FRMO Corp. Q2 2019 Conference Call
Thursday, January 17, 2019

Operator

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 Thérèse Byars. Please go ahead.

Thérèse Byars – Corporate Secretary

Thank you, Todd. 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 second 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.

Steven Bregman – President & Chief Financial Officer

Well, I'd like to intercede. As is now becoming a habit, I'd just like to make an observation about your reading of this preface, Thérèse. I'm waiting for the day when you'll have that sheaf of papers in hand, but you won't actually be looking at them; it'll just be coming by memory, straight from your head out through your vocal cords. I'm sure it will happen.

Thérèse Byars – Corporate Secretary

Yes, soon.

Murray Stahl – Chairman & Chief Executive Officer

Thank you, everybody for joining us. Thank you, Thérèse. Thank you, Steve, for your always witty remarks, and let's begin. First, if I may, one or two minor housekeeping items. When you look at this quarter's financial statement, specifically the balance sheet, you'll see it's somewhat more condensed than the prior balance sheets. Please don't get the idea that we're trying to not disclose information, because all of the details that formerly existed in the, if I can use the word, busier balance sheet of prior quarters is in the footnotes. We'll cover it in the Q&A, but if you're interested, information on Horizon Kinetics Hard Assets, the securities exchange investments, and the rest is all there in the footnotes. Today, we'll supply a little more supplementary data, but it's all there in the footnotes. The idea is that we want to be able to look at the balance sheet in one fell swoop, and it was getting kind of busy, so this was the way we decided to go.

The numbers speak for themselves, but what you can't pick up from this is that we are increasing our exposure to cryptocurrency in a gradual but more substantial way than we did previously. One of the cryptocurrency investments at Horizon Kinetics—and, of course, FRMO owns nearly a 5% interest in Horizon Kinetics—is that we purchased the majority control of another operating company that is not, I repeat, not an asset management company. The purpose of this entity is to host cryptocurrency mining activities. This investment will accomplish two purposes: one, we'll have outside clients that have nothing to do with Horizon Kinetics; second, it will host our cryptocurrency mining activities, including some of our proprietary cryptocurrency servers and investments.

The idea is that cryptocurrency, in its essence, is designed to eliminate what economics would call the rent-seekers, or the intermediaries, if you prefer that term. The goal was to get closer to the utility providing the electricity and, thereby, to get a much lower price for the power, which we were able to accomplish. It resulted in a big decrease in the price we pay for electricity. Part of the necessary equipment for crypto mining are certain transformers, which are very expensive. In light of what was happening with cryptocurrency during the last quarter, which was that they all went down—the prices of many cryptocurrencies fell by 50% or more—we thought it was the time to act, so we committed a modest amount of money, and we now own a sizable interest in a hosting company. We're negotiating a second deal with another hosting company. If we come to an agreement on the terms, we might have an equity interest in that one as well.

The Cryptocurrency Mining LLC, which is more fully invested in terms of cash flow, made more money in the quarter ended December 31, 2018 than it made in the quarter ended September 30, 2018. I think the increase was about 10%. Had we closed the deal with the hosting company sooner, we would have had an even better experience, because it was after we closed the deal with the hosting company that we were able to change our arrangements with the utility. That change couldn't have happened within the confines of the monthly billing period, which ended on December 15. It was only during the last two weeks of the year that we were able to get a better price on power, so that could only have a marginal effect.

In case you're wondering why we pay so much attention to cryptocurrency, it is because it relates to the asset management business. In the world of bonds, for instance, I think it's self-evident when you look around the world and see what bonds are yielding that it's very difficult to get a positive real rate of return, which is to say a return that's above inflation, even if you don't figure in taxes. And, if you deduct for taxes, it beats me how to do it.

In our humble opinion, the biggest problem the investment world faces with respect to fixed income is to achieve an income yield that is positive after inflation. In the current environment, the only place we can think of attaining it is in the asset class we call seigniorage, which we also call cryptocurrency mining. We think this asset class will be really big. We also recognize that it's a very misunderstood kind of investing. But we're really talking about FRMO in this forum, so I won't turn it into a lecture about cryptocurrency. I'll just cover a few points and say that if you have more questions about it, you can send them to Thérèse, and we'll answer them on the next call.

If the price of a cryptocurrency were to fall by 50%—to pick a round number for the purposes of discussion—then 50% of the miners would likely drop out of the system. If, however, you keep mining—or hashing, as they say in the industry—at the same rate, then you would have twice as much hash power. Although you would be getting a 50% lower price if you sell the coins that you mine, you would be mining twice as many coins. If you did nothing other than that, you would be in equilibrium with your prior economic position.

The way the computer algorithms are set up, when the price of the coin falls, it happens nearly instantaneously because, although an electric signal moves at the speed of light, it takes some number of minutes before you see the decline in the aggregate hash power of the system reflected on the blockchain, because the block cycle for bitcoin is in 10-minute increments.

Some participants look at what they think is the instantaneous hash rate of the system while they calculate what they think is their instantaneous profitability or margin, and make their capital allocation or mining decisions on that basis. But if they were willing to wait about 10 minutes, they would see that they were still profitable. But, as they say on Wall Street: "I want immediate gratification, but I can't wait that long." Cryptocurrency mining is a very misunderstood aspect of investing. I find fascinating, and we're going deeper into it.

On the last conference call, I promised to provide more detail on our cryptocurrency holdings than what you can see in the financial statements. First, I'll talk about the cryptocurrency exposure of the funds. Our investment in the Grayscale Bitcoin Investment Trust (GBTC) constitutes the bulk of it. On a look-through basis, including the various fund holdings of GBTC, the market value would be $2,134,577. That figure should be compared to the shareholders' equity.

FRMO itself owns 7,644 shares of GBTC which, as of December 31, 2018, was worth a little over $30,000.

In addition, there are various crypto coins that we've mined and held. In that connection, we own 14.12 bitcoin, and you can calculate its value. We don't have very many servers yet, but we plan to increase the number. We also own 20.25 Ethereum coins, 365.3 Ethereum Classic coins, and 19.81 Zcash coins. These are all coins that we mined. We're also looking into mining other coins and expanding our mining business.

Getting back to the balance sheet, you can see that we still have a very high cash balance. In the last couple of sessions, we either did a very good job of explaining what we do, or we did a very bad job, because many of the questions pertained to points we otherwise would have made on this call. Given that, we'll turn to the questions now.

Question 1

As of November 30, you have an equity security that accounts for 22.2% of equity attributable to the company. Would you consider disclosing this position and, more broadly, would you consider disclosing the equity positions that the company holds? I understand that there are plenty of reasons why you may not want to or be able to do so, but this would go a long way to helping stockholders understand the complexion of the balance sheet.

Murray Stahl – Chairman & Chief Executive Officer

We're certainly able to do that, and if we were required to do so, we would, but we don't want to do it and here's why. There are two reasons, and the first is that people would arbitrage us and we don't want to turn FRMO into an arbitrage security. They would either buy FRMO and sell short the security, or they would sell short FRMO and buy that security. That's not something we want for FRMO because, in our humble opinion—and maybe we're wrong—it would cause distortions.

The second reason for not disclosing the equity positions merits some color because, although 22% is an accurate number, there's a difference between buying a 22% position with the shareholders' equity that we have available and buying some far lesser quantity in relation to the then shareholders' equity and having it appreciate several fold. As well, it's important to understand that, yes, it's 22%, but there are also taxes to be considered against it. If it were to decline by 1%, our shareholders' equity wouldn't go down by 1%; it would go down by less than 1%, because we would have to reverse the deferred gains taxes that would otherwise be payable. Even if someone were to try to arbitrage that 22%, they should bear that in mind.

This is a long-term investment for us. If it's successful, we'll have to disclose it, and we certainly will do so. But just understand that we don't look at it as if we took 22% of all our money and threw it into something. We invested a much, much smaller portion, and it appreciated. We left it alone because we don't want to have to pay taxes on the gain at this time. Paying the taxes would mean a considerable diminution of the cash we have on the balance sheet, and we don't want that.

Phrased alternatively, if someone suggested: "Well, a large position gives you a certain amount of volatility; why don't you sell a piece of it and control for that volatility?" I would reply that yes, it would control for the volatility, but it would cause an outflow of capital from the company. The result would be an event that we fear, which is the diminution of our capital, and we would be the cause of it happening.

Question 2

Performance in the limited partnerships has been quite impressive, but it's hard to get a sense of what these look like on a compound basis. Would you consider disclosing these figures, given the long-term nature of the ownership interests?

Murray Stahl – Chairman & Chief Executive Officer

We won't just consider disclosing them; we will disclose them. We don't have the audited numbers with us for this call, but for future time periods we'll have some form of disclosure. One possibility would be for me to prepare a one or two-page abbreviated letter, perhaps with an accompanying table of performance data on the partnerships. I'll find some way of making it clear.

Question 3

What is driving the increase in General and Administrative (G&A) expenses for both the second quarter and the first quarter of 2019 and year over year?

Steven Bregman – President & Chief Financial Officer

From what I can see, it appears to be an increase in a certain expense in our tabulations, and it seems to be coming from the accounting expense. Accounting expenses versus the preceding quarter and last year's similar quarter were more or less the same. They were steady, but it was a lot higher in this most recent quarter.

When we first started FRMO Corp., we began with a very limited amount of income. Being conservative, we made sure that we had our first revenue stream when we organized the company. At the time, it was just enough to cover our estimated accounting expenses for being a public company, and it was roughly $20,000 a year. When we hired our first accountants, we didn't have much for them to review, but they do have a process and, even so, they were generous enough and had enough of a long-term outlook that they were willing to give us a discounted rate. We knew they were giving a discounted rate, and so we were able to remain profitable even before we began establishing additional revenue streams.

Eventually, I guess their hope, or expectation, or investment in us turned out to be successful, because we began generating more income as we became a larger company, and so too their fees rose. Their fee stream would make a great stock, I suppose, because in terms of volatility of periodic results, if we measured that by the accounting fees we pay to that firm, they have very little volatility and they mostly trend up, and they continue to trend up, so much so that maybe it's something we should look at. But that appears to be the major difference.

Murray Stahl – Chairman & Chief Executive Officer

I'll read you some numbers and give you a little more color on it. In the quarter of September to November of 2017, the accounting fee was $90,402. (I'm leaving off the pennies because they're not relevant.) In the quarter of June to August 2018, the accounting fee was $85,672. And in the quarter of September to November 2018, the most recent quarter, the fees were $142,770. So that's the bulk of it.

Steven Bregman – President & Chief Financial Officer

I know there are actually different bodies that contribute to the accounting profession—there's the FASB, the PCAOB, and others—and they'll periodically come up with modifications that require our accountants to make changes as to how they calculate various financial statement items. These must be discussed back and forth during our various meetings, both telephonic and in person when the audit committee meets, and that costs money.

We had a long and fascinating discussion with our accountants at the most recent board meeting about changes in the standards for revenue and expense recognition. When I took accounting in college, they told us that a critical precept in accounting is to present fairly how the underlying business is performing so investors in it can understand the business.

For instance, if you have a manufacturing business and that business has enough accumulated profits on the balance sheet so that they've been able to make additional investments in some bonds, stocks, or whatnot, those securities can be quite volatile. But they're not part of the core business. We were taught that it would be a distortion—it would actually obscure people's understanding of the underlying business—if from quarter to quarter you took the gains and mark-to-market appreciation or depreciation of those securities and recorded them in the income statement. Maybe the business itself is doing poorly, but a gain from the stocks makes it look as if it's doing well.

You don't want to mislead investors in that way, so the regulators made an exception. There's a tradeoff for every decision, and that decision was that you take those gains and losses or mark-to-market changes in values from investments that aren't part of the core business, and you sidestep the income statement. That's a big thing to do but they had a reason. You sidestep the income statement, and you just credit or debit those periodic market value changes and gains directly to the shareholders' equity. Economically, it all flows through to the same place, but with greater income statement or operating profitability clarity

Just recently, though, the regulators said that it's now better if you show the increases or decreases in market value of these ancillary securities that are not part of the business directly on the income statement. You can imagine what that means for a company like FRMO Corp. It completely distorted various line items on the balance sheet, income statements, and the calculation of our taxes. That change affected virtually every part of the financial statements. The Audit Committee here had to spend many hours trying to understand why the changes occurred, how to explain them, what kind of footnotes to make, and then back and forth with the accountants.

Periodically, the accounting profession, for whatever their good reasons, changes a rule, and it requires a lot of effort and a lot of time, which means money. It's not as if suddenly we decided to have extra accounting expenses because, you know, we just like to. It was quite an interesting set of discussions.

Murray Stahl – Chairman & Chief Executive Officer

The accounting is most of the increase, but let me just give you a bit more color so you can get a sense of what's going on. I'm leaving out the items that increased from $1,000 to $2,000 because you might not find them interesting, but here's something you will find interesting—and it's more than you asked for in the question.

In the September to November 2017 quarter, income from cryptocurrencies, which is basically the revenue we earn from mining, was $25,678. Remember that we don't sell the cryptocurrencies; we keep them, as I indicated before, and cryptocurrency prices were very high at that time. Basically, the income is calculated by using the cryptocurrencies prices at the time that they are mined, irrespective of their appreciation or depreciation thereafter. The cryptocurrency hosting fees for us were only $3,880; that was the operating cost required to generate the $25,678. It gives you an idea of how unsustainably profitable cryptocurrency mining was at the time. In the same quarter, we also recorded $4,678 in depreciation of the mining equipment.

In the June to August 2018 quarter, income from cryptocurrencies, unsurprisingly, was a lot lower: $10,792. Obviously, the prices went down a lot. The depreciation expense was $8,448, and cryptocurrency hosting fees were $7,716. On a formal accounting basis, you could say we lost money on that, since those two expense items well exceeded the mining revenue; however, you should be very careful about saying that because you haven't heard the next number. In the September to November 2018 quarter, income from cryptocurrencies was $17,823. (I'm reading off the income statement.) Cryptocurrency hosting fees were $7,292, and the depreciation expense was zero.

Why zero? Because we basically wrote everything off, as we're allowed to do under the tax law. To save on taxes, we took accelerated depreciation. At the end of the day, given the size of the income statement, you can see that the capital invested in mining is not a big deal. I'm giving you this kind of detail, because sometimes you take actions for tax purposes that make you look less profitable on an income statement basis, but which make a lot of sense for tax purposes. In the August quarter we look unprofitable, while in the sequentially following November quarter, we look unduly profitable.

I don’t think you can then say that if you calculated this November-quarter profit margin, we would have $17,000-odd of mining revenue in cryptocurrencies, and we really have $7,000 of operating expenses and, therefore, we have a profit margin that really is astronomical. Because at some point in the future—although we hope it will be a long time from now—we’ll have to replace those servers. But that’s just what you’re allowed to do in accounting expense, erase for this past period any depreciation expense. Even though most of the time, as analysts and investors, we’re looking at financial statements, we’re looking at someone else’s financial statements. Now we’re looking at our own, and there are a lot of choices to make.

I’m providing you with some insight into the choices we make. When you look at the G&A expenses, it’s a good idea to take all of that into account. Armed with that information, when you look at our decisions in cryptocurrency, you can measure with some degree of precision what the actual profit is, even at depressed prices. Therefore, you can understand our interest in continuing to invest in this asset class, if you want to call it an asset class. That gives you even more detail than you had hoped you would receive about G&A expenses, but we’re trying to be as transparent as is reasonable without boring you too much.

Question 4

Did FRMO put any money to work during the volatility in December?

Murray Stahl – Chairman & Chief Executive Officer

Yes, but not by purchasing; rather, we put some money to work in terms of changing the complexion of our short portfolio. Remember, you can do many things in a short portfolio, the results of which you can see on the balance sheet.

During the quarter that will end on February 28, 2019, one of the ETNs that we are short will reach maturity and, therefore, it will have to go off our balance sheet, because it will no longer exist. We will have to realize a gain, which will change the cost basis of the investments. If you’re just looking at sequential balance sheets, it might give you a distorted idea of how profitable this is. In fact, it is a very profitable undertaking.

Over the years, we’ve used options, ETNs, and ETFs, and we’ve had to make changes in the portfolio mostly when the instrument ceased to exist, and we have to close out our position and realize gains. If it weren’t for those necessities, we’d keep them forever.

I think the sense of your question is asking if we invested any more money in equities. We didn’t invest significantly more money in equities, although every quarter we buy a small number of equities, because we're adding to HK Hard Assets. We'll discuss HK Hard Assets in a moment, so I don't want to go into it right now. Even with the decline in equities in December, they were nevertheless still very expensive in relation to their historical valuations. Here and there we find some stocks that we like and we buy them, but it's not a tremendous amount of money.

Question 5

Given the decline in the FRMO share price, is there any interest in buying back shares, and/or will the plan continue to be to wait for an opportunity to buy a company during a period of market distress?

Murray Stahl – Chairman & Chief Executive Officer

Yes, we're waiting to buy a business or to expand the cryptocurrency business during a period of market distress. As far as the latter, we're basically doing that. In terms of buying back shares, it's important to note that Horizon Kinetics has been purchasing FRMO stock and now owns approximately 150,000 shares. FRMO owns nearly 5% of Horizon Kinetics. FRMO and we personally are the owners of HK, and we chose to buy those FRMO shares through the HK pile of capital rather than a different pile of capital. In one way or another, those shares went off the market. The only difference is they didn't get canceled; we own those shares. We're interested in acquiring shares, but we are not interested in shrinking FRMO's shareholders' equity. The challenge was how to acquire shares without shrinking the shareholders' equity. That's why we did it that way, through the modality of HK, if that makes sense to anyone.

Question 6

As an investment thesis either receives confirming or non-confirming information, how does this change FRMO's portfolio allocation (or not), such as with Texas Pacific Land Trust (TPL) or bitcoin?

Steven Bregman – President & Chief Financial Officer

If I may, I'll be the guy to warm up the audience for you on that question. This question is one that in more general terms we're receiving from all corners now. Why? It's not unusual, because stocks were down in December. In addition, it was year-end, which means investors received urgent calls from their accountants telling them about a loss they could take to offset a gain and so forth. As a result, clients were asking us: "What are you doing? Are you reallocating? Are you selling?" Or they told us: "You should sell and take losses," and so forth and so on. It happens every year.

We really want to do what's best for our clients. We really do have their best interests at heart, but it's very difficult to say: "Calm down. Don't get excited." to someone who is anxious and tense, whose eyes are fixated on the red exit sign above the door, or to help them to think about it in higher, more subtle terms.

I'll read you something from an email response I wrote to a client on December 20, 2018, who was asking me: "What about Texas Pacific Land Trust (TPL)? If we have any high tax cost lots, should we take the benefit of it?" Without context and sufficient information, investors typically resort to price as the front-and-center investment variable. That's what they can focus on, so all their attention and their higher cognitive powers contract into a singularity around something they can readily understand like the exit door or a single metric like a stock price. It's instant, effortless analysis.

My response was: "Look, I'm going to give you two facts. Here's Fact A. The Shares of TPL are down about 45% from their high earlier this year. If price behavior carries information content, then it suggests that the distillation of all investor knowledge is that TPL's business must be worth less. Not worthless, but worth less. And that must be why the market sold the stock down. And, moreover, we know that the price of West Texas Intermediate oil is down about 40% from its high this year (2018). Yeah, that must be it. Not a good stock.

"Now, here's Fact B: TPL is up 2% from the start of the year, and the S&P 500 is down about 6%. Yep, it must be a pretty good stock."

Which is it? What should we do?

Another client asked me a generally related question some weeks later. This client wanted me to take tax losses across the board, wherever they were found. I said, "Look, if you have—let's say, as a general case—a 50% mark-to-market loss in a stock and your accountant tells you, 'Look, you could take the benefit,' What really happens? Okay, so you get a 20% tax benefit on that 50% loss; that's 10% of the stock price. What's happening, though, is that in the second and third week of December, everybody's doing the same thing. They're all focused on that exit door."

I took something like a half dozen stocks that we own in various entities, including companies like Civeo, Texas Pacific Land Trust, Lionsgate Entertainment, and Royce Micro-Cap Trust, and I showed them the prices as of December 3rd and also the prices as of the end of the second week of December and, more or less at the end of the third week of December. They were going down, then down some more, and down some more. Then, by the first week of January, they all were more or less exactly where they had started before the decline in December.

Anybody who started selling along with the crowd in the middle and end of the month basically took a loss of market value of 20% to 30%. They can't buy it back, because of the 31-day wash sale rule for tax loss recognition. They got a 10% tax benefit on a price that was 30% lower. That's what happens. There's a reason for the phenomenon called the January effect.

I know that this question was a lot better informed than that, because there's been a lot of price action in TPL. But TPL finished the month of December not far from where it started. Murray may have a different view, but I'm not inclined to make major changes in a security nonspecific manner without being more informed just because prices go topsy-turvy. And they didn't even go that topsy-turvy. It's not even such a big deal, but people feel that way, so I try to help them.

Murray Stahl – Chairman & Chief Executive Officer

I have some similar things to say, but I'll express them differently. I'll talk about TPL first, then we'll get into bitcoin. To give you specific examples, because you're asking a specific question, I've been in TPL stock since 1984 in one incarnation or another. At the end of the year, the price of oil went down 40-odd percent and, from its then higher price, TPL went down by a relatively similar amount. From 1984, this decline might be the 16th or 17th time I've endured a price drop of that magnitude, though the numbers might be a few percent higher or lower on different occasions. I've lived through that many times, but I didn't react. Let's go into the prior time so we can get a little more historical perspective on what happened.

In the latter half of 2014, you might recall that oil went from $114 a barrel all the way down to the low $40s. There might have even been a day—I don't remember anymore—when it traded even lower than $40, but let's call it the low forties because I think that was the trading range. TPL's stock price might've gone down 40-odd percent; I don't remember the exact number, but it was something like that. If you look at that time period—and that was also near the end of the year—TPL might've ended up—I'm going to be a few dollars off, but let's say $110 a share.

Oil is a little bit higher now than it was back then, though not that much higher, but TPL is six times higher. I completely get it, that in a relatively brief period of time, the price of oil is clearly the dominant variable, maybe to the virtual exclusion of everything else, because oil can go down a lot in a few weeks, and there's very little an oil-related business can do to materially improve its operations. Maybe there are some ways to make it marginally better, but there's very little that can be done in a matter of weeks.

Maybe the TPL share price will decline a bit less than the price of oil, maybe it won't, but that's what it is. You shouldn't forget the key fact that with TPL you're sitting on what we believe to be the greatest hydrocarbon property in North America, maybe even in the world. The technology keeps improving, and pipelines are being constructed so that in 11 months, much of the gas that is currently being flared will no longer be wasted. There are the land leases, and there is the water that is being sold. There are all kinds of things happening, but those variables don't change in any appreciable way in a matter of weeks because of momentary changes in oil prices.

It's completely understandable that people react as they do, but those who choose to react to the share price are ignoring all the other aspects of this company. Think of how many times we could've done that trade since 1984. And if we had sold it because we thought the price of oil was going to decline, think of how many times it went down 5% and then went right back up? How many times would we have we missed the rebound? To do that presumes a certain talent that I don't have. If the shares go down 2% or 3%, is that the signal for a 45% decline, or is it just a 2% or 3% deviation before they go higher? I don't really know, and I can't know. Imagine if it had been a different scenario. Imagine if something horrendous had happened in Saudi Arabia and, immediately after a 10% decline, the price of oil went up 100%. In addition, if you sell, then you have to pay the gains taxes. I don't think it's a profitable undertaking. I think the best thing to do is to leave it alone.

With bitcoin it's the exact same thing. To be a success, bitcoin lacks two attributes that it will have in short order. What does short order mean? It's certainly not going to happen in a week or two but, in a year or two, it will definitely happen, in our opinion. What are those two things? One is institutional grade custody, which is being developed. If you want people to own bitcoin en masse, they must have a way to safely store their private keys. That's coming and is in the process of being implemented. It takes time to implement, but it's going to happen. An example is Bakkt, which is in the process of being implemented.[1]

The second item that bitcoin needs is price surveillance. When we look at the price of bitcoin, which trades on unregulated exchanges, it is not like looking at the price of wheat, for example, on the Minneapolis Grain Exchange. Theoretically, Steve and I could take a bushel of wheat or one 50,000 bushel contract and sell it back and forth on the exchange to do what used to be called painting the tape. But that activity is prohibited on regulated exchanges where there is price surveillance.

While there are over 16,000 venues in the world where bitcoin is supposedly trading, there's no price surveillance. If Steve and I were trading on certain so-called cryptocurrency exchanges—which are really brokers—theoretically, we could take one bitcoin and trade it back and forth at an agreed upon price, even though we never had any intention of settling that transaction; we're just reporting trades. Are those really bona fide trades or are they wash sales?

In a supervised real exchange universe, you can get in big trouble for engaging in wash sales, because you're distorting the price for your own gain. With cryptocurrencies, for the time being, we have to accept the prices, because it's the only thing we have, but we don't know if those are real prices. What we do know is that the largest holders of bitcoin own the lion's

1 Bakkt, backed by the Intercontinental Exchange (owner of the NYSE), is designed to enable consumers and institutions to buy, sell, store, and spend digital assets.

share of it by far. I don't remember the number, but a relatively small number of addresses hold roughly 90% of all the bitcoin. You can see the data on the blockchain, at bitinfo.net, for instance. When the large holders transact, they are generally buyers, not sellers, with occasional exceptions.

The majority of transactions on the bitcoin blockchain are trades valued at $36, $50, or $100—in that range. They trade for who knows what reason. Until there is exchange price trading supervision, which is coming, we don't really know what the price is, because we have no reliable mechanism for price discovery. Therefore, I would be loathe to draw conclusions about the price of any of these cryptocurrencies until we have a better understanding of what the bona fide prices are. That's coming in the not too distant future. Once we have institutional grade custody and price surveillance, there can be institutional grade investing in cryptocurrency.

By the way, even though you didn't ask it, but because you're asking about confirming or non-confirming information, I think I should add the following. I like to tell this to people. Let's say bitcoin is a failure in the sense that not a single person in the world is interested in buying it, with the exception of the residents of one particular nation. Moreover, all the other cryptocurrencies fail completely. There are some currencies in the world that are highly inflationary—I'll name them in a moment. At least insofar as one of those currencies is concerned, let's say that its populace prefers to use bitcoin with its fixed issuance rather than their own national currency, because in roughly 490 days, bitcoin's interim inflation rate will be down to 1.8%, and that rate will continue to decline thereafter.

Consider the Brazilian reais, as they call it. The Brazilian reais has a roughly $720 billion market capitalization (the value in U.S. dollars of its M2 money supply). That's 11 times the current market capitalization of bitcoin—11 times! If bitcoin is a failure except that it ends up being a better alternative to the Brazilian reais, that $720 billion of reais M2 would represent the amount of market demand for the fixed supply of bitcoin. With a fixed supply, the only equilibrating mechanism to satisfy that demand is a higher price. Investors in bitcoin at today's prices would make 11 times their money. By the way, recall the Brazilian cruzeiro, cruzado, novo cruzeiro, or novo cruzado, plus I think they had two or three iterations of reais, they had a second cruzeiro, a second cruzado. The Brazilian currency has been inflated more times than anyone can remember. To have the purchasing power today of, say, one original 1944 reais, you would need, literally, billions upon billions, which is something like 10^{18} or some unbelievable number, of today's reais.

Let's take it a step further. I'll only talk about currencies that begin with the letter R, though I'm not using all of them. Consider the Iranian rial, which seems to have a very high inflation rate and a government that isn't averse to debasing its currency. Let's say that bitcoin ends up displacing or replacing, if you like, the Iranian rial. Well, the Iranian rial has a $360 billion market cap, call it 6x the value of bitcoin. If both the Brazilian reais and the Iranian rial are replaced by bitcoin, now we're not at 11times but at a 17 times appreciation coefficient of expansion.

Then there's the Russian ruble. I don't know about you, and I don't want to say anything pejorative about any group of people, but the government of that country as well as its central bank are, well, let's just say that their currency doesn't rank at the same level as the Swiss franc. I think we'd all agree with that. They have a pretty high inflation rate and a certain tendency to debase when the mood suits them. That currency has about a $720 billion market cap. If bitcoin were adopted as a substitute for the Russian ruble, we would add another 11x times for a coefficient of expansion of 28x times; that's 28x times!

For illustrative purposes, let's say that someone made bitcoin a 1% position. I'm not saying that anyone should make bitcoin a 1% position; I'm just using it as an example. The worst that would happen is that the investor would lose 1% of their portfolio or savings. But, if the investment is successful, even if only in the context of the three currencies I mentioned, the investor could make 28x their investment. Where else do you find a risk-reward ratio like that? One can also readily see that it's not the sort of item you should be trading in and out of. In light of these comments, I think you should be holding it, but that's my opinion, and people can do what they like.

If we consider taxes, referring back to my comments on the market capitalization of GBTC, which has appreciated many, many fold, it would cost a lot of money in taxes to exit that position. If its value were to decline to zero, it wouldn't hurt that much but, if successful, it would provide an enormous increase in shareholders' equity, even if it works only to the degree that I described, let alone if to a greater degree. I hope that's more than enough color on that topic.

Question 7

Please explain the approximately $500K increase for the investment in Horizon Kinetics LLC.

Murray Stahl – Chairman & Chief Executive Officer

That's easy to answer. We did not increase the investment. The increase you see on the balance sheet is entirely attributable to our proportional share of earnings that had been retained on the balance sheet of Horizon Kinetics, plus any appreciation in the market value of the assets held on the balance sheet. We didn't buy any more Horizon Kinetics; it's just the way they do the accounting.

Question 8

Please explain the changes to the investments in stock exchanges (National Stock Exchange holdings) and the cryptocurrency investments.

Murray Stahl – Chairman & Chief Executive Officer

I think we already addressed the cryptocurrency question.

Regarding the stock exchange investments, we haven't changed them except that we had to eliminate the National Stock Exchange investment—not because we wanted to, but because the New York Stock Exchange bought it. I believe we mentioned in a prior conference call that we didn't like the terms of that transaction, so we decided to dispute it. Given the size of the investment, however, there's a limit on how much money you want to allocate to such a dispute. We did fight it and we ended up with a settlement, but we had to sign a non-disclosure agreement, so I can't go more deeply into it. We weren't happy that we were forced to sell it, but such is life. Other than that, we retain all our investments in the exchanges.

I should say one other thing. With regard to three of the exchanges, including Miami International Holdings, OneChicago, and the Canadian Securities Exchange (CNSX), the policy is to hold them at cost. In my humble opinion, they're probably worth more, but that's just my opinion. There has been some appreciation in the Bermuda Stock Exchange.

Regarding South LaSalle Partners, which holds our membership seats on the Minneapolis Grain Exchange (MGEX), the exchange's website lists the market for membership seats. I believe at the moment, the bid is $215,000 and the ask is $220,000, so perhaps a transaction is imminent.[2] The last membership transaction, incidentally, was a couple days ago at $220,000. These sales took place subsequent to the end of FRMO's 2019 second quarter.

As I mentioned before, GAAP accounting dictates that nonmaterial investments be carried at cost until there is sufficient reason to alter their values.

Question 9

Do you agree that markets are late cycle (nearer a recession), and, if so, where do you see value? Equities, commodities, and credit tend to underperform during recessions. Is it simply a matter of having the discipline to stockpile enough cash, and then having the gumption to invest this cash after asset prices have collapsed?

[2] http://www.mgex.com/seat_prices.html

Murray Stahl – Chairman & Chief Executive Officer

That's a complicated question, because I think, as a generalization subject to qualification, that there's always a stock or two that you might like. But it's self-evident that equities, bonds, and any form of credit are really overvalued. Pick whatever category you like—the 10-year Treasury, the 5-year Treasury, corporate bonds, the bonds of any country—and the return is not enough to maintain yourself against inflation, even before tax considerations.

Speaking for myself, because I don't think the country would be in better shape if I were the policymaker, so I'm just giving you my personal point of view here, but in any event, two days ago, the U.S. passed a milestone. What is the milestone? It is that the U.S. has now reached $72 trillion of debt in all forms—that's not just federal debt— that figure includes federal debt, state debt, car loans, mortgages, student loans, and everything you can possibly think of. The total is over $72 trillion, and it increases by well over $8 billion a day, and that rate of increase is growing.

Let's say that you're a policymaker who would like to normalize the yields and make the yield curve slope upward instead of the current downward slope, which is really bad for banking. Everyone agrees on that point. What if you raise the interest rate by 1%? Well, 1% of $72 trillion is $720 billion of additional interest expense, and that's in a $20.9 trillion economy. That's a big increase and it would be enough to bring it all down. If you make it 2%, just for the heck of it, that would be over $1.4 trillion of added debt expense. Bear in mind that this debt service figure is a moving target, because the total amount of debt increases by over $8 billion every day. If you extend that daily accumulation of additional debt over the course of a year, you'd have to take $8 billion x 365 days. That should give you an idea of how serious a problem this level of debt is. If you want to make the scenario a bit worse, if that rate increase brought on a recession or, alternatively, you just coincidentally had a recession, government revenues would drop as they always do in recessions, and that would prompt a grand question about the creditworthiness of everything.

We're not in your typical downturn of the past when we would have a recession, work it out after a year or two, and then return to normal. We're not going back to normal. Given that situation, policymakers have an awful decision to make, which makes me glad that I'm not a policymaker, because I wouldn't want to have to make the decision. They can't raise interest rates, because if they normalize the rates, they'll bring down the whole system. By the way, the bond market worldwide is about three times the size of the stock market. Yet, if they don't normalize interest rates, the world's central banks are asking their citizenry to buy bonds that are guaranteed to lose purchasing power. Which really means asking people to commit economic suicide, which is something they should never do if they're rational. Either way, it's bad.

With that background, now you can understand how we look at asset prices. It's not a question of a price that goes down X% and we have the guts to buy it. You can't solve this investing problem within the context of conventional asset classes, because their valuations and returns are all tied together with interest rates and global monetary policy. You have to step outside that realm. Now perhaps you can understand why we are mining and investing in cryptocurrencies, why we focus on path-dependent ETFs and on other idiosyncratic endeavors. The current investment problems are not solvable within the context of normal equities. There will always be some interesting companies that we want to be involved in, but you can't solve the investment problem that way. You have to do something radically different, which is what we're doing.

With that foundation, you can understand why it's not merely a question of having the discipline to stockpile enough cash and then just back up the truck when it all goes down, if it ever goes down. The equity markets might not collapse like they did in 2008. The scenario might be more akin to the situation in Japan, where the monetary authorities basically imposed a zero interest rate policy for decades. That might be the regime everywhere in the world. In my humble opinion—and I say humble because no one really knows, because we have never experienced it—this could be a very, very bizarre experience for everyone, so it bears a lot of thinking about.

I hope that answers the question. It's not merely a matter of repeating history in terms of cycles; this is a much, much more serious situation. That's one of the reasons we have all this cash on the balance sheet, and we'd like to have more.

Question 10

With regard to the non-controlling interests recorded on the balance sheet, would it be possible to add more color as to which assets these interests represent? Do they consist primarily of equity securities or does some portion of the cash and cash equivalents on the FRMO balance sheet sit inside Horizon Kinetics Hard Assets (HKHA)?

Murray Stahl – Chairman & Chief Executive Officer

That question is easy to answer. The non-controlling interest of $51,278,792 all pertains to Horizon Kinetics Hard Assets (HKHA). Every penny of it. That portfolio is almost fully invested, although there is a small amount of cash there. To the degree that HKHA has a small amount of cash, it is consolidated in FRMO's cash balance, but 99% or so of that cash belongs to FRMO. Call it in round numbers, only about 1% of FRMO's cash belongs to the non-controlling interest. So, the cash is FRMO's cash less a certain amount that we don't own of HKHA, and the non-controlling interest in its entirety refers to HKHA. I hope that answers the questions with enough specificity.

Question 11

Why does the RENN Fund (RCG) trade at a 35% discount to net asset value? Is it in the best interest to do a rights offering at these levels or would shareholders be better served by a stock repurchase?

Murray Stahl – Chairman & Chief Executive Officer

The RENN Fund trades at a deep discount to net asset value primarily because we're in the process of conducting a rights offering in which we're offering to sell shares to all the participants at way below net asset value. Of course, the shares will go to a discount to that number; that's just the way it works in closed end funds. I guess what you're asking is why would we do a thing like that? Why don't we take the cash and buy back the shares, since we do have a reasonable amount of cash relative to the NAV in the RENN fund, as we do in all our funds.

With that cash, we could repurchase shares, but we don't want to. The reason is that in a closed end fund, you must have enough assets to qualify for a continued listing on the New York Stock Exchange. When we took over this fund, we didn't have enough assets, but now, happily, and as you can see from the reports that you have at your disposal, the NAV has increased a lot, so we solved that problem. But what goes up sometimes comes down, although we hope it doesn't, but it might. Therefore, we want to raise enough capital to make sure that we don't run into that problem again.

We're not diluting anybody. We're all able to participate pro rata, but if someone doesn't want to participate, Horizon Kinetics will back it up, or we principals will personally back it up. The result should be that we have more cash in the fund. The idea is that we want to have a closed-end fund, and there are certain listing requirements you have to comply with. That's why we're doing it.

Had we used our cash to buy in shares, while it is true that would have increased the net asset value per share—maybe even by a lot depending on the price at which we could have bought the shares—but to what end if the fund no longer qualified for listing? That's the problem. The more shares we might repurchase at a bigger discount, the less shareholders' equity we would have and, therefore, the more we would deviate from the listing requirement. We would then end up with a non-tradable security, at least from the New York Stock Exchange point of view, which no one wants. So that was the logic of it.

That was our last question, so with that I'll thank everyone for listening to our call this afternoon. I hope we gave you even more detail than we normally do in these calls. If you want information, don't hesitate to request it. If we can provide it to you, as long as it doesn't interfere with some objective we have, we'll certainly do so. We hope to have a more in-depth written accompaniment to the next press release in which we can include more data, like the longer term returns of the funds and maybe other items that occur to us. With that, I wish you all a great afternoon. Thank you for joining us and, of course, we will reprise this again in three months. Thanks so much for being a supporter.

Operator

Thank you, ladies and gentlemen. This concludes today's conference. You may now disconnect. Have a great day.

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