FRMO Corporation Q3 2013 Conference Call

Tuesday, April 23, 2013 4:15 PM ET

Operator

Ladies and gentlemen, good day and welcome to the FRMO Corp. third quarter 2013 earnings conference call. As a reminder, today's call is being recorded. At this time, I would like to turn the conference over to your host, Ms. Thérèse Byars. Please go ahead.

Thérèse Byars – Corporate Secretary of FRMO Corp.

Thank you, Paula. Good afternoon, everyone. My name is Thérèse Byars, and I'm Corporate Secretary of FRMO Corp. We appreciate all of you joining us today for this discussion.

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Today's discussion will be led by Murray Stahl, Chairman and Chief Executive Officer of FRMO Corp., and Steven Bregman, President and Chief Financial Officer. They will review key points related to the quarter's earnings. Once Murray and Steven complete their remarks, we will move to Q&A. An edited transcript of this call will be posted on the FRMO Corp. website at www.frmocorp.com.

With that, I'll turn the discussion over to Steven.

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

Thank you, Thérèse. Steven Bregman here. Good afternoon, all. This is called the earnings conference call, but generally one talks about more than just earnings. Today we'll talk more than about earnings in the narrow sense, as in what kind of revenues we earned in the last three months and nine months. We'll do that, but there are some other activities going on at FRMO Corp. that have been announced in a couple of recent press releases. They're on our website and they were released to the news dissemination bureaus.

In order to cover our earnings in the ordinary way, I'll say most of it is in the earnings announcement. The highlights are that revenue from our consultancy and advisory fees was up, we have some earnings from investment partnerships that was up, we have earnings from our pure balance sheet interest and dividends, and that was up. So, the earnings per se were up, and that translates into some per share numbers.

The difference between the changes in operating income and net income has to do with taxes and some timing issues. Maybe too little, as it turns out, ex post, might have been accrued for last year, and there was a make-up for this year.

The earnings end up finding their way to the balance sheet for anything that's not paid out, and we don't have a dividend program at present. In terms of book value, that translates into our tangible book value, which was, at end of February, $61 million versus the prior fiscal year-end $54 million. On a per-share basis, it went to $1.55 per share from $1.38 a share. That was up about 12%.

As far as our balance sheet, it remains really quite liquid. Nearly 90% of it is invested in cash—if you call that an investment—and in bonds and other investments. All that is clear enough, I think, on the financial statements that we've released.

More pertinent than what has occurred to date on that balance sheet, which is dated February 28, is what has occurred since. That has a lot more implications for future earnings and the future of our balance sheet.

The first announcement, which was dated April 15, was a private placement that FRMO engaged in with certain accredited investors, quite a number of them. We issued just fractionally under $5 million worth of stock. It was priced at $2.89 a share, simply the result of the prior 20 days of trading. That private placement was made for certain reasons that I'll leave to Murray Stahl to expound upon.

There was a set of announcements made on April 16 that relate to FRMO Corp.'s relationship with Horizon Kinetics LLC ("Horizon Kinetics"). One has to do with an exchange of shares, and the other relates to how we calculate revenues that FRMO receives from certain investment programs at Horizon Kinetics.

Before I describe these in brief—and, again, they were described in the announcements—I'll go back and review the recent history of FRMO Corp. vis-à-vis Horizon Kinetics, just so we have a little bit of timeline context here. If we go back to May 2011, just before Kinetics Asset Management LLC and Horizon Asset Management LLC effectively combined, FRMO Corp. had an interest in an affiliate of Kinetics Asset Management LLC called Kinetics Advisers, LLC which primarily engaged in the management of hedge funds and was responsible for a lot of FRMO's earnings. The Kinetics Advisers interest became subsumed within the new Horizon Kinetics combined company. Therefore, FRMO Corp.'s direct interest in Kinetics Advisers became an interest in Horizon Kinetics overall, which established our first interest in Horizon Kinetics, which was just under 0.5%.

In the next year, in August of 2012, FRMO transferred to Horizon Kinetics one of its revenue streams in an asset management program for an outside firm, and received some additional shares of Horizon Kinetics in payment for that. Our interest in Horizon Kinetics rose from just under 0.5% to just under 0.9%.

We now have two additional transactions, which will have certain important implications. Various revenue programs that FRMO has owned were each calculated separately. We decided to simplify that calculation so that, instead of having several different revenue streams coming to FRMO Corp., effectively through Horizon Kinetics, we recalculated it at its equivalent dollar revenue amount calculated as a percentage of the consolidated Horizon Kinetics revenues. Going forward, instead of four or five separate contracted revenue streams, we'll get one. FRMO is giving up some specific revenue streams and getting what will be approximately 4.2% of all the revenues of Horizon Kinetics. That's one transaction.

Another transaction involves certain Horizon Kinetics shareholders who have elected to sell some of their own Horizon Kinetics shares to FRMO Corp. in exchange for more FRMO Corp. shares. That makes three different transactions in April 2013. One is a private placement with outside accredited investors, and the other two transactions with Horizon Kinetics, one of which we'll call a recalculation of revenue interest and the other a share exchange.

I think those are rather more interesting and important to discuss than some finer details of the earnings this year to date from various programs at FRMO Corp. because, going forward, those won't exist anymore within FRMO Corp. They will be reabsorbed into Horizon Kinetics in exchange for the transactions I described.

We've received some questions and we can anticipate others about each of these transactions. We'll start with the first and probably the simplest one, which is the private placement we made with accredited investors. Murray, would you like to talk about that?

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

Yes. Looking at our financial statements, one can see that we've always maintained a very strong balance sheet. The offering wasn't done for that reason. We were approached by a group of accredited investors. It's important to note that, from the FRMO point of view, of course we are a publicly traded company, but our shareholder base was relatively narrow. We were known to very few people. To expand the scope of what we want to do, and offer our shareholders the best opportunity for value realization, it was important to expand our shareholder base. Having the opportunity to do so, we decided to go from being a de facto club to being a much larger company in terms of the shareholder base. That's fairly straightforward and easy to understand.

Having answered that question, I will review some of the topics Steve discussed and give you more color on them, starting with the financials. Then, I'll come back in a few minutes to talk about these various other transactions.

In the financials, if you look at the balance sheet, I call your attention to the investments line under Assets. You will observe that the cost basis of our Investments Available for Sale is some $31 million, and the market value is nearly—not quite, but nearly—$46 million. There is a fairly large unrealized gain there, which is a different kind of asset, if you really want to think about it. Of course, we have to reserve the appropriate tax liability, but we don't have to pay that until such time as we realize gains. From time to time, we do realize gains. Clearly, in this instance, we haven't realized the bulk of the gains. You might say, quite legally, that we have a tax-free loan from the government.

Similarly, I call your attention to the Liabilities line, “Securities sold, not yet purchased,” which represents short sale proceeds of $4.6 million, or thereabouts. The market value of those short-sale securities on the balance sheet date was $2.283 million, or thereabouts: again, an unrealized profit we have yet to realize.

Summing the two numbers—and I’m speaking in round terms—the roughly $1.3 million and the $14 million—there is some $15 million of unrealized gains. That has value for the company. People need to—I guess one doesn’t need to do anything, but I suppose one should pay attention to that, because I think it’s important. It’s certainly important from the way we look at the company.

Regarding the transaction pertaining to the revenue interest, Horizon Kinetics itself, the underlying operating company, has planted a lot of little seedlings in the last 24 months. At the moment, they don’t amount to much in terms of revenue and, therefore, they’re not really important to anyone other than the fact that one day they could be substantial.

FRMO is in the circumstance of having selected, in years past, certain revenue streams to participate in, and there were other revenue streams it didn’t participate in. It seemed reasonable to change the basis of calculation for the benefit of both parties (a) for simplification and (b) because we wanted to make sure that adverse selection risk didn’t disadvantage one party or another party. It was reasonable to simplify the agreement. More about the implications of that in a few minutes.

Then, of course, there is the share exchange. Now, you probably don’t know this but, in the context of the merger of Horizon Kinetics, there were created two classes of stock, the so-called A-1 and the A-2 shares. The difference is really voting. The only difference is that the class with the higher number of votes is included in subchapter S corporations that were essentially collapsed into Horizon Kinetics, for the purposes of consummating the transaction. To sell any shares of those would really involve, in all probability, a very onerous tax. There is much less tax payable on the A-1 shares, if there is any at all. Economically, they have the exact same interest.

It makes sense, yet again, for FRMO to participate more fully in what’s happening at Horizon Kinetics. If you permit us to discuss Horizon Kinetics, if you observe what we’re doing across the various investment products and the investment results, I think you’ll find them interesting to say the least.

We organized this transaction in which certain shareholders of Horizon Kinetics could sell their A-1 stock to FRMO in exchange for FRMO stock, thereby giving FRMO a greater participation in the enterprise than would have been available by merely recalculating the revenue share. The revenue share is a dollar-per-dollar transaction, meaning that, if we had X number of revenue programs, generating $100 in revenue, we’re still taking in $100 of revenue. The only basis for calculating that change is we’re dollar-for-dollar neutral, unless the revenues change. Of course the revenues change every quarter for every program in any event, so there’s nothing new there. The share exchange is merely another way of participating in Horizon Kinetics.

Now, back to the revenue share. This is an important point, and it's more a philosophical point than it is an income statement or balance sheet point. When you look at the revenue share number, it's important to note we haven't done a good job explaining what exactly it is. In most corporations, the payment to the shareholder, such as it is, whether it's merely a share of the net profit that belongs to them or one in which that net profit is paid out in the form of a dividend, is taken after all the expenses for employees, management, et cetera.

What does that do in the corporate governance sense? That puts the shareholders in the position that the shareholders are paid after management is paid, and we happen to be the management. Speaking theoretically, we control the company; we can pay ourselves, justifiably, a lot of money. But we don't want to do that. The purpose of the revenue stream is that the shareholders get paid, in some degree, not always from the bottom line, which is after we get paid, but from the top line, which is *before* we get paid. From an arithmetic standpoint, it's as if we created a line item from which we, as employees and management, really can't participate.

You would see it much more clearly if we simply took the revenue share and paid it out in the form of dividends; then it would be visible to you. At the moment, it isn't visible, but it is delineated separately on the income statement. You can track it and see that it goes to shareholders' equity.

It's also worthy of note, although it's a small point, that Steve and myself, in the FRMO context, pay ourselves virtually nothing. I say virtually nothing, because we're required to take an insignificant salary, because we've been informed that, since we're working for the company, there's a tax issue if we don't take some salary. I tell you that the salary we take is de minimis. It's merely an item that, if you had a sufficient level of detail on the income statement, you would see. However, we actually don't accept the money, and it goes right back to the company in the form of contributed income. So, we really take nothing.

When we talk about creating a company that is not merely shareholder-friendly, but we're actually interested in putting the shareholders' interest before our own, when we say that, it's serious, because we ourselves are the biggest shareholders. One of the problems with the modern corporation, of course, is that intrinsically they're not shareholder-friendly. Intrinsically they're not shareholder-friendly because the management can always pay itself in preference to the shareholders.

We've created this structure from the inception. In the inception, it was very small and it didn't really mean anything. You can look at the numbers yourselves and determine whether or not they are indeed small. And we intend to continue with that sort of thing. It's unique, I think, in the world of corporate structures I've seen. We've spent a lot of time thinking about how to make it unique and how to make it shareholder-friendly. And we're in the process of thinking about other methods.

Now, back to the balance sheet again. Clearly, at some point, it will make sense to use the cash to make some kind of acquisition. Steve and I have looked at various sorts of investments. For one reason or another, we've rejected everything that we've considered to date. The day will come when we'll deploy some portion of that capital towards that end. Of course, with the proceeds of the private placement offering, with the increase in shareholders' equity that will come from the FRMO/Horizon Kinetics share exchange, you can readily imagine that our shareholders' equity is going to increase by some not insubstantial amount. We're going to have, subsequent to this transaction, a sensibly arranged, very respectable balance sheet. We continue to invest capital in securities that we think are reasonable, and we'll always be continuing that.

FRMO is now a bigger company with a greater scope of operations, with a bigger balance sheet, with a more liquid balance sheet, and with a larger shareholder base. I think all those things are to the good. We're actively considering other actions as well. We invite your comments as we invite your questions. If you have questions or comments, we'd like to take them. If you'd like to reflect on these matters and send us an email or a letter—we mean this seriously—we're interested in your thoughts. With that, I'd like to open it to the telephone audience for questions.

Questioner 1

Hello, gentlemen. I wanted to first of all thank you for your stewardship of the company. I first learned about the company last December, and the annual meeting transcript, I thought, was just a real asset for understanding the company, as well as the other reports, so I wanted to thank you for that. Secondly, also, the commentary in your research reports, I enjoy those a lot.

My question would be with regard to the holding of cash on the balance sheet, which was partially answered. I guess what I would ask—I'd read recently that Warren Buffett viewed cash as a call option without a strike price. I wonder if you felt the same way.

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

Well, to a degree, the interesting thing is that investments become available at the oddest of times—sometimes in the middle of a financial crisis, sometimes not. Sometimes you just discover the existence of something of which you were previously unaware. Let's look at it this way. I certainly agree with Warren Buffett's comments, but I just have my own phraseology, and perhaps it amounts to the same thing.

I like the flexibility to be able to act when I need to, or when I wish to. But I don't want to have the obligation to do so, merely because I happen to have cash. Let's say that all the cash arrived on the balance sheet today. Of course, it didn't, but let's just imagine it did. Therefore, should I limit in time, temporally, my selection set to the next couple of days? If on a certain Tuesday, the money were to arrive, should I then limit myself to saying I intend to have all that money or the bulk of that money, invested by Friday, simply because it existed?

Let's say the money was due to us and we didn't receive it until next Tuesday. What should I do? Should I take out a loan against money that I know is due next Tuesday, and should I then feel the compulsion to invest it immediately? Or should I do what I'm always going to do: I have certain criteria that make for a sensible investment and, if I don't find that investment, and those criteria are absent, I'm going to wait until such time as I do.

The funny thing about the investment process is that, in the modern day and age, it's possible to move, if you wish to, billions of dollars in the click of a computer mouse. It's a technological achievement; I'll certainly agree with that. But whether or not it's conducive to good investment results is an entirely different question. I certainly don't think it is. We like to be reflective. We like to be deliberate. We like to study our potential investment candidates to the degree that we can, and sometimes it's very time-consuming.

All those are ways of saying that we wish for ourselves the same kind of flexibility that Mr. Buffett does when he says it's just his call option waiting to be exercised. I guess it amounts to the same thing, but I thought I'd give you more color on it.

Questioner 1

Also, could you comment about, just very briefly, any observations you have about the managed ETF universe that's appearing here, whether or not that is a long-term threat to open-end funds or whether it's just going to be another investment choice?

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

I'll take the liberty of extending the question in scope a little bit by saying the ETFs are really an extension of indexation in general, so I'll make some comments about indexation as well. To begin with, in direct answer to your question, the idea of indexation itself, the idea of the ETF, which is basically a basket of securities, is a reasonable way for people to invest. If you wanted a certain kind of market exposure, to buy a package, so to speak, of securities that might have several hundred in it, you're exposed to a vast variety of companies. There's nothing wrong with that, if people don't want to make an active decision on picking companies, if they want to make a passive decision but they want to be exposed to a variety of companies.

The problem is that indexation went from being merely a benchmark in the beginning by which to compare Steve and myself to something else, and either we beat it, in which case we were brilliant, or we didn't beat it, in which case we were bums, which is fine. Now, instead of being a way of getting market exposure via the S&P 500 Index in the form of a basket, it has become a business. The business, in one sense, you might say is the greatest business in the world. Why is it the greatest business in the world? Because, if you operate this business, you really don't have very many costs, or at least the costs you do have are basically discretionary.

The challenge is to maximize your revenue. How do you maximize your revenue? Well, you want the index to be as scalable as possible. How do you make it as scalable as possible? You're going to focus on the companies that are the most liquid. That's all well and good, except for the fact that the most liquid securities aren't necessarily the best securities. For example, you might look on the internet for the largest American companies in the last 100 years—so let's say you start, as a simplified exercise, with the Dow Jones Industrial Average—and see what's been in it for the last 100 years and how infrequently a member of the Dow remains in that index over the long run. Or, look at the S&P 500 and think how many years ago was it that there was no Microsoft in it, that there was no Apple in it, and so on and so forth.

Here we get a little more technical, which is why I switched to indexation as opposed to mere ETFs. The indices themselves, upon which ETFs are based, underwent a transmogrification sometime around 2006. What do I mean by that? They changed the way they were calculated. Historically, indices were calculated on a market capitalization-weighted basis, which is the value of each company. So, if IBM or Exxon had twice the market value of Wal-Mart, they had twice the weight. If IBM were double the size of Wal-Mart, and IBM had a 2% position then, by definition, Wal-Mart would have a 1% position. Subsequent to 2006, that method changed. The indices are now computed on what's called float, which is the number of shares that can theoretically be bought by the public, as opposed to the total number of shares outstanding times the price—a very different consideration.

Historically, we know Wal-Mart was a wonderful company when Sam Walton ran it. We know by looking at its weight in the S&P 500 that the index basically eliminates the shares that are owned by the Walton family, and they're not selling. Historically, of course, those shares were owned by Sam Walton. However, historically, the index weight would have included all the Sam Walton shares, because the index made no distinction about the float. At that time, had the S&P been calculated using the float method, Wal-Mart would have had a lower weight. The same would have been true of Intel in the glory days of Gordon Moore and Andy Grove, of Microsoft in the Bill Gates glory days, Teledyne in the Henry Singleton era, Hewlett-Packard in the era of those two people, and so on and so forth.

You could go back to 1957, when the S&P 500 started, locate all those companies—which would be fairly obvious from a historical retrospective—and look at the documents to see the outstanding share count. You could see how many of those shares were owned by the insiders. In many cases it was substantial. You would see that, in each and every case that I cited—and many others that I didn't cite because the list would be fairly lengthy—that the weight of those wonderful companies at those times would have been lower in the S&P 500 if it had been using the float method of calculating the weights.

They were the best stocks in the S&P 500, so what could you possibly have replaced that weight with to equilibrate? I'm at a loss to tell you what it would be. There's certainly nothing better than those companies. So, it must logically follow, I think, that if the S&P 500 were computed historically using the same method as is used today, the returns would be lower. It's for people to determine how much lower. If it is lower, of course, that makes it less desirable. The volatility would be the same, more or less.

That's the problem with indexation. The question is: have the index and ETF orchestrators inadvertently created a system in which they're basically underweighting all sorts of interesting companies merely because they choose to concentrate on float? Let's say the same thing in a more succinct manner. Let's say there exists some imaginary company, maybe it's the next Wal-Mart. The manager is so impressed with his own prowess that he keeps buying back stock. If we owned that stock, we might be favorably impressed, too. It would probably make us feel good. We'd take comfort in that. But from the narrow indexation float-adjusted point of view, that company's weight in the index would be lowered, because the float would be diminishing.

Let's take an imaginary company in the reverse case. Let's assume that the management of this otherwise well-managed company decides to sell all its stock in the marketplace on one day. Of course, this example is for illustrative purposes; in the real world, it doesn't happen exactly this way. But let's say that the management decides to sell all its stock. More float comes to the marketplace, because the management is selling. If we owned that stock, we might not be pleased with that development. From the indexation point of view, however, the float has increased, and *ceteris paribus*, which is Latin for "all things being equal," the company's weight in the index would go up, because the float increased.

That's the fundamental problem of indexation as it's practiced today. Whenever you do something en masse, like they do in indexation, you're actually changing the investment reality. I'll give you one more example. As an aside, clearly I can go on with this topic. I think I could give a pretty good lecture on it without any preparation at all, totally extemporaneously. But, I'll give you just one more example, because I don't want to tie up the phone with indexation. The whole subject fascinates me.

Let's take the recent slide in the price of gold and gold stocks. Here we have an instance in which, historically, the gold stocks, such as they were, were correlated to the price of gold. Then we have a 10-year time period, the last 10 years, during which the gold price has increased mightily, but most of the gold stocks have gone down.

What happened? Well, the idea itself was sound to a degree; the trouble with it was that the mere fact of indexation actually changed the reality. How so? People decide that the time has come to have a gold index. In this case I'm referring to the Market Vectors Gold Miners ETF (GDX). There's nothing wrong with GDX, other than it needs more than one or two stocks in it, or it wouldn't be an index. Historically, when you looked at the correlations, you looked at Newmont Mining, Barrick Gold (in the old days, it was called New American Barrick), AngloGold and some others.

Now that there's an index that needs members, it's possible for smaller gold companies to sell shares to the public, which wasn't possible before. Looking at that index, you'll see a company like Yamana Gold, and you can observe how many shares that company has issued in the last decade. There's nothing wrong with issuing shares. They're financing expanding operations, which is what they should be doing as a company. They are not the only company doing that. There's nothing wrong with that, except that from the index shareholder point of view, all these companies are collectively issuing shares. What are they doing? They're all competing for the same geologists, the same leasing opportunities—which is the land—the same tractors, the same equipment, the same everything, which drives up the price of replacing an ounce of gold.

The mere fact of having the index has changed the economics of gold because, if you're a gold producer, and you sell one ounce of gold to your customers, you have to reproduce it in reserves. It might cost you $1,200 an ounce to produce it. But if the gold price is, let's say, somewhere between $1,400 and $1,500 an ounce and years ago it was $300 an ounce, it's actually not as good. Your cash cost of production when gold was $373 an ounce might have been $273. When gold is $1,473, your cash cost of production might be $1,273. So, the gold price goes up a lot, but you don't get the benefit. All of a sudden, it's not correlated, which you can see by looking at a chart. That's the problem with indexation.

If I can hazard one more observation, I think that's not the last instance of it happening in the indexation world. I think it's the first and most obvious instance and that stuff like this is going to be happening for the next quarter-century. I hope that's a full answer to your question.

Questioner 1

Absolutely. I appreciate it very much.

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

You're welcome. Other questions?

Questioner 2

I actually had my question answered. It was just about how you thought about your balance sheet. I appreciate your thoughts today. Thanks.

Questioner 3

Murray, Steve, first off, thank you very much for hosting the call. I appreciate the enhanced disclosure, and congratulations on increasing the critical mass of the business. I've got two questions. Firstly, if one goes on the Horizon Kinetics website, there's information specific to that asset management business at year-end December 31, assets under management, employees, and such. Would it be possible for you to update us on those specifics as of March 31? That's one question. The other question is: can you please give us an update on your business relationship with Virtus, in whatever way you can? Thank you.

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

As to the assets under management at Horizon Kinetics, before we—and I'm speaking as Horizon Kinetics—before Horizon Kinetics releases them, they have to go through a proofing process, as you might imagine, and compliance review and whatnot. Our figures are as of February 28, and I'll compare them with November 30. I happen to have those two schedules in front of me.

The total assets under management at Horizon Kinetics were $7.06 billion at November 30, 2012. As of February 28 of this year, they were $7.79 billion. I don't recall from the schedule that's up on the website how much detail we gave. Generally, they are broken out by client asset type, such as whether they are sub-advised, or hedge funds, or institutional accounts, or high net worth individuals and that, in almost every one of the categories it's very evenly dispersed, with one exception.

The one exception—it's very small—is what we'll call Alternatives. Those are investment programs that have become more the focus of what we might call applied research activity at Horizon Kinetics. Those are $403 million as of November 30 and $529 million as of February 28. That small increment—I think I might have gone through an exercise like this before—that small increment, in terms of its profitability, because of the nature of those alternative investment programs, can account, believe it or not, for the majority of the increase in reported profits at Horizon Kinetics. This is despite the far larger inflows or appreciation of all the other assets, because those might include—and maybe this is a segue to your second question—although this particular product would not have had much impact at all yet, products like an indexation idea, such as Virtus is helping us to establish in the marketplace.

We come up with, I'll call it, an improved index, or an intelligent index, or a predictive index. That is an idea. There is a rule set for establishing it. There's a tiny bit of human effort that goes into updating it according to the rule set each month, or each week, or each quarter. But there really isn't any meaningful expense to Horizon Kinetics to maintain that index. A company like Virtus, as a distributor, has some skill and know-how to be able to help distribute that. Whether they raise $10 million or $1 billion for that index, there's no effective cost increase for us, "us" being Horizon Kinetics, and through Horizon Kinetics, FRMO Corp. That's just incremental profit, pre-tax profit. Murray might want to speak some more about those alternative assets and about Virtus.

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

Yes. Many of the alternative dimension products have performance fees. If you end up having good performance, the profitability can change disproportionately if you have a certain amount of alternative assets. There's that dimension to it.

Specifically in regard to Virtus, we're essentially sub-advising a fund on behalf of Virtus, so it's a Virtus fund. At the moment, in round terms—I suppose that you could look up on the Virtus website what the net assets are—I'm going to be off by a few dollars—it's very small, about $3.7 million. It certainly doesn't have any meaningful impact either way on our profitability. I'm sure it has no impact on Virtus's profitability either. But understand what this is. This is, in my view, a more predictive means of indexation.

It's the Virtus Wealth Masters Fund, the idea of the index the fund is seeking to track, being that it's not quite the owner/operators, but it's approximate. It's the index approximation thereof. The idea is that there are very large shareholders of companies and, in most instances, they're either billionaires or not far from being billionaires. Because their holdings are so large, they take an active interest in the fortunes of those companies. Historically, when that circumstance happens, as a generalization—it's certainly not true in every instance—as a generalization, you will see that those companies have a proclivity to demonstrate excess returns, expressed in terminology that people might call alpha.

If that proposition is true—I believe it's true, and we have some data that says, yes, it's true, but there's no guarantee that it really is true—and you combine that idea with the one I discussed in the indexation question in regard to float-adjusted indices, companies with a large shareholder, or shareholders in the plural, are systematically discriminated against in the indices. You're buying something—that which we do on the active management side—you're buying something that people choose, for whatever reason, not to hold, except in this case it's a computer that chooses not to hold it.

Therefore, you could argue some of those companies might be systemically undervalued, and you could say, in a long-term return-on-equity sense, or return-on-capital sense, or however you want to phrase it, they have a tendency to produce excess rates of return. It could be a very intriguing product, and I think it's a better way to make those kinds of investments.

I don't believe that it's going to be the last instance of such a product that we issue. It might make its appearance in the not-too-distance future in some other form; I can't say for sure. All I can say for sure is that we're working on various other what we would call—I can't use the word "predictive"—but groups of companies, baskets if you will, that manifest intriguing characteristics.

Virtus Wealth Masters Fund is small, yes. I'd say that Virtus fund is a seedling right now. Whether it gets a few dollars here or there in the next week or two, it's not going to make a big difference one way or another. In theory, one day, if it proves itself—and we believe it will prove itself—it could be substantial. We are looking forward to that happening, if indeed it does happen.

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

I'll also mention, as a technical aside, you'll note on our income statement, that although revenues in total have comprised various different types of revenue, and although those, let's say, went up, you'll note that our expenses didn't really go up, which suggests that we don't need to increase our expenses to increase our revenues. And, indeed, after these transactions that we discussed, they'll actually be lower. There happen to be some expenses on our income statement that will probably be reduced after that.

But, in any case, FRMO Corp. will be receiving some equivalent of what you might call royalties or revenue streams, which really are costless in terms of their expansion. To the degree we have some operating leverage, we don't really have a very high expense base. We have a rather high operating margin. That will be one of the features of it going forward.

Questioner 5

Hi, good afternoon. Thanks for taking my question. You're going to be getting 4.2% of consolidated Horizon revenues. As a private company, I'm curious how big are Horizon's revenues, and also what percentage that is of your total revenues?

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

In terms of operating revenues, meaning other than income from investment partnerships we might be participating in, or dividends and interest income, that 4.2% of revenue interest will be, I believe, all of our revenues. The calculation was adjusted so that whatever our trailing revenues were for the four quarters—I think we used trailing revenues for all those programs—through February, we'll get the same—on a snapshot basis going forward; we'll start with the same dollar amount of revenue.

So, other than the details, had we had this contract outstanding for a full year, our total revenue would be the same. And going forward, for at least the first month, it will probably be the same. And then it might grow more or less rapidly than the original series of contract revenues FRMO Corp. would have had.

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

Right. But whatever changes it will have, either favorable or unfavorable, are going to be the vicissitudes and vagaries of being in the investment management business.

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

And what you could do—you'll find out very soon, with our next set of financial statements—for the first quarter of our new fiscal year—is you can take those revenues, and there will be a line item that describes what they are. I suppose you can divide that figure by 0.041990, and you'll infer what the revenues of Horizon Kinetics are.

Questioner 5

Right.

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

It will be a very simple calculation.

Questioner 5

Also on the interest in Horizon Kinetics, 4.9%, is that going to be booked on the balance sheet as available-for-sale securities?

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

No. It's not an available-for-sale security because, for starters, it's a private company. I suppose, in theory, we could sell the company. But we have no interest in selling the company, and I don't think you'd want us to. That's a whole different kind of discussion. It's merely—well, I guess you would say it's an unconsolidated investment.

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

I would actually say that precisely how it's going to be phrased and described on the balance sheet, as well as any associated deferred taxes or anything—I'm sorry, excuse me, I misspoke. I was confusing the revenue transaction with the share transaction. For the share transaction, those shares will be held on the balance sheet. Exactly how they're described is something that will be suggested to us by our auditors and our accountants, and they always have very specific, subtle reasons for describing something one way or another. But, whatever they suggest, we will accept.

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

Thank you all for listening. Just to briefly review: we covered the transactions; the quarterly earnings; the philosophy of how we've structured the company, especially the revenue share, which we never before discussed in any meaningful detail; the role the revenue share plays in enhancing shareholder value; and the role it plays for us in corporate governance.

I want to stress that we intend to be a shareholder-friendly company. We invite, to the degree you would like to participate, the comments and suggestions of all our shareholders. We hope you have found this call useful. Should there be points that we didn't cover or information that you are interested in on a supplementary basis, to the degree that we're able to provide it, subject to the applicable laws and regulations of the United States of America, we'll be happy to do so. I thank all of you for listening.

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

Might I interject something?

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

Of course.

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

It's a little unofficial, but it is philosophically important. There are many ways to have done this transaction with Horizon Kinetics. The idea of structuring it as a revenue share, which is like a royalty, is really important. We consider ourselves students of public market investments; that's what we do. We write research about it. I think we have a feel, over time, for what investors like and don't like, what they trust and don't trust, because we have to make these evaluations ourselves for our own client portfolios and for our own capital at FMRO Corp. and Horizon Kinetics.

There are two extreme types of sharing, and then there are those in the middle. For instance, there are well regarded, let's say, investment management companies that are publicly traded. They could be private equity companies; they could be more conventional asset management companies; they could be hedge fund companies. We like the managements; we think they're skilled; we like their philosophy; we like their business model. We'd like to participate with them and maybe buy some of their shares, except that we get a little conflicted. We see that they might be a business kind of like ours with some long-only activities, some mutual fund activities, and some hedge fund activities. Yet, the way they're structured, they have a management section for the publicly traded arm that is outside the publicly traded arm. It acts as kind of a general partner and it gets base fees and incentive fees. They take something off the top. We wonder: how much are we really getting for what we're buying? We sometimes use the term "leakage" there. I guess in retail you call it "shrinkage."

Then there's a question—can you really capture what you think you're going to capture? Markets are up, their investment prowess is up, their marketing capabilities are up, and the assets flow in. How much will they raise their own compensation? That's kind of in the middle. They're perfectly good companies. The return is somewhat diluted, but still could be quite adequate.

Then there's the other end of the spectrum, the worst end of the spectrum. I don't know if you guys recall a fellow named Art Buchwald. He was a very famous humorist, columnist and book writer who died some years ago. Toward the end of his life, he was embroiled in a very well publicized lawsuit with a major movie studio, because he had written, I think, a screenplay for a movie that, by all accounts, if you were in the general public, must have been a very popular movie. Lots of people saw it, lots of actors were paid, lots of producers were paid, and directors were paid and so forth and so on. He, waiting for his fair share, had unfortunately signed a contract that accorded him some portion of the net profits, of which there were none, and he had to battle what they called "Hollywood accounting."

Anyway, that's the far end of the spectrum on the bad side. I hope what we're doing is on the far end of the spectrum on the good side, where there's no Hollywood accounting between the revenue share, as it should be, and what FRMO actually gets. I, as an analyst, if I were looking at FRMO Corp. from afar, I would observe that, and I would accord a fairly high quality to what the earnings will be. Anyway, that was just my viewpoint.

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

Let's just sum it up by paraphrasing Oscar Wilde. You might recall the remark he made when he was going to prison. Upon observing the prison, he said, "If this is the way Her Majesty treats her prisoners then she doesn't deserve to have any." If we don't treat our shareholders right, then we don't deserve to have any. We'll be thinking about that constantly. We know that confidence of shareholders is not something we deserve; it's something for us to earn and for you to judge. We leave it to you, and we invite your comments and reflections. We'll reprise this for the next quarter. Thank you very much, and good afternoon.

Operator

That concludes today's conference. We'd like to thank everyone for their participation.

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