset management business—and we talk about this a lot, and it's worthwhile stressing—it is not characterized by permanent capital in the way HK Hard Assets is. We'd love to have more HK Hard Assets. So far, the only people we've let into HK Hard Assets are those whom we know share our philosophy of long-term investing. A lot of the money in HK Hard Assets actually comes from the people who run FRMO. Ultimately, we will find other people, so that could turn into an interesting business in and of itself.

In general, the investment management business is characterized by ever lower fees. Believe it or not, there are now zero-fee index funds. How do you compete with a zero-fee index fund on a diversified portfolio basis? You've likely seen by looking at index fund companies that the flows into indexes are starting to wane because, no matter how big it is, at the end of the day, there's finite number of dollars that can or will be allocated to them, and it's becoming problematic.

To be in the investment management business in the future—and it has a bright future—you've got to do something very, very different from a diversified portfolio. There's no way to do that unless you start with your own money and show people the way.

Horizon Kinetics just closed the second cryptocurrency mining company. We've raised over $8 million. This is a fee-paying vehicle, unlike the first one. And it's important to us because it's a permanent capital vehicle. If it works, and we think it will work, expect to see more of them. And expect, one day, that those entities will be listed securities. It's just a question of time.

You'll have also observed that, in the last month since we had the annual meeting of shareholders, there have been some further announcements about developments in cryptocurrency custody, which is the next step on the critical path toward making cryptocurrency use a generalized reality. In our humble opinion, in the not too distant future, cryptocurrency will be a bona fide asset class. We like it; it has a lot of return potential.

Steven Bregman – President & Chief Financial Officer

I remember you saying that for the investment world to take cryptocurrency seriously, you need one party with suitable gravitas accept it. And, of course, once one such institution does—whether it's State Street, Fidelity, or some other so-called big player—then the dam will break and they will all rush in. It's one thing to say it, but here we are, six months later, and it's happening just in that way. I can't turn on Bloomberg Radio in the morning without hearing them talking about another one. This morning and yesterday, it was Fidelity working on custody solutions, then it was International Securities Exchange and Microsoft, and so forth.

Murray Stahl – Chairman & Chief Executive Officer

Yes, and we've gone through many reasons why this is happening. What you're likely to see in Horizon Kinetics and in FRMO are more unique investments that other people don't make.

While we're on the subject of cryptocurrency, you're aware that we've had significant exposure to cryptocurrency, and we haven't sold even one dollar's worth of our crypto holdings, not one. Of course, you're aware of what happened to cryptocurrency prices from December 31, 2017 to the most recent balance sheet date, meaning it's down a lot. I don't remember the exact number, but it's got to be somewhere between negative 60% to negative 70%. I don't think I'm straying far from reality. And you can see that we sized it right. We didn't fail to increase shareholders' equity, even living through that decline.

We have a little secret weapon that is worthwhile sharing with you, which is really long-term investing because, when we make X dollars of profit, as you see on this balance sheet, in cryptocurrency, and we value it at market, understand that to some degree, there's an offsetting deferred tax liability. When cryptocurrency goes down in value, if you take that in isolation, the deferred tax liability will go down as well. We get to share some of our depreciation, as it were, with the United States government, which is only fair, since they took it upon themselves to take a share of the profits in the good times.

Ironically, from a mathematical standpoint, the tax system is actually dampening volatility in an interesting way. It's the government's effort—*nolens volens* or inadvertently—at volatility control. So, when you look at the financial statements, and you're looking at them in relation to crypto, please keep that in mind.

In the Polestar Fund, the cryptocurrency position size is about 8%, in round numbers, just to give you some information of how to look at it. In the CDK Fund, the position size is something like 17%. In the Multi-Strategy Fund, it is roughly 14%.

I've said this before, but it's worthwhile stressing why crypto is such an important asset class. In the bond asset class, consider these numbers. Let's say you bought, in round numbers, a 10-year Treasury bond that yields a little over 3%. Let's just call it 3%. Deduct the tax rate that you think is appropriate for you and now maybe you're at 1.6%. What's the inflation rate? It's higher, so that is a guaranteed loss of purchasing power. That can't be the rudder to windward of a diversified portfolio.

You could say: "Okay, what if the rate wasn't 3%? What if it were 6%?" All right. Let's make it 6%. Apply the tax rate, whatever it is, and where are you now? Maybe you're at 3.6%, and the inflation rate, generously calculated, is 2.9%. You're left with about 70 basis points. But some people think the inflation rate is higher than 2.9%; you can debate that question.

Another consideration is what happens if the rate were really 6%? The U.S. has $71.5 trillion of debt, including all debts of any type. That's everything from Treasury bonds to car loans to student loans, etc. Say that the average interest rate on that debt were 6%. I key into my calculator $71.5 trillion, multiply that by 0.06 to get $4.29 trillion. The entire U.S. GDP is $20.5 trillion, so if I take $4.29 away, then the real GDP would be considerably less. By habit and convention, when people speak of the GDP we have achieved, they're thinking of that figure as total output of the economy. But we really need to look at the GDP that we have available for consumption, because GDP is consumption. But part of it is really monies that we can't use because we, as a country, have to pay that interest expense on the debt.

At FRMO, as you can see from our balance sheet, we don't actually have any debt, so it doesn't affect us, which really means that the debt burden is not spread evenly across the population; rather, it's concentrated on some subset of the population. Raise the rate to 6%, and all sorts of stresses on the system begin to be revealed, and that's not a good situation. It's not a good situation for the equity market which, in our opinion, trades at a high valuation. It's not a good situation for the economy. And it's a good reason why we have a lot of cash on the balance sheet.

Now I'll turn to a couple of questions.

Question 1

Does the revenue from "Consultancy, advisory and participation fees" on the income statement come solely from FRMO's 4.199% interest in the Horizon revenue stream? If not, what percentage of the Consultancy and advisory fees comes from the interest in the Horizon revenue stream?

Murray Stahl – Chairman & Chief Executive Officer

On the income statement, the consultancy fees were $540,000. Included in that are $2,000 of board fees for my being a director on the Minneapolis Grain Exchange board. Of the balance, there is roughly $10,000 in consulting fees that comes from a source other than the HK revenue share, so the HK revenue share number—I'm rounding—is $519,000.

Steven Bregman – President & Chief Financial Officer

So, about 96% of that revenue line is the HK revenue participation.

Murray Stahl – Chairman & Chief Executive Officer

There's also a little bit less than $11,000 so far in the quarter in cryptocurrency mining revenue. That goes into the mix. Add all those things up, and the way we look at it, if you put the directors' fees in the consultancy and advisory fees, it comes to about $542,000.

Question 2

Have you considered using cash on the FRMO balance sheet to buy back FRMO stock? If not, is there a price at which you would start buying back FRMO stock with cash from FRMO's balance sheet?

Murray Stahl – Chairman & Chief Executive Officer

You will be aware, looking at our proxy statement, that as shareholders of FRMO, we own the bulk of the FRMO shares. Please understand that, if we were to buy back a de minimis amount, it wouldn't matter. If we were to buy back a substantial amount, it would be tantamount to taking the company private. We have almost enough money on the balance sheet to buy back all the shares that we don't already own. But then we wouldn't be a public company; we'd be a private company, and we want to be a public company. So, we really need to be judicious as to how we buy back our shares.

That said, Horizon Kinetics, also has liquid assets on its balance sheet, which you don't see here because Horizon Kinetics is unconsolidated. Horizon Kinetics has over $80 million of liquid assets on its balance sheet. We are, of course, long-term holders of FRMO at Horizon Kinetics, and the firm buys shares of FRMO with some of its cash. Horizon Kinetics owns approximately 150,000 shares of FRMO stock.

As for the balance of the cash, we're just waiting for an opportunity. We are positioned to be very aggressive when we see opportunities, but we want to act at a stress point. We are not yet at a stress point, and we hope there won't be a stress point. If one develops, we will have a lot of cash, and we'll figure out something to do with that cash.

Steven Bregman – President & Chief Financial Officer

We're earning many, many multiples more on that cash today than we were six months ago.

Murray Stahl – Chairman & Chief Executive Officer

That's true. I think we're earning a whole 2%-plus on it, which it's better than it was.

Anyway, those are the only two questions we received. So, we covered what we're doing strategically. We covered the changes in the income statement and balance sheet, and how to read it. We covered the cash. We answered a question or two, and those are the main items we wanted to cover. Steve, did you want to add anything else?

Steven Bregman – President & Chief Financial Officer

Only that it continues to be an honor and a pleasure to work on behalf of FRMO's shareholders.

Murray Stahl – Chairman & Chief Executive Officer

Yes, and I say the same. We will look forward to your questions and your queries when we reprise this forum in three months. Thanks so much for attending.

Operator

That concludes today's presentation. You may disconnect your phone lines and thank you for joining us this afternoon.

DISCLAIMERS:

THE INFORMATION CONTAINED HERE IS INTENDED TO PROVIDE A SUMMARY OF THE COMPANY'S FIRST QUARTER 2019 EARNINGS CONFERENCE CALL, AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE PRESENTATIONS. AS SUCH, THE COMPANY DOES NOT ASSUME RESPONSIBILITY FOR ANY INVESTMENT DECISIONS MADE BASED UPON THE INFORMATION CONTAINED HEREIN. READERS ARE ENCOURAGED TO READ THE COMPANY'S FILINGS WITH OTC MARKETS AND THE SECURITIES AND EXCHANGE COMMISSION BEFORE MAKING INVESTMENTS OR OTHER DECISIONS.

Past performance is not a guarantee of future results. The information and opinions contained herein should not be construed to be a recommendation to purchase or sell any particular security or investment fund. Furthermore, the views expressed herein may change at any time subsequent to the date of issue. It should not be assumed that any of the security transactions referenced herein 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 referenced.

During the course of this transcript, certain investment products may have been mentioned, specifically, exchange traded funds. You should refer to each respective exchange traded fund's applicable disclosure documents for a complete set of risks, expenses and other pertinent details. Index returns assume that dividends are reinvested and do not include the effect of management fees or expenses. You cannot invest directly in an index.

Horizon Kinetics LLC is the parent holding company to certain SEC-registered investment advisers, including Horizon Asset Management LLC, Kinetics Asset Management LLC, and Kinetics Advisers, LLC. For additional information on these entities, you may refer to the website of the Securities and Exchange Commission, which contains Parts 1A and 2A of Forms ADV, located here: www.adviserinfo.sec.gov. Horizon Kinetics, on behalf of its registered subsidiaries, may collect management fees for certain of the investment products referenced herein. Additionally, Horizon Kinetics, through its subsidiaries, may hold positions in certain of the securities referenced herein.