Parliament Capital's Performance vs. the S&P 500

Year	PCM	S&P
2015	61.05	1.38
2016	92.46	11.74
2017	41.92	21.64

Notes: *PCM results are the collective return for Limited Partners, after expenses and fees. The S&P 500 includes dividends reinvested. Both PCM and S&P 500 results are pre-tax. Refer to: http://pages.stern.nyu.edu/~adamodar/ for data sources, errors, limitations, etc.*

To the Partners of Parliament Capital Management, LLC:

In January of 2015, I organized Parliament Capital Management, LLC as a personal investment vehicle, specifically to hold an equity interest in Grandview Tavern. Two months later, a long-time friend of the family ran into some excess cash and convinced me to handle it. Suddenly, with no initial plot to manage money for others, an investment partnership was born. Four more of you have joined us along the way.

Parliament Capital was founded on and continues to revolve around the core belief that assets of any nature are best cared for by the long-term owner. A commitment to this careful mindset yields discipline, patience, and perseverance - all traits correlated with a successful investment program. My capital allocation decisions do not take into consideration what may happen this month, this quarter, or even this year. I'm peering out decades from now and believe we have a huge advantage because of our unorthodox long-term commitment of capital. Importantly, we're all in it for the long haul.

Today, though scant, Parliament Capital forms an operation with sizable aspirations. The mission to generate an above average after-tax return on equity capital has never wavered. The method, however, has evolved from an experiment dabbling in stocks, to one focused on building an enduring investment holding company from scratch - we are just getting started.

Performance Results

We outpaced our benchmark for a third consecutive year. Performance gains were closer to, but still above what should be an appropriate expectation as we move forward. Of course, all of our investment positions carry an unpredictable nature, especially in a short year's time. We should prepare for some negative years. My experience, perhaps inadequate, leads me to believe that I'd be disappointed if we didn't achieve an advantage of 10% or better over the S&P 500. Just remember a year in which the S&P is down 25% and we are down 5% is a wildly successful result.

It is important to note that we cannot deliver these outsized returns without applying unconventional methods. The bulk of our capital is held in two positions - both instruments difficult to value and difficult to sell. The other piece of our portfolio is invested in *marketable securities* at a time when the majority of asset classes are either fully priced or overvalued. Indeed, the average TTM earnings yield for the S&P 500 is around 4%. Stocks alternate, bonds, are even less attractive. The 10 year treasury yields under 3% while the Federal Reserve has telegraphed an inflation target of 2%. In other words, your after-tax purchasing power for deferring consumption now won't change much down the road without earnings growth or an unhealthy multiple expansion. Needless to say, I need to turn over a lot of rocks to find something worthwhile.

Legendary investor, Charlie Munger recently said, "There's a rule of fishing that's a very good rule. And the first rule of fishing is 'fish where the fish are.' And the second rule of fishing is 'don't forget the first rule.' Investing is the same thing. And some places have lots of fish and you don't have to be that good of a fisherman to do pretty well. Other places are so heavily fished that no matter how good a fisherman you are, you aren't going to do very well."

The beginning of this decade spawned lots of fish. Now, public markets are heavily fished. It doesn't matter how good any investor may be, if one is to deploy capital to a widely diversified mix of *marketable securities*, they're not going to do very well. Absent panic or euphoria, the value of the market as a whole has entered a low-return world. We must fish outside of the well-known bodies of water. Thus, I will deploy our capital using following strategies for the foreseeable future:

1. Concentrate a high percentage of our portfolio in a select few investments.
2. Position for the bulk of blue-chip securities to move sideways or advance slightly for the next several years.
3. Shift time, energy, and capital to grow our subsidiary, Grandview Tavern.
4. Explore additional acquisition opportunities to add to our *operating subsidiaries* collection.

I will remain flexible with our capital as prices can change course rapidly. Fear and panic overtake the psychology of markets in short order. I don't know when the fisherman stop fishing, but when they do, we'll be ready to fish again.

<u>PCM Portfolio</u>

Operating Subsidiaries

Grandview L.L.C.

Most would lead you to believe that the restaurant business is lousy. Profit margins are slim and the industry sports some of the lowest barriers to entry. Everybody and their brother believes they can design, construct, open and operate the next great concept. The result is a ferociously competitive marketplace. Competition yields innovation, but too much ultimately results in the loss of market share and commodity-like pricing behavior. Worse yet, the more that set up shop, the tougher it is to attract and retain talent - a costly predicament.

Believe it or not, there's good reason for these competitive dynamics - the economics of the restaurant business are far from subpar. If operated efficiently, returns generated on invested capital can exceed those in many industries. Moreover, a competitive advantage can be had by integrating a mix of proprietary intellectual property, sound finance, and a unique culture.

Grandview L.L.C**.** is the parent company for our Grandview Tavern restaurant operation. The parent company was organized in 2017 to house all tangible and intangible assets, and any future development of the company - we own half of the equity. Our economic focus is on maximizing returns on invested capital in order to transform a leveraged balance sheet into one conservatively financed. Our short-term objective is to open two additional locations in the northern Kentucky market. Operating three stores with average efficiency should solidify Grandview's financial position and move the needle substantially for Parliament Capital.

We want to complement existing competitors, not oversaturate markets. Recent history suggests that the hunt for yield, surging private equity dollars, and easing lending standards have fueled an imbalance between the growth in restaurant seats versus the growth in mouths to feed. While total sales for the industry have increased at a moderate clip, same store sales for the majority of operators have declined. Our marketing strategy to offset this economic challenge is to go where the competition is not. We plan to differentiate the brand by searching for geographic regions with affluent, growing populations that offer relatively few options in our category. We've selected Union, KY as a perfect prospect for #2. While this project has been slow to materialize, we are moving in the right direction. We will not compromise on our strategy and we're confident our persistence will pay handsome, steady dividends in the near future.

Non-Marketable Securities

Promissory Note

Though I favor equity ownership, I won't ignore the fact that lending may at times be more appropriate for our long-term success - this was my conclusion when we opted to lend $80,000 to Grandview in December. We will receive 15% on our principal for the next three years.

The investment was attractive because first, it gave us an opportunity to secure our interest with a lien against all assets of the business. Second, the cash lended was important for paying down and refinancing bad debt at the subsidiary level, ultimately improving our equity position. Third, we receive consistent interest income in the form of cash to re-invest in our *marketable securities* portfolio.

This is simply a short-term bet that the vast majority of stocks within my circle of competence will not generate 15% returns for the next three years. I believe a variety of stocks we'd love to own have a reasonable chance to fall in price during this tenure - something we're cheering for so that we can accumulate shares at more compelling prices. Whatever the outcome, 15% for three years is satisfactory.

Marketable Securities

We were forced to sell some positions in order to fund the loan to Grandview. I didn't want to liquidate these positions so soon, but felt the note was presently more appealing. Nonetheless, what we sold resulted in a small tax gain for the year as you'll see on your K-1. We are interested in repurchasing those stocks as the cash comes back to us.

As you know, I will not publicize specific stock holdings, nor will I publicize any method of trading in order to establish these positions. Our ideas and methods are the intellectual property of Parliament Capital. If I were to casually share our trade secrets, it would make a hell of a lot more sense to wait on my disclosure and piggy back my picks. There would be no reason for anyone to contribute to PCM and and I could not make a living that way. This lack of transparency will undoubtedly limit prospective partners - I'm ok with that. Secrecy will always take priority over fund-raising.

Marketable Securities are basically a spot for us to park any excess cash not needed to grow our subsidiaries. Because our *operating subsidiary* is in its infancy, the size of our *marketable securities* portfolio relative to our total net asset value is small. The bulk of earnings at Grandview will be used to grow that business for the next couple years. That should change. If we are successful at growing those earnings, our portfolio of *marketable securities* will become the biggest piece of our operation in about 5-10 years.

We may at times liquidate some or all of our *marketable securities* to fund the growth of *operating subsidiaries* or to acquire a new *subsidiary*. All things equal, we would prefer to buy all of, or a controlling interest in other small businesses. This may temporarily limit our available liquidity, but if successful, will help us pile up the cash for many years to come.

Taxes & Miscellaneous

Due to anomalous costs associated with capital improvements and a premature management arrangement at our *operating subsidiary*, we should show an ordinary business loss for tax purposes. This is a tax benefit to us, but never what we want to see. We would prefer to pay a lot of taxes at low rates. Nonetheless, this was not the result of a deteriorating business operation. Capital investments are in the rear view and we've rearranged our management so that we should produce sizable tax profits for 2018 and beyond. Still, the most prudent course of action for 2018, is to estimate based on your 2017 liabilities. If you do this, you will avoid interest and penalties.

I look forward to reporting to you in July about the first half of 2018 - it appears we should have some fairly significant news. Meanwhile, if you wish to discuss anything in more detail, please feel free to write, call, or stop by. It gets pretty lonely in this office - I'd welcome your visit anytime.

Your Partner,

Timothy J. Grogan II
2/23/2018