Parliament Capital Management, LLC
2223 Parliament Ct
Burlington, KY 41005

To the Partners of Parliament Capital Management, LLC:

First Half Performance

The S&P 500 index increased 8.2% in the first half of 2017, including dividends. We're down at half, up .48%.

I am not sure what market prices will do in the near term. The business of forecasting the action of other market participants is someone else's game; however, if you dust off the 2016 Annual Letter, I came as close to making a market prediction as I ever will, stating:

> *"We must prepare for market forces to expose the limitations of the securities business."*

As I've indicated in conversation and past letters, we are in the business of buying *marketable securities* (minority interest in publicly traded stock) and *operating subsidiaries* (controlling interest in privately held stock). At year-end 2016, we were heavily concentrated in an illiquid marketable security and its price appreciated substantially. Though I believe the move was appropriate, a quick run up in the market price of a thinly traded security is almost certain to pull back in the near term, as *longs* take profits and *shorts* establish new positions. I know of no publicly traded common stock that has increased in a perfectly linear fashion; consequently, I'm making no plans to own the first that ever will.

Long-term shareholding demands a sober, almost stoic nature to endure the natural vicissitudes of economic cycles and markets. We should not be phased by temporary declines in the quoted market value of an exceptional business, so long as the original thesis and calculated intrinsic value have not deteriorated. No one ever remembers who won the first five furlongs of the KY Derby.

Our Competitive Advantage - Operating Subsidiaries

In the midst of our mediocre performance, an easily understood competitive advantage manifested itself. To this point, I've been well aware that our methods are unconventional. However, an unusual operation alone will not deliver superior results.

Our competitive edge lies in the free rein to allocate capital. We're not forced to buy a particular asset class, in a particular industry, of particular size. Instead, we can buy private stock, public stock, preferred stock, bonds, real estate, options, or virtually any financial instrument available for purchase. We can invest in mature or emerging industries. And the amount of capital we are working with allows us to entertain a deal of any size.

Currently, we hold a strong private business, or *operating subsidiary*, with a platform to grow organically and make future acquisitions. The wherewithal to own and operate *subsidiaries* that generate cash and earn superior returns on capital, is clearly at the root of our competitive advantage vs. the S&P 500, and all other businesses for that matter. I am committed to buying common stocks at the right price if the underlying businesses carry those same characteristics. On the other hand, I will not hesitate to liquidate *marketable securities* to purchase or fund *operating subsidiaries,* if the long-term economic prospects of the two businesses are equal.

Operating Subsidiaries afford us a "hedge" to our overall performance because they possess two key defensive characteristics. First, there is no trading that assigns a daily quoted market price for private companies. I reappraise their market value twice annually (June 30 and December 31), creating stability for the net asset value (NAV) of our portfolio - also the primary reason I believe we will struggle to keep up with a rapidly advancing S&P, but should do relatively well in a declining market.

Secondly, we receive 100% of our share of earnings not needed for reinvestment at the *subsidiary* level, in the form of a cash dividend (S&P average is 40% payout ratio) - a potentially lucrative situation as our current *subsidiary* should dramatically increase earnings and reduce debt for 2018 and beyond.

I've become less and less interested in diluting your current ownership as I am in tune with the prospect of earnings growth from our *operating subsidiary*. There are no guarantees, but the potential growth is substantial and the business is in my financial control - I can find nothing else quite like it right now.

It would be naive of me not to mention the liquidity disadvantage of holding an *operating subsidiary* in our portfolio, particularly a large percentage of our assets. To carry a *subsidiary* at a market value in dollars when I have no intent on selling the asset anytime soon, could be slightly misleading. On the other hand, our *operating subsidiary* generates cash and produces well above average returns on invested capital. I'm confident we own an asset with real value. I just want to be sure you're not misled to believe we plan to sell for cash anytime soon. The plan is to gradually monetize our investment over the long-term by steadily increasing earnings, reducing or eliminating debt, and keeping capital investment subdued - aka generating cash. Still, we always reserve the right to sell the business if it becomes most appropriate.

Partnership Principles

Before we went into business together, I was sure to give you a copy of our *Partnership Principles*. This is not the lengthy, legally binding Partnership Agreement. To me, however, the words of our *Partnership Principles* bind our trust. Therefore, I thought it worthwhile to refresh your memory and highlight (bold) the addition of two new principles:

- ❏ There is no rate of return guaranteed on our capital.

- My wife, children, and I will contribute our entire liquid net worth (aside from retirement accounts) to Parliament Capital. If your investment goes down the tubes, we're going down with you.

- Our goal is to generate a long-term compounding rate of return, net of fees, expenses and taxes, that exceeds that of the S&P 500. For the sake of measurement, we define long-term as 5 years. If any 5-year window fails to outdo our benchmark, our operation has no purpose and we should find somewhere else for our dollars.

- **I am extremely reluctant to admit new partners. As your Managing Partner, it is my duty to be a steward of your capital. Selling your business to others solely for the sake of size is inconsistent with our goals. I will only issue new equity ownership if we are sure to acquire more in intrinsic value than we receive in cash.**

- **My first choice would be to acquire a controlling interest or entire businesses that generate free cash flow and earn a superior return on invested capital. A close second is to own a fractional share of similar businesses through the purchase of marketable securities. The availability and price will determine our capital allocation from year to year.**

- I understand hardship and the need for liquidity is unpredictable. Therefore, our partnership agreement allows for cash withdrawals. However, I cannot emphasize enough the importance of long-term for our operation. If you can imagine, even in a worst-case scenario, needing any of your investment as cash in the near term (5 years or less), this is not a suitable partnership.

- Performance results may be higher or lower than realized gains (losses) for tax purposes. For example, we may realize gains for tax purposes in years when our performance is lower than those tax gains; and vice versa. The blueprint to a successful investment program is paying a lot of taxes at the lowest possible rate.

- We don't do macroeconomics. We are in the business of buying other businesses. I'm not in the business of making stock price or market predictions. I haven't the slightest idea what market prices will do in the near term and I never will.

- I will not publicize our investments in *marketable securities* unless it is legally required to disclose our position. There is no gain in broadcasting our public market activities. When I am buying stock, my hope is that the price of the security remains at current levels for some time, so that I can buy more. Any public announcement could potentially disrupt the favorable buying price.

- My compensation is based solely on performance. If I am unable to generate a positive rate of return, I do not deserve a reward. In the event of a loss, we will carry forward the amount of your loss to offset future gains for performance fees.

- I cannot promise results. I can promise our collective, long-term performance is what drives me.

Taxes

Some of you incurred more than the deductible amount of $3,000 in realized losses in 2016. If so, be sure to hang on to last year's tax records for your carry forward amount above the $3,000 that you can utilize for gains in future years. We have substantial realized gains thus far in 2017.

I'll have a letter out in November with 2017 tax guidance, notable developments, and any other administrative needs.

Please contact me if I was unclear about anything.

Your Partner,

Timothy J. Grogan II
7-7-2017