PARLIAMENT
CAPITAL MANAGEMENT

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

Year	PCM	S&P
2015………………………………………………………………	61.05	1.38
2016………………………………………………………………	92.46	11.74

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/*](http://pages.stern.nyu.edu/~adamodar/) *for data sources, errors, limitations, etc.*

To the Partners of Parliament Capital Management, LLC:

Imagine Parliament Capital to be publicly traded. We've assembled a group of 6 shareholders. Our corporate headquarters occupies all of 120 square feet of office space next to my bedroom. Tangible assets, carried at cost, total around $700. We hold cash, cash equivalents, and securities with a combined capital value of $462,494.59. Our market capitalization would undoubtedly be one of the smallest listed on a public stock exchange. Amongst our peers, we are microscopic in size, unheard of on Wall Street; or anywhere else for that matter. However, at no point have we set out to be big in size just for the sake of it. The amount of capital we have deployed is not relevant to our mission. Exclusively, our objective has been and always will be to increase each partner's share of value at a compound rate of return that exceeds that of the S&P 500. So far, so good.

Performance Results

2016 marked our first full year in operation. The S&P 500, advanced 11.74% after adding back dividends. PCM Limited Partners gained 92.46%, after fees and expenses. Unrealized gains and distributed earnings were the primary contributors.

Just as I feel 1 or 2 years is too short a time to judge bad performance, good performance is no exception. Suffice it to say investment opportunities will not consider Earth's orbit around the sun or the timing of my reports to you. I haven't the slightest idea when the really good ideas will surface. I am certain however, they won't be available often enough to keep this pace We must prepare for market forces to expose the limitations of the securities business. Nevertheless, we should be optimistic as we have constructed a stable foundation of capital to reinforce our long-term efforts.

An Enduring Enterprise

Apart from *hedge fund*, the common description of an investment partnership structured as ours is: one that pools money from sophisticated investors, commits bets on the direction of market prices with borrowed money, and programs technology with complex algorithms - all in effort to rapidly execute the next profitable trade. In my seemingly unconventional view, stock is not merely a fluctuating quoted market price to trade for a profit, but rather a lawfully binding receipt which grants ownership of the underlying capital and future cash flow of a business. Stock ownership is no different economically than the family business composed of a few partners that share in the earnings proportionally. Public companies may have more mouths to feed, but only the size of the pie should be deliberated.

Our partnership is organized not as a temporary investment program, but rather as an enduring business enterprise. The method of our operation is to acquire securities with exceptional economics - private or public, in whole or in part - at a rational price. We use little technology and have no time for complex algorithms. Seldom do we trade, but when we do, we buy for keeps. And I'm fairly certain none of our partners refer to themselves as sophisticated investors. Call us a hedge fund if you must, but frankly the name of our partnership is the only resemblance.

Our Portfolio Composition

In our 2016 First Half Report, I stated the following:

"Of our three investment categories, one will not necessarily be more profitable than the other. However, it is a pleasure to create economic value in more ways than simply making money on money. Also, it is my belief that our leadership can be influential to management executives and hence more productive for our partnership. Therefore, I lean toward the opportunity to own a controlling interest or whole business, if our capital and the asking price allows."

I feel no differently today. If anything, my affinity for *operating subsidiaries* has heightened. Perhaps it is because we've experienced great success in this arena; or that my search for *securities* has resulted in very few good ideas. Probably, it is my fundamental belief that assets are best cared for by the permanent owner - a mindset virtually non-existent in the *securities* business. Furthermore, remarkable business leaders not only find value, but also create value from resources that others fail to recognize - an opportunity further administered through the ownership of *operating subsidiaries*. Thus, it is no accident the order in which I have arranged our three investment categories:

1. *Operating Subsidiaries* are control positions or wholly owned companies. They may start as one of the other two. We attempt to buy businesses in lasting industries with honest and talented management teams, so that we can remain passive and hold on to the business forever. However, we will become active in a business, if need be. We don't consider ourselves liquidators. In other words, we aren't planning an exit strategy to sell the asset for a quick capital gain. Rather, we fully intend to own *operating subsidiaries* forever. We use excess cash not needed for reinvestment at the subsidiary level to reinvest in other cash-producing assets at the parent company level (Parliament Capital). Our contribution is strictly focused on capital allocation.

2. *Non-marketable Securities* are passive, minority positions in stock that is not liquid, or trades infrequently. The open market bid is often times far below the quoted market price. If forced to sell quickly, we could suffer big losses. Usually, these are small, obscure companies owned by a handful of shareholders (we like when management has skin in the game). Our goal is to buy a large

percentage of the shares outstanding. I expect *non-marketable securities* to take several years to materialize.

3. *Marketable Securities* are minority positions in public stock that is liquid. In other words, we could sell at or near the quoted market price relatively quickly. Our mindset when buying *marketable securitie*s is no different than if we were purchasing the entire company. In fact, our hope is that the attractive price level persists long enough for us to accumulate a large chunk of the shares outstanding. However, gains in market prices could materialize quicker than we can accumulate capital to deploy.

<u>2016 at Parliament Capital</u>

Operating Subsidiaries - Return on Invested Capital

Particularly as a controlled subsidiary, the *good business* is one that generates a return on invested capital marginally higher than the interest rate on a risk-free 10-year treasury note. A step above the *good business* is one that requires very little capital for growth - a business we refer to as having *exceptional economics*. These are the types we seek to own. To find them is rare; finding them for sale at the right price is most unusual. I believe we struck the bonanza in Grandview Tavern.

Investment in an independent restaurant, notably one founded by the investor's mother, is not an ordinary foundation for building a business enterprise. However, the opportunity aligned with our most fundamental requirements: a recognizable brand, pricing power, high return on invested capital, little capital needed for growth, good management, and a reasonable purchase price. We executed a convertible promissory note with Grandview Tavern & Grille, LLC: in exchange for three separate cash injections and debt guarantees, Parliament Capital received an 8% note with the option to convert the loan to equity, equal to 50% of the outstanding interest in the company.

Just 2 short years ago (around the time we got involved), Grandview was buried in debt to the point of insolvency and operating at a loss - a malignant combination. Since, we've influenced a turnaround that has delivered owners an average 20% annual return on invested capital. Consider the same company, debt-free: the operation produces roughly 40% ROIC with the vast majority of earnings available for distribution - a valuable condition for a method of operation such as ours.

We instructed the company to convert the debt to equity, pursuant to the terms. We now hold 50% of a *good business* that I fully expect to get better. There's still much to do and I'm solely responsible for allocating capital. In short order, we are working to overcome the burden of unfavorable debt repayment terms. To ease the cash flow strain, we've implemented variable cost controls, eliminated numerous expenses, and negotiated new lease contracts.

In 2017, a capital investment will be deployed in order to upgrade technology and renovate outdated pieces of the facility. The project allows for certain expenses to be permanently eliminated, resulting in a 50% perpetual return on investment. Furthermore, the improvements are designed to better the customer experience and enhance the brand, or quantifiably, to increase revenue.

We are presently studying new markets and have targeted precisely where to build our next property. I will keep you posted on the progress. Incidentally, if you get hungry or want to host a private event, call on the folks at Grandview Tavern - grandviewtavern.com - you won't regret it.

Non-Marketable Securities

My enthusiasm for our position in a *non-marketable security* is at least parallel with that for our *operating subsidiary*. I spent the bulk of 2016 accumulating a relatively large position in a company that, in my judgement, holds the rare combination of remarkable leadership and attractive business economics. As you are aware, my policy is never to broadcast what we are buying until I'm certain our buying has ceased. In this case, I remain very interested in accumulating more shares if the price remains at or below current levels. Though I'm fairly certain no one is riding the coattail of your inexperienced, 32 year old money manager, I don't want to take any chances. If SEC regulations force me to disclose our ownership publicly, I'll fill you in.

I've categorized this particular security as *non-marketable* not because it is tough to sell, but because there is very little regular market activity. The average daily volume illustrates that it would demand the bulk of 2017 to sell our accumulated stake. Probably not true as there are willing buyers standing by. But, if forced to sell, our gains could dwindle. More importantly I ask myself, why should we think about a sale? We haven't thrown our cash together because we want to have a great year or two; instead, we've set out to examine the wonders of compounding for many years to come. Much has been made through deferred gratification. I intend to hold my share of this particular security forever.

This scenario exudes precisely why I've demanded a long-term mindset. In my opinion, the special brands are built over many decades. I am interested in buying and building businesses with managers that make decisions based on the impact they will have for many generations to come. My gut tells me we have found a relatively young, uniquely talented leader in the midst of developing an unusual system - I look forward to following this one and hope you share in my vision.

Marketable Securities

Our work in this category was muted in 2016. It has been a challenge to find the good business for sale at a fair price. I think when interest rates are considered (as they should be), stocks overall are in a reasonable price range. That's not to imply fear or greed can't lead to a sudden mispricing in either direction. It simply means not many pitches have been thrown in my wheelhouse. My search continues, but until I find something of equal or greater value to our other two ideas, we will continue to concentrate there.

Taxes & Miscellaneous

For your 2017 taxes, the most prudent course of action is to estimate based on your 2016 liabilities. If you do this, you will avoid interest and penalties.

Our strategy for taxes is to pay a lot of them, at low rates - that's the blueprint of a successful investment program. Far too many poor investment decisions are made for tax considerations alone; never will I buy or sell a position solely for this reason. To invest successfully is to deliver the most possible after-tax dough at the end of the game. If we are victorious, the tax man will eventually come calling.

I look forward to sharing our progress in July. Meanwhile, if you wish to discuss anything at all, feel free to write, call, or stop by - I realize 120 square feet isn't all that inviting, but I've gotten creative with the space.

Your Partner,

Timothy J. Grogan II
02-22-2017