Operator

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

Thérèse Byars – Corporate Secretary

Thank you, Noah. Good afternoon, everyone. This is Thérèse Byars, 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 2017 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 who have joined us today. We're going to change the format of this call slightly. We'll still make some general remarks, but we're going to keep them briefer than we normally do, because this time we received lots of really great questions, many of which embrace much of what would have been in the general remarks. So, we'll make some general observations and then we'll elaborate on the other topics as we answer the questions.

As you can see from our financial statements, we have over $50 million in cash. That's going to be a recurring theme because, as of a couple years ago, the opportunity set for investing money in general has been relatively narrow, and I think this pertains to just about every asset class. That doesn't mean there are zero investment opportunities; it just means there are far fewer. And we've written a lot about this topic.

That situation shouldn't come as a surprise to anyone, because interest rates are close to all-time lows in most parts of the world. There are other issues, particularly in the United States, where you see a narrowing of the spread between short-term rates and intermediate-term rates, which doesn't bode well for the financial services industry in general. You have the rise of indexation, which some say might plays a role in distorting prices.

Now, when I say, "some say," the "some" are a very small number of people, of which I am one. I might even be the leading person who says it.

Steven Bregman – President & Chief Financial Officer

You might be a very high weighting in that sector.

Murray Stahl – Chairman & Chief Executive Officer

Yes, I might be a very high weighting. By the way, I also might be wrong about that. But, nevertheless, I hold to my view, and I keep saying it.

As you look at our balance sheet, you can see the proportion of cash to total assets is a big number. Shareholders' equity is also at a record high, because some of the investments made have been successful. But the opportunity set for investing continues to be narrow, which has implications for the investment management business.

If you want to be a thoughtful, reasonable, and honest person, you have to say something that's more or less consistent with you do and what you write, which is that the opportunity set is narrow. We'd like to hold a lot of cash in the managed accounts for Horizon Kinetics LLC; however, many of our clients are disinclined to hold cash in their accounts. Even if they're not billed for it, they take the money out of the account, because they hear from plenty of other people in our free enterprise society who claim that the opportunity set is as rich and diverse as it's ever been. That they find no shortage of opportunities, which is in contradistinction to what we say. It is worth saying again that they might be right, and we might be wrong.

Given our point of view in that regard, FRMO is a company with a tremendous, probably record amount of cash. It's a very strong balance sheet. By the way, it's also worth mentioning that inside FRMO's various fund investments listed under "Other Investments" and in the footnotes, where you'll see various funds listed, those funds also have proportionally higher amounts of cash than they usually do. On a look-through basis, the cash is even higher than what you see on the balance sheet.

We're about as liquid as we've ever been, and that's by design. You're not going to grow the asset management business if that's the posture you put forth to the public, but it's something that we feel we have to do. Now, that could change; the opportunity set might expand, in which case we'll change our posture. But, if the opportunity set continues to narrow, expect to see something along this order.

I'll talk about some relatively minor points, and then I'll go to the questions. If you look at our schedule of investments, you'll see the National Stock Exchange, which I believe I said last time is merging with the Intercontinental Exchange. Technically speaking, it's merging with the New York Stock Exchange Group, which is a wholly-owned subsidiary of the Intercontinental Exchange. FRMO had a 0.25% position in the National Stock Exchange, which is not a lot, but we take issue with the way that merger is being conducted. We object strenuously.

I realize it's not a lot of money in the context of our balance sheet, but we object so strenuously, that it's not inconceivable that we might litigate the question. And maybe it's not a big deal financially, but, to us, it's a question of morality and practice. We'll see what happens. Next time we meet, I hope that we will have more information about that issue.

On the short side of the portfolio, you can see what's going on. We haven't grown that side either, but that posture might change in the not-too-distant future, for reasons that we'll get to in the questions. Nevertheless, we've done very well in that arena, and there may be some opportunities to expand there.

With that, I'll answer the questions.

Question 1

Looking at the historical stock price data, FRMO is at the same price it was in August 2013, with an interim high point value of about $9.65 in May 2014. What else can be done to increase shareholder value?

Murray Stahl – Chairman & Chief Executive Officer

That's an excellent question. I guess you might say that what we're doing at the moment is not likely to increase shareholder value, at least in the short run, because we're building cash. While it might be very comforting to some people, like ourselves, that we have a lot of cash on the balance sheet and we're very liquid, knowing that cash is cash, and its market value is not going to fluctuate, it's not comforting to others. When you ask the question, "What can be done to increase shareholder value?" it gets to the matter that we're going to have to deploy that cash at some point. But there's no point in deploying it if we don't find the suitable opportunity set; we have to wait for the right moment. That moment might come very soon, or it might not.

It's worthwhile recalling that some years back, in an FRMO Shareholder Letter, we first discussed that the opportunity set was narrowing, that interest rates were (and are) at all-time lows, and that we would be raising cash on the balance sheet. Even though it's not exactly the same time period, it's so close that I think we can take the liberty of saying the two periods overlap. The stability, if you wish to call it that, of the stock price is more or less related to that Shareholder Letter, and we've been building cash in some consistent manner ever since. In some quarters, we've raised a little bit more cash; in some quarters, we've raised a little bit less. But that's really the story.

To grow the business and increase the net asset value, we have to do something other than accumulating a lot of cash. We're just going to have to wait until the moment is right.

A recurring theme in our answers to these questions will be that an asset manager should want to be an asset manager and investor, not an asset gatherer. You don't want to invest money just for the sake of charging people a fee on it, and you don't want to invest money in businesses unless you foresee a suitable rate of return in relation to the risk. It's not easy to do that in the context of a mutual fund or other vehicle in which investor funds flow in and out whenever they like.

In that regard, you might be interested to note Horizon Kinetics is involved in making a bid for a closed-end fund called the RENN Fund. Information is available on the SEC website (www.sec.gov), and I call your attention to it. We hope that this fund will open up a whole new business opportunity for us. More about that in due course.

Question 2

Would you please elaborate on the strategic fit and financial contribution to Horizon Kinetics of its Research Team, both direct and indirect?

Murray Stahl – Chairman & Chief Executive Officer

The research business, relative to the range and scope of things we do, is relatively small, and doesn't directly add a tremendous financial contribution; however, indirectly, and I would dare say strategically, it's very important. First, it's the vehicle by which we communicate our thoughts and ideas to the world. You might say it's a way of calling attention to ourselves. We're very proud of what we do, and we like to show it to the world.

Further, the mere exercise of writing down your thoughts in proper, expository English is of value, apart from any financial aspect. The reason is that it's very easy to formulate an investment idea in your mind, but we make it harder, because we force ourselves to think things through. It's even easier to move around $1 billion, if you really wanted to, or $10, $20, or $30 billion for that matter. People do it every day; it's as easy as pushing a button. As a matter of fact, with modern technology, you don't even have to push a button, because there are algorithms that do it for you. You can do it thoughtlessly and effortlessly.

Given my position in life, if I didn't like the investment management business and didn't like investing money, I certainly wouldn't be writing the quantity of material that I personally write. It shows that I'm interested in the game, and I'm active in the game. I dare say, if it ever gets to the point where I don't want to write, that might indicate that I'm less interested in the business, and maybe you should draw the appropriate conclusions. But, at the moment, I write a fairly copious amount of material. To me, it has a lot of value, and we’re going to keep doing it.

Question 3

Is Fromex Equity Corp. an active entity? It still is listed under your website SEC links.

Murray Stahl – Chairman & Chief Executive Officer

Fromex is active in the sense that it actually does things and it has cash balances. Both Fromex and FRMO hold a lot of cash and, as far as investments go, they make similar investments.

There was a time when we were thinking of spinning Fromex Equity out as an active entity. Why were we thinking of doing that? Because, going back many years, you might recall FRMO had an issue that prevented it from producing audited financial statements. It was due, at the time, a certain amount of money from a company called Kinetics Advisers LLC, which was one of the companies in the Kinetics Group. Now it’s all united under the banner of Horizon Kinetics, but in those days they were all separate companies. It was impossible to quantify with the appropriate GAAP precision necessary, how much money was due us from Kinetics Advisers, even though we could estimate it very closely. But it had to be estimated with the required GAAP precision, and it couldn’t be done at the time. Therefore, although we could produce financial statements, we couldn’t produce audited financial statements.

The thinking was to form a new entity called Fromex Equity Corp., spin it off and let it carry on with the company’s business, while leaving FRMO to collect the money due from Kinetics Advisers. Ultimately, the problem was solved, and now we have audited financial statements. However, we didn’t think it was reasonable to unwind Fromex Equity Corp., because having it doesn’t increase the audit fees. Maybe one day we’ll need it for something, although at the moment it’s vestigial, like an appendix. But, having set it up years and years ago, if we ever dismantle it, what will probably happen is, the next week, we’d have use for it. So, we leave it alone.

Question 4

In previous periods you have talked about your desire to acquire a controlling position in a company. Whilst I completely understand your reluctance to elaborate, I was wondering if you could give a very general sense of the characteristics, be they qualitative or quantitative, that you're looking for in a potential investment.

Murray Stahl – Chairman & Chief Executive Officer

First, I’ll just make a general remark. You see, one of the reasons for acquiring a controlling position in a company is that we want to have access to recurring and stable cash flow. In the investment management business, because the market value of the assets under management fluctuate, if you say the investment opportunity set is narrowing, you're basically telling your clients to withdraw some money. If they do that it ultimately has consequences for the fee income.

Given that fact, the idea is to diversify our sources of income. That's why we want to have a controlling position in a company. We want to have access to the cash flow, so that, when we find an opportunity, it would be possible to act on it.

Over the years, we have explored different areas. First, in a general sense, we wanted a business that we wouldn't have to operate on a daily basis. We would leave daily operations to the employees of the company. It had to be a business we really understood, so that limits the field of opportunities. For example, we're not going to acquire a bank or an insurance company. Those are examples of businesses we're not going to invest in.

Let's take the insurance company example. We have had plenty of opportunities to get into the insurance business. Had we done so, we'd have a lot bigger balance sheet than we have today. But, every time we had the opportunity to do it—and you can blame me for this—I said no—categorically no. I didn't say no in the sense that I would never, philosophically, do it, because never is a very un-philosophical word to use. But every time it came up, I was very much opposed to it, because in the insurance business, we'd be getting capital from the people writing policies, who are providing the underwriting function with our capital. We would have use of the float, and we could invest the money on an interim basis. However, if you're in, say, the property casualty or catastrophe insurance, a catastrophe could indeed happen, would indeed happen, and then we would have to write a big check.

The trouble is that at the moment we might be writing a big check for a catastrophe that occurred—we would be legally obligated to pay it out—it might be the very moment when we find an investment we really want to make. But we'd be writing a check to cover the catastrophe. We have always thought that kind of risk was at cross-purposes from what we want to do, even though a lot of very sound investors—most of whom are well known—think that's a really great business. But we didn't think it was for us.

A business has to be one that we really understand, and where the risks are fairly well contained. One of the businesses we found interesting is securities exchanges. There are many small exchanges in the world, and we're still working on investing in that arena. It's an area that we think we understand very well. Although we haven't yet purchased a controlling interest, that might happen one day. It's possible; we just don't know.

There are other types of businesses that we find interesting. We like the idea of having a hard, or some would say tangible, asset. The idea would be a company with a hard or tangible asset—probably a commodity, preferably one that's in the ground. If it's in the ground, as opposed to being extracted, it doesn't require the same degree of management as would a major producing company. That's the one area of investing today that's under great stress, and where there might even be some opportunities. It's something we understand; if it's in the ground, it doesn't require a huge number of employees; and if it's something within the current scope of operations that we can do.

We don't want to inherit a lot of leverage. We want the business to be cash-generative. We're not worried about the cycles, because we're likely to enter at the bottom of a cycle, meaning when the earnings are relatively low. We're willing to live with the cycles and limits.

Those are the characteristics we are looking for in a business. In terms of the industry or sector in which they occur, we're contrarians. Whenever that industry or sector is out of favor, that's when we get interested.

I hope that gives you a sense of what we're trying to do, which is, basically, buy a company with a good balance sheet that has an asset that has largely not yet been exploited. In such case, we're working with the equity yield curve, meaning the exploitation is some time off, and we're not paying for that presumptive cash flow. You might even describe it as a dormant asset. That's the kind of business we're looking for.

We'll be coming back to that topic, because there are other questions that pertain to it.

Question 5

Is FRMO's bitcoin investment directly in bitcoin or is it in the Bitcoin Investment Trust (GBTC)?

Murray Stahl – Chairman & Chief Executive Officer

Well, there are two questions to answer here. Yes, FRMO's bitcoin investment is in the Bitcoin Investment Trust. But that's not to say it's directly in GBTC. That security is held in various funds. If you look at the footnotes of our various funds, that's where the investments in GBTC are held. We do have some tiny amount of that investment directly on FRMO's books, but almost the entirety of it is invested in the funds.

Question 6

How much is invested in bitcoin indirectly and directly?

Murray Stahl – Chairman & Chief Executive Officer

In the manner which I just defined directly, meaning it's an investment in the funds, it's about $500,000, on a look-through basis at the moment. That's a round number, and I'm probably some thousands of dollars off, but that's the best I can do off the top of my head.

Indirectly we have a bigger investment in bitcoin, because we've created our own bitcoin funds at Horizon Kinetics. In those, we've made the bitcoin investments in a number of ways, including buying bitcoin directly. We have some of Horizon Kinetics' capital exposed to bitcoin, and that comes from performance fees. If bitcoin were to rise dramatically, Horizon Kinetics would get a performance fee and, obviously, FRMO would share in that.

There's another indirect investment in bitcoin, which you can see on the balance sheet, and that is via Digital Currency Group. It's a very small investment, but that is the entity that controls a company called Grayscale, which manages GBTC. Digital Currency Group also has a variety of investments in various types of crypto-currency enterprises.

Question 7

Do you intend to invest in any additional bitcoin?

Murray Stahl – Chairman & Chief Executive Officer

Well, lawyers would say the proper way to answer that question is: it's possible. I'm sorry I have to answer it that way, but I guess must.

Question 8

GBTC was trading at a big discount to its net asset value a number of weeks ago, and now it trades at a premium. Given that situation, would you buy GBTC?

Murray Stahl – Chairman & Chief Executive Officer

When people talk about the premium to the net asset value (NAV) of the bitcoin contained in the GBTC, one of the important things to consider is, if you look on the internet at the various places where bitcoin itself is either priced or traded, you will see a variety of prices. I don't have time to do it right now, because I'm on the conference call, but there are at least two places on the internet where it could be argued that bitcoin is reliably priced, and the differential between the two prices is at least 5%, if not more. It depends on the time of day. On some days, I've seen it as far apart as 7% to 8%. Right now, it's probably a differential of 5%.

When we say "premium" and "discount," you really can't think of it the way you would in the case of a closed-end fund, because the proper way to establish the price of bitcoin is a regular topic of debate. There are swaps that trade in bitcoin. People trade bitcoin in a variety of venues for a variety of reasons. In certain places in the world, because bitcoin is hard to come by, it trades at huge premiums to its trading price elsewhere. Arbitrages are possible. All sorts of things are possible. We can't think about bitcoin the way we think about closed-end funds. Therefore, we have to be very careful when we even use the words "premium" or "discount."

Question 9

Why would you not sell FRMO's GBTC, and buy bitcoin directly, if you have not already done so?

Murray Stahl – Chairman & Chief Executive Officer

Actually, we have done that, from time to time. As noted when I answered the previous question, I don't like to use the word premium in the context of GBTC, but there was a time when GBTC traded at an extraordinary premium relative to the net asset value of the bitcoin held in that trust. We did sell some GBTC at the so called premium to NAV and we reinvested the proceeds back into GBTC, but directly through Grayscale at the net asset value. So we sold at the premium, and repurchased at NAV.

Before we take credit for doing something brilliant, at least at the margin, even that trade has a disadvantage, so we didn't do much of it. The disadvantage is that we have to pay taxes on the profits from those transactions, so you don't capture the whole premium. The United States Treasury, the State of New York, the City of New York take some of the profit. That's the law and one we must comply with it. No one says you have to like it, but that's just the way it works. For the tax reason we're hesitant to do a lot of trading.

Question 10

Do you believe the Bitcoin Investment Trust (GBTC), will become an ETF?

Murray Stahl – Chairman & Chief Executive Officer

Eventually, I believe there will be a bitcoin ETF, which might end up being a very good thing or, from a certain point of view, it might not be. The good part would be obvious, because an ETF, or perhaps several ETFs, would raise a lot of money thereby creating all kinds of buying pressure. Obviously the price of bitcoin would go up a lot, and we might all celebrate and feel really good.

But bear in mind that if or when that happens, it would invite the entrance of all sorts of people who really don't understand what bitcoin is. It's not inconceivable that this situation could have some very bizarre results. My personal preference is to leave things the way they are. To understand why, which might seem counterintuitive, I'll elaborate when I answer the next question.

Question 11

Please describe what an ideal dream use of the $50 million or more of FRMO cash should look like.

Murray Stahl – Chairman & Chief Executive Officer

I'll answer the part of the question on the $50 million, but first let me just deal with more of this bitcoin question.

Ultimately, bitcoin is a store of value. I believe that most people understand it as a method of transacting, which it is. But, from my perspective, that's not its primary value because, as a means of transacting, whatever modalities are devised and however wonderful they might be, it's important, even critical, to understand that bitcoin is open-source code. Anybody can see what the code is, and anybody can copy it, use it, modify it, or do whatever to it.

It's open-source by design; it's intended to be that way. It's unlike all the software you've come to know, like Google, Facebook, Microsoft Office, the iPhone, and others, which are all largely closed, proprietary systems. You couldn't copy the code of Google and make your own search engine that is basically identical to Google, with maybe a little enhancement or two, without facing some very serious consequences. But you can do that with the bitcoin source code.

An important function of bitcoin is as a store of value, because it's a noninflationary. You could even argue that it's a deflationary currency, which makes it unique in history. Even gold, with all its so-called hedge qualities or properties vis-à-vis inflation, was never really a noninflationary currency. If you read a book on the history of Spain, you know very well that South America and Central America were colonized by the Spanish empire. Spain took tremendous quantities of gold and silver from the Incas and the Aztecs. Historians will tell you that the importation of all that gold and silver caused inflation.

You will recall that Spain was a great power in the 16th century. It's conceivable that Spain could have conquered Great Britain. It's possible, but it didn't work out that way. Spain was the great world power, but it is no longer, and many historians argue that was due to the inflation caused by all that South and Central American gold and silver.

The main point of delving into the history of Spain's inflation is that more gold can be mined if the price goes high enough. At higher prices, mining companies can extract gold that is not economically feasible at current prices. The difference with bitcoin is that the maximum number of bitcoin will be attained in the year 2140, when there will be 21 million units. That's all that will be created. At the moment, there are roughly 16,280,000.

Some would say—and I think they're right—that bitcoin is deflationary, because of a phenomenon called bitrot, which results from people forgetting or losing their private key, which means neither they nor anyone else can ever access that money. Or, they have their private key but they have an amount of bitcoin measured in satoshis[1] that's worth a couple of pennies, so it's has little value to the owner and they sit dormant in an account, in the same way that everybody seems to have some odd number of cents in the back of a drawer. You know it's there, and you could retrieve it if you wanted to, but it's not worth the effort, so it stays in the drawer. It's the same for those very small amounts of bitcoin.

When I say that there are 16,280,000 bitcoin in circulation, that's not an accurate number. No one knows what that figure really is. Some people have suggested—and maybe they're right—that you have to take away 1% for every year that bitcoin has been in existence, which is since 2009, so that's eight years. If 1% of the bitcoin out there is a little over 160,000, and you multiply 160,000 by eight, you get about 1.3 million. Subtract 1.3 million from 16.280 million to get about 15 million, so that's one estimate of the real number of bitcoin out there.

Whether that number is right or wrong, I don't know, but the important point is that bitcoin is a deflationary currency and a store of value. Nobody else has figured out a way to match it yet. Why that hasn't happened is a completely other discussion.

Why did I go into such detail on bitcoin, when the question really is about what the ideal dream use of $50 million would be? What we really want is to have a unique investment that no one else has; to get an exposure that no one else is likely to have. Bitcoin will not be that investment, because there is no need to put $50 million in bitcoin. We would never bet the whole company on the success or failure of bitcoin. We're willing to risk X hundreds of thousands of dollars on bitcoin. Either we're going to be right or we're going to be wrong. And, if we're wrong, we'll get a tax write-off and we'll live to fight another day.

To risk that capital, we really need to have something that's almost the opposite of bitcoin. It won't be something that *might* happen and on which we're willing to take a risk; it will be something that *is* happening and is dramatically undervalued, something within the scope of our ability to understand and that has a substantial margin of safety. One day, it's going to happen. Maybe it's already happening.

[1] A satoshi is currently the smallest unit of the bitcoin currency (BTC) recorded on the blockchain. It is a one hundred millionth of a single bitcoin (0.00000001 BTC).

Question 12

Do you think it is worth diversifying into ethereum along with bitcoin?

Murray Stahl – Chairman & Chief Executive Officer

The short answer is no, I don't think it's worth it, so I haven't done it. First of all, ethereum is designed to be an inflationary currency, meaning they will keep printing up the stuff. There's no theoretical, finite limit. That could change at some point, but I don't believe it's likely to, because ethereum has some other properties.

Ethereum is ultimately going to be a closed system. It'll have an open aspect to it, so there will be some open-source code, but it's going to be a closed system. Right now, I believe there are 80 or so companies in the ethereum consortium. They're big companies, many of them are banks, like JPMorgan Chase, which is not unexpected. You might not be aware, however, that Microsoft, Intel and others are members of the consortium.

The evolution of bitcoin as a store of value and as a transactional medium is a huge threat to the financial services industry. It's also a pretty big threat to the technology industry, although that's a bit less obvious. For the financial services industry, it's completely obvious. Imagine that you have $100 that you put in the bank. What do you get? Basically nothing for interest. What does the bank do with it? They lend it out to someone else and, by the way, on the capital they have, they basically lever up their balance sheet 10 times. They might give you some pittance for interest, but they keep the bulk of it for themselves.

That model basically originates from before the Renaissance, in Venice and Genoa when, even though there was money in the sense that we understand it, money was gold. For security reasons, people deposited their gold with goldsmiths. The goldsmiths observed that their depositors wouldn't come for their gold all at once. If they had, let's say, 1 million ducats worth of gold in the vault, it was unlikely on any given day that people would come for 1 million ducats. They might come for 20,000 ducats, but rarely the entire amount on deposit. The goldsmiths kept, let's say, 100,000 ducats available, and they would lend out the rest. That's the origin of fractional reserve banking.

Fractional reserve banking and the way the free enterprise system evolved over the course of seven or eight centuries is not really talked about a lot. Central banks evolved as a way of being lenders of last resort to the banks, because sometimes people do come for their money all at once. There was a need for an entity to stand behind the bank to avoid bank failures. That's one of the functions of the central banks.

Once the central banks saw their role as being not only a lender of last resort, but as the agency by which the economy is stimulated, they lowered interest rates to encourage people to borrow money. It might be to build a factory, buy a car, build a house, remodel a house, go on vacation, or pay for an education. They could borrow money for just about anything, not necessarily a capital asset. However the money is spent, most of it is included as part of GDP.

The whole logic of fractional reserve banking as the basis of a free enterprise society is that it involves debt creation. But when more debt is created than the economy can service, voila! You have a financial crisis. That's basically how it works.

A crypto-currency, like bitcoin, provides an escape from that dynamic. Assuming bitcoin is safe, which is still an unproven proposition, but assuming that it is, if you converted $100 into bitcoin and, let's say, bitcoin doesn't appreciate the way I believe it will—even if just remains stable—you would know that at least it is not inflationary. At least its purchasing power wouldn't erode the way the dollar, euro, yen, and every other currency does. In that fashion, you would actually be earning a positive return, equal to the inflation rate of your home currency. You might say, "Since I'm not getting anything in the way of interest anyway; why don't I just keep my $100 in bitcoin?"

If the average person put even a small amount of their savings in a non-inflationary currency like bitcoin rather than in a bank account, how would it be possible to have fractional reserve banking if money is being taken out of the banking system? If that were to happen, the system would be de-monetized.

Getting back to the difference between bitcoin and ethereum, ethereum is a closed system. Ethereum will utilize a "proof of stake" system. How is more currency created? Let's say you're XYZ member of the ethereum consortium, and you have 1 million ether tokens. (An ether is the token or coin based on the ethereum blockchain.) You start with 1 million ether, and they keep creating ether. How much ether are you entitled to? Well, as a percent of how much ether is out there, if you have 1 million ether, you get more just for having it. It's not really interest. The big members of the consortium will have the most ether. Since it costs something to maintain the system, they will pay themselves with ether. In a way, they will almost be their own central bank, so it's like a dream come true.

The consortium will decide how much ether will be produced and, because they have large balances of ether, they will receive the most ether. They spend the money to maintain or enhance the ethereum system, so they receive more of it, which they will sell. Then they will charge you a certain amount of ether to use the system, and they will get repaid in ether. They will have a greater percentage of the ether, and will get even more ether when the next mining protocol comes through, which will be every five minutes. If the system actually works that way, you can see how it would be a dream come true for them.

The competition between ethereum and bitcoin is really the struggle between the fractional reserve banking system, which I would put under the banner or the rubric of ethereum, and bitcoin, which represents a deflationary currency that is a store of value outside of the fractional reserve banking system. It's worth remarking that bitcoin is nothing other than a store of value, because it could appreciate relative to other currencies as well. But, even leaving that question aside, for us, bitcoin is just a dormant asset, similar to the dormant asset we have in the $50 million on our balance sheet. We just hold it, and that's all there is to it.

This struggle is a historically unique event. It's almost as if, as a global society, we were able to go back in time eight centuries and do the whole monetary system over again. If you let your mind wander and you're really interested in history, get a book on the history of Venice, or on the history of money. We could have had a free enterprise society with property rights, but without having to be socialistic. We could have been as free enterprise or libertarian as you like, and be interested in property, and be interested in the profit incentive, without need for fractional reserve banking.

But even if we had fractional reserve banking, it wouldn't have to be everything. There could have been a fractional reserve banking system and—I'm going to use the word "custody" even though it's not really the right term—the custody system, or a holding system if one is outside the fractional reserve banking system. The financial system could have evolved in a different way than it did.

Now we're at a point in history where it's an eighth century do-over. Opportunities for do-overs in history are rare, but bitcoin presents this chance, making this a unique historical moment. Since the dynamics are so intriguing and fascinating, at the moment, I'm with bitcoin.

There's no guarantee that ultimately bitcoin will be the dominant store of value. It could be something else; it could even be ethereum. I have gone into this elaborate explanation to suggest to you that this is kind of the way it works, at least at the moment. It's constantly subject to change. Maybe I'm wrong but, at the moment, I assess that bitcoin has a lot better shot than ethereum. As I said, one ethereum, or ether if you like, is a way of preserving the existing fractional reserve banking system, while bitcoin, is a way of exiting the fractional reserve banking system. That's the struggle. And I think exit is better than entrance.

Steven Bregman – President & Chief Financial Officer

You put me in mind of something that is a lot less rich and subtle, which I hadn't thought about, although I know it exists. In the realm of private client investing, of wealthy people and families who have a lot of money to invest in portfolios, many of them, maybe even most of them, have their securities in a brokerage firm of some sort, where it is available to them on a normal basis, but it's actually commingled with the assets of the institution. Many don't think much about it, or they're not worried about it, but there are some who refuse to have their money in that kind of structure. They custody the securities with a bank, and then they don't have to worry about their assets being commingled with the bank's and the possibility of the bank having a financial problem. They're assets are custodied, segregated from the bank's balance sheet, and they prefer that method.

It's a far, far simpler and unidimensional kind of example. But they do exist side-by-side, just as you said that a fractional banking system doesn't have to be the sole method by which money is kept.

Murray Stahl – Chairman & Chief Executive Officer

Right; it doesn't have to be the sole method. Of course, when you take a course on money and banking, if you read cover-to-cover any textbook on money and banking, there's nothing in there other than fractional reserve banking. Any textbook you're likely to find in a library just basically says, either explicitly or implicitly, that the idea of money and banking is synonymous with the idea of the fractional reserve banking system. Nothing else is even conceivable. But it doesn't have to be that way. So, we'll see how this situation evolves.

Question 13

Dundee's stock price seems to go down every day. Do you still think it has potential as an investment?

Murray Stahl – Chairman & Chief Executive Officer

Dundee Corporation used to be a holding company for an investment management business, but it sold that business a number of years ago, and put a large part of the proceeds into inflation-beneficiary assets right before the average commodity prices dropped 50%, and some more than 50%.

If you looked at Dundee before its share price dropped a lot, what was it? It was a holding company for just about every commodity you can possibly think of from hard assets like gold to real estate, agricultural commodities and so on. Then commodities prices fell.

That's really what happened to Dundee. The idea was sound, and maybe it will ultimately prove to be a brilliant idea. But, at least so far as we can tell, events didn't work out to make that the robust investment everyone hoped it would be.

Question 14

Observing that the fastest-growing part of FRMO's equity is the consolidated, non-controlling interest, is this primarily an investment in HK hard assets?

Murray Stahl – Chairman & Chief Executive Officer

The answer is easy: yes.

Question 15

To what extent is this growth due to new capital contributions by the holders of the non-controlling interest, and to what extent is it gains in that investment? It appears that FRMO's interest in these investments is also one of the fastest-growing parts of the common equity.

Murray Stahl – Chairman & Chief Executive Officer

Well, the proper answer to that question is: all of the above. The HK Hard Assets investment has appreciated tremendously in the last year or so. When I say "tremendously," it's hard to quote a number, but it's a big number. There's been a lot of appreciation there. And yes, the outside investors have also contributed quite a bit of capital, and are continuing to do so.

The non-controlling interest is held basically by the main shareholders of FRMO, of which I am one. If I'm not mistaken, though it's hard to think of myself this way, I may be the biggest non-controlling interest contributor to FRMO. I'm hesitant to say that, but I'm 99% sure it's true. We all have individual investments in it, and then there's a company called Horizon Common that has an investment in HK Hard Assets, in which Steve, I, and others are all shareholders. Taking everything on a look-through basis, I believe that I am the largest investor in that entity. And I can tell you that I intend to put more money in it. Whether that's wise or not, we're going to find out, but I'm going to add more money into it.

Question 16

Regarding MGEX and South LaSalle Partners, on valuation and operations, the value of our investment has declined, even as we appear to be adding capital. To what extent is this due to the market value of a membership on the exchange (which has declined), and to what extent is it a share of operating losses?

Murray Stahl – Chairman & Chief Executive Officer

First of all, there are no operating losses at the Minneapolis Grain Exchange; it's a profitable company. If you go to the MGEX website (http://mgex.com/) and click on the "News" tab, you will see a few news stories that feature the volume, which has been increasing. Basically, the exchange business is more or less a function of volume. There is also the building itself, which is a landmark building, and I think it's fair to say that the building is worth more, not less. But anyway, there are no operating losses; the exchange has made money. As a matter of fact, the entire time that we've been an investor in it, it has made money, and it continues to do so.

Remember, when we value the Minneapolis Grain Exchange on the FRMO balance sheet, we're not really valuing the Minneapolis Grain Exchange; we're valuing South LaSalle. How do we value South LaSalle? Well, it's circular, in a way. In the past, we used a formula that took into account the average between bid, ask, and the last transaction, whatever that happened to be. Now, the auditors of the South LaSalle fund think we should just use the bid side, so, we use the bid side, which results in a lower value.

On the website of the Minneapolis Grain Exchange website, if you click on "Membership", you can see how few transactions there are for memberships, or seats. Membership owners are not really desirous of selling seats. Every now and then, one becomes available, but not frequently. I think it is fair to say that the seller is usually not an economically motivated person. You can see on the website how long it's been since any of the memberships traded.

On at least some of those trades, South LaSalle was the buyer. Think about it; we tried to buy the membership at the lowest possible price, and why should we not? We succeeded in buying it at the lowest possible price, but then people say, "Aha, it obviously isn't worth very much." If we had paid a much higher price, I guess it would be worth more, but then we'd be paying a higher price. Why would we not want to pay the lowest possible price?

I wouldn't jump to the conclusion that the value of the Minneapolis Grain Exchange is absolutely equivalent to what you see on the bid side, especially since, in at least some instances, South LaSalle was the bid. There's a certain self-referential paradox in that. But there are certain generally accepted rules of accounting by which we must abide, and we do. That's the way it works out. So, I wouldn't draw any conclusions from that price.

Question 17

I realize that we are accounting for the Minneapolis Grain Exchange investment based on the market value of a seat. Would it not be more helpful to ignore mark-to-market and simply count equity share of income, with a disclosure about the total number of seats owned and the percentage ownership of South LaSalle?

Murray Stahl – Chairman & Chief Executive Officer

We can do all that and maybe we'll do that next time to provide a little better indication. But we cannot consolidate it, because there are certain rules of accounting that basically tell you when you're allowed to do that, and we certainly won't do an end run around the accounting conventions and say, "Well, the earnings of the Minneapolis Grain Exchange are X, and we own Y percent of it, and therefore it is what it is."

In addition, the Minneapolis Grain Exchange is a private corporation, and they might not care to reveal what their earnings are. It's a private matter. I'm a member of the board and also the vice-chairman, so I'm not at liberty to disclose that, even apart from the accounting conventions.

However, we can certainly disclose that South LaSalle owns 62 memberships (seats) at this time. And, as of the most recent reckoning, FRMO owns roughly—this is in round numbers—45% of South LaSalle. So, I hope that helps you.

Question 18

There appear to be three sources of revenue/profit from a Minneapolis Grain Exchange membership: the trading/market-making profits, seat rental fees, and shares of the exchange profits. Which of these strategies is FRMO/South LaSalle using?

Murray Stahl – Chairman & Chief Executive Officer

Well, you don't get a lot of money from renting your seat out. You do get something, but it's so small that I'm frankly embarrassed to tell you how small it is. There is the share of exchange profits itself, but we don't get that as cash flow; it just stays with the Exchange.

Basically, what you're asking is: how is the Minneapolis Grain Exchange going to prosper? They prosper in a variety of ways. One is that it could have more trading volume in hard red spring wheat, which actually has been happening, as you can see on the website, so there's no secret there.

The second mode is the building. There's a large urban renewal project going on in the portion of Minneapolis where the exchange building is located. You can walk around the neighborhood and see what's happening there. That project can only have a positive impact on the value of the building. Anyone can walk around the neighborhood and see what's happening. It's really quite extraordinary and very gratifying to see.

The third mode is that the exchange has valuable licenses. It is a licensed derivatives clearing organization or DCO. A topic we discuss about the exchanges is that there is likely, in the future, to be ever-new asset classes that are likely to come in the form of contracts for commodities. It hasn't happened yet, but one day it will.

Why do I believe these contracts will be created? Because equities, be they global, be they large-cap or small-cap, be they international equities, or bonds of whatever variety, and real estate of whatever variety, and private equity of whatever variety—are all correlated now. They have one common denominator: interest rates, and that's a tremendous danger. One risk is from a valuation standpoint, because interest rates are exceedingly low, but they might not stay low. Another risk is even worse: interest rates might stay low, in which case, how will pension funds earn their actuarially required rate of return? How is an insurance company going to operate? How is a bank to achieve a profitable spread?

In that sense, society is at a real turning point and, therefore, the investment business itself, and the whole field of investments even beyond investments as a business, is at a turning point. Something has to happen and there are only so many DCOs out there. The licenses are very difficult to obtain, because the CFTC doesn't give them out readily. So, one day, the exchange's DCO license will have value.

Why hasn't someone devised something up to now? Because, until very recently, all an investor had to do was buy an index. I write about this week by week by week. All you had to do was buy an index. It could be a bond index; it could be an equity index; it could even be a real estate index, it could be a private equity index. As rates came down, the valuations went up. You didn't really have to do much. There wasn't a lot of pressure to do anything. But now the game is very different. So, we'll see what happens.

Question 19

Minneapolis Grain Exchange seats prices and rental fees have declined even as the volume on the MGEX stands at record levels. The South LaSalle fund has been acquiring seats, often, apparently, from estates or other non-fundamental sellers, which seems likely to be a good thing for FRMO. Assuming South LaSalle is not trading on its own account that suggests that trading volume is going to be more concentrated by the remaining share traders. Shouldn't this increase the value of the seat? Is FRMO looking to be primarily the buyer of last resort for liquidity-seeking sellers, or is there a deeper objective, consolidating trading to a very few key firms? What is the natural maximum for seats, as there must be some volume of traders to make a market? Would FRMO be more comfortable owning most of the seats and renting them? How much danger is there FRMO could hurt the exchange by becoming too dominant?

Murray Stahl – Chairman & Chief Executive Officer

There's a premise to the question that I have to correct. The fact that FRMO owns X number of memberships has nothing to do with the trading. Historically, in an exchange, the membership or seat is what enabled you to trade. For all intents and purposes, the seat does give you a right to trade, but we don't trade wheat. Since they demutualized exchanges, traders can get a permit to trade. They don't need a seat, and they don't need to be members of the exchange. You can be a member and own a seat, but you don't have to. You can lease a seat. You can do all sorts of things.

The fact that we have seats, doesn't displace any traders whatsoever. It doesn't matter if we buy more than one seat or we sell another seat. It's going to have nothing to do with the trading volume whatsoever. We're not in any way, shape, or form influencing the trading, nor are we looking to influence the trading.

The other unspoken premise of the question is if we bought some seats, shouldn't that increase the value of the seats? Yes, it should if they traded, but they don't trade. The premise in the question is that whoever decides to sell a seat, for whatever reason, has done a completely objective and thoughtful analysis of what a seat is worth, and that the offering price reflects that analysis. Whoever is the buyer, decides whether the seat is worth the price or not. Unfortunately, that's not the way it frequently happens. Some person or entity, for completely non-fundamental reasons that have nothing to do with the value of the exchange, needs to sell a seat. Then it's just a matter of supply and demand, and there aren't very many buyers. South LaSalle is one of the buyers, and we acquire the membership at a price of X.

I wouldn't necessarily assume there's information content in whatever the bid is out there, especially since there are times when we ourselves are the bid. When you look at the price, you're looking at the bid. And on a certain day, you might be looking at us and you shouldn't expect us to put a bid in for what we think the actual fair value is. We are not hurting the exchange by buying memberships.

Beyond all that, we cannot buy more than 35% anyway, because there's a CFTC regulation that prevents us from buying more than 35%, so we are capped at that level.

Question 20

What consideration has been given to recapitalizing the MGEX as a stock company, rather than a mutual?

Murray Stahl – Chairman & Chief Executive Officer

All I can say as to that is that I think the exchange is fine the way it is. I don't believe that anything would be gained by changing the structure; I don't know that anyone is thinking too much along those lines. The hard red spring wheat crop is a big wheat crop, but the MGEX trading volume is not commensurate with what it should be. One day, that might change. I think that's much more important than a possible recapitalization.

Question 21

Management has indicated a desire to increase the number of asset classes in which FRMO holds a croupier-style investment. Knowing the incredible returns possible from small out-of-the-money options that make good, is your preference to continue to add small minority stakes in more exchanges and asset classes, or to consolidate existing ownership positions and increase control over those businesses, if you could not do both? What is the reason?

Murray Stahl – Chairman & Chief Executive Officer

We are certainly looking to add more minority stakes. Basically, the way it works is that when you get involved in one of the small exchanges, it's one thing to look at them from the outside; it's another thing to work with them and get to know them on the inside. We make a tiny investment with the purpose of getting to know them, getting to understand them, to see if we can work with them in a larger sense. It's possible, one day, something bigger will come out of it, and we would certainly like that to happen.

Question 22

Given the size of the balance sheet, one could imagine doing both. To what extent is the issue liquidity and limits on the shares that can be had?

Murray Stahl – Chairman & Chief Executive Officer

While we certainly have the money to take over a small exchange, it's really not a question of money; it's really a question of regulators. Will the regulators allow it to be done? Therein, you know, is a puzzle. If it is allowed then, of course, we all have to be willing do it.

The small exchanges have many virtues, but we have to accept that they have one very large deficiency: They are small exchanges, and they exist on the margin of trading. We must ask ourselves if we, as a company, want to tie up all of our liquidity in something that exists at the fringes, and then try to figure out a way to change that. I don't think we want to tie up all of our liquidity in doing that. There are some other things we'd like to do.

We'll just have to see how that goes. At the moment, I wouldn't expect that we're going to drop $50 million on exchanges. Philosophically, you don't want to say never, but I wouldn't be expecting anything like that to happen in the foreseeable future.

Question 23

Regarding operating businesses, in previous calls and letters, management has indicated an interest in acquiring one or more operating businesses that could generate additional cash flow for FRMO to reinvest, outside or inside the operating business. This discussion has faded away of late, which I realize does not mean management is any less interested in looking about for a firm. How is the search going?

Murray Stahl – Chairman & Chief Executive Officer

While there are some exceptions, many assets are at all-time record high valuations and, normally, you would pay a control premium on top of that. So, the opportunity set is far narrower than it's been in a very long time, and it's not as if we saw a plethora of opportunities previously.

If you look back at the FRMO annual reports during the 2008 to 2009 financial crisis, you'll see that we had a far less liquid balance sheet than we have right now. The range of investments open to us at that time was relatively limited. Given the resources we have right now, and including borrowing power, cash, and the capacity in our funds, we have far, far more resources than we had then. If an economic environment were to happen like the one in 2008, we'd be in a better position to capitalize on it. I'm not saying that 2008 will happen again—I hope it never happens again, but you never know.

As a generality, you want to deploy a lot of cash when valuations are low, not when they are high. When valuations are high, you want to retain the cash, which is what we're doing. That's basically how the search is going. To buy an asset that will give us a minimum of a double-digit return on the invested capital, and to pay the control premium, we are not likely to find very many opportunities at the moment, but we keep looking.

Question 24

What thought have you given to creating a profile of the kind of business you are looking for, and advertising it like some other holders? For example, is FRMO looking to be a home for businesses on the Berkshire Hathaway model, or perhaps more merchant banking like Leucadia, which seems to be the other operating model?

Murray Stahl – Chairman & Chief Executive Officer

Well, let's put it this way: if anybody has a great idea for us to look at, we certainly would welcome it, and we would look at it. We're not really interested in being a merchant bank a la the financial services in the classical Leucadia model. We would be interested, a la what Leucadia once was, in making a distressed investment. Basically, the format would be a good business with a bad balance sheet. If that were to happen, we'd be very interested.

If, let's say, there were a good business that was over-leveraged, and we could use our cash flow to de-leverage it, and assuming suitable constraints could be put on the management such that they would never again repeat the error of over-leveraging themselves, we would consider an investment of that type. At the moment, there are plenty of over-leveraged companies, but they don't seem to fall into the category of, "Good business, bad balance sheet." They fall more into the category of "overvalued business, not so great business, bad balance sheet;" a company that stays alive because interest rates are low. We have no interest in that sort of thing.

We would like to be a home for businesses on the Berkshire Hathaway model if we could find such, but we’re not looking to pay the current rate for such businesses. It’s all a question of interest rates. Interest rates are what they are; it’s not a big secret. We’re just not going to buy a business unless it can generate a very high return on its cost basis. It is possible to develop a business by improving it a lot, and you ultimately might be able to get a double-digit rate of return on it. That’s what we’re trying to do in the HK Hard Assets business. We’ll see if we can succeed.

That exhausts the questions, and it probably exhausts your patience as well. I know I’ve been talking for a long time, but I really welcome the questions and the dialogue. I’m very gratified that we’ve received questions like these, and I hope we get a lot more of them. I look forward to reprising this in three months. As I said, we welcome your questions. You don’t necessarily have to wait for the conference call. If you have questions, feel free to contact us, and we’ll get you the information if we can. Thank you so much.

Operator

Ladies and gentlemen, this concludes today’s conference call. Thank you for your participation.

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