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THE WALL STREET TRANSCRIPT
Connecting Market Leaders with Investors

Investing Thematically in Private Equity and Disruptive Technology

CHRISTOPHER ZOOK is the Founder, Chairman and Chief Investment Officer of CAZ Investments. With nearly 30 years of experience investing in both traditional and alternative asset classes, he is a regular contributor to major media outlets, including CNBC, Fox Business and Bloomberg. Mr. Zook is actively involved in public policy and frequently serves as a resource to state and local officials. Most recently, Governor Greg Abbott appointed Mr. Zook as Chair of the investments committee for the State of Texas Pension Review Board after he helped find a solution to Houston's pension crisis and spearheaded efforts that resulted in the city's most sweeping public pension reform of the last 40 years. He recently served two terms as a member of the Greater Houston Partnership's executive committee and is a past President of the "C" Club of Houston. Prior to starting CAZ Investments in 2001, Mr. Zook served in senior leadership positions with Oppenheimer, Prudential Securities, Lehman Brothers and Paine Webber. A lifelong Houstonian, he is a graduate of Texas Tech University where he was recently honored as a Distinguished Alumni. Mr. Zook is former Vice Chairman of the Deacons and serves on the finance committee at Second Baptist Church. He has held leadership positions on a variety of charitable boards, including his current role on the board of Elizabeth Ruth's Home, an organization helping adults with autism. He previously served as President of the board of trustees of Avondale House and President of The Children's Fund. He is a proud father to Christopher, Jr. — and daughter-in-law Cecelia Schmidt Zook — and husband to his high school sweetheart, Lisa.

SECTOR — GENERAL INVESTING

TWST: Please start by giving us some history on CAZ Investments.

Mr. Zook: We started the firm in August of 2001 to create a vehicle for my family and our shareholder families to invest our capital while at the same time enabling other families, institutions and investment advisers to come alongside us and invest in what we are doing. We recognized that we could provide access to opportunities others would not normally have, either because the investment minimums were too high or because the opportunities were not easily sourced and may have required preexisting relationships. Ultimately, our motivation was to provide access to innovative investing that folks would not necessarily be able to get to on their own. We currently have more than $1.5 billion in assets deployed, with more than 1,400 investors in our ecosystem.

TWST: What is it about CAZ that provides unique opportunities, and can you expand on how that is different than what the average investor has access to?

Mr. Zook: Individually, we are small, but collectively, we are very large. While we have shareholders that are significant families in their own right, ultimately they are just one family. However, when you add all of them together into one investment group, we end up with very large buying power that makes us equivalent to some of the largest institutions in the world.

Because of our buying power and vast ecosystem, it is not uncommon for us to make $100 million-plus commitments into investments if they align well with our core themes. There are not many families, and frankly, not many institutions, that can invest $100 million-plus into one fund or one specific company. We have the ability to do that because we are aggregating buying power from so many different sources and so many different pools of capital, which means we get access and we see things that may not otherwise be available.

The second part is that some investments have very high minimums, and those minimums can make it prohibitive for families who would need to invest $25 million or $50 million at a time, which may be outside of their range of comfort. Our ecosystem and buying power provide us the ability to make those investments.

Additionally, because we are a single source of potentially very large investment dollars, and we can move much faster than the typical investor might be able to, we often receive preferential rights, protections or, in many cases, co-investment opportunities that would not be available to the average fund investor. In one specific case, as an example, we have co-investment rights that are only available to those investors who commit $100 million-plus to a particular fund. And so even though there are some really wealthy families and investment advisers that have invested $20 million, which is a large dollar amount, they may not get those co-investment rights because the rights are only reserved for those that have made nine-figure investments, not eight-figure investments.

Further, we have 30 years of history investing in the alternatives world. Over that history, we have developed deep relationships with a vast network of people. Ultimately, this is still a relationship business. Sponsors know that we can invest large dollar amounts, we can do it quickly if needed, and we can provide value to their organizations, which frequently makes us a preferred investor.

TWST: You are a thematic investor. What does that mean to you?

Mr. Zook: We are very much thematic investors, in that we try to identify a theme that will persist for not just a few months but for several years or even several decades and then identify the best risk/reward method to take advantage of that theme. From there, we seek to find the best team to partner with that is truly the expert in that area and then invest accordingly to provide access for ourselves and for others to come alongside us.

When we look at potential investments, everything gets filtered through our themes. We have about 1,500 investments per year that we evaluate. There is no way to completely evaluate that quantity of opportunities, so we must have a filter that narrows the field and helps us focus on what matters.

When something comes through the door, the first question is going to be, "Is this something that matches a theme that we are interested in?" If the answer to that is no, then the hurdle is very high as to whether we would even consider doing any work on it. If the answer is yes, then we start going through the normal process of asking, "Is the team credible? Does the sponsor have a competitive advantage or an edge that can lead to persistent alpha? Etc."

We are looking for opportunities where we have a significant tailwind and we can say, "Even if this team does not execute at an optimal level, we are still likely going to do well because the tailwind is strong enough." If the team executes well and we have that tailwind, that is where outsized returns come from.

While not every investment we make is with the wind at our backs, most are. If we are ever investing when the wind is in our face, we are going to have very high expectations for returns. Otherwise, it is not worth taking that wind in our face.

When we look for a theme, we want to see a significant tailwind. We want to see that it is persistent and that there is an advantage that someone can garner because of expertise. And then, we ideally like to find opportunities with positive asymmetry, meaning that the downside is relatively limited compared to superior upside potential.

TWST: The environment we're in right now is certainly unique. What themes and opportunities are you all seeing in this unprecedented time?

Mr. Zook: We have two major themes right now that we believe are going to persist for many years, and they are also our largest themes by far. The first of which is the growth of private equity as an asset class. We are one of the largest investors in that space where we own stakes in private equity firms, and we have invested almost $1 billion in this particular theme. We believe the private investment world — including private equity, private credit, private real estate, etc. — will see significant growth, and owning the businesses that will benefit from that trend will provide an excellent risk-adjusted opportunity set going forward.

As a simple example, you may recall that a few weeks ago the Department of Labor ruled that 401(k) plans can now invest in private equity for the first time ever. Consequently, there is about $6 trillion currently in 401(k) plans that now for the first time can invest in private equity. If you are a manager of a private equity firm, then you can now tap into markets that you previously could not go to.

Combine that regulatory tailwind with the reality that almost every single pension, retirement plan, etc., around the country has a near-zero chance of reaching their actuarial assumptions with a standard 60% stock, 40% bond mix given an expensive stock market and an interest rate environment where the 10-year Treasury is yielding less than 1%. The result is a set of natural buyers who have no choice but to invest in private assets to have any chance at achieving their actuarial goals. That is why we have seen very consistent growth in private equity as an asset class itself.

And by owning the businesses that manage that money for investors, we benefit tremendously from the growth of that asset class as a whole. Add to those tailwinds that private equity firms operate with some of the highest operating margins in all of business. This all adds up to a combination of outstanding people making excellent investments,

Highlights

Christopher Zook discusses CAZ Investments. He says the firm is able to provide unique opportunities through its buying power and vast ecosystem. As a thematic investor, Mr. Zook aims to identify themes that will persist for several years or several decades. He then looks for the best risk/reward model to take advantage of the theme. His two largest themes currently are private equity as an asset class and disruptive technology.

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with a very high amount of demand coming from the investor universe, which leads to significant cash flow. That is a very good example of the type of opportunity that we look for.

These assets are also very asymmetric because these private investment firms are investing locked-up capital, meaning investors are paying contractually obligated management fees for several years, which provides high visibility to cash flows. Additionally, if the private firm does a good job and performs well, they get a percentage of the profits that they create for their investors. That is the very definition of asymmetric: If things go OK, we do well, and if things go really well, we have an outstanding result as owners of the business. The tailwinds and asymmetry show why the growth of private equity as an asset class is our largest theme by far. It is something we are very excited about for the next decade-plus.

Our next largest theme is disruptive technology, which for us crosses a very wide range of investments. In particular, we are passionate about the enterprise software space, as it has an incredibly sticky customer base, extraordinarily high margins, is growing dramatically as an ecosystem, and it is imperative for people to have reliable and sustainable enterprise software to operate their businesses. Whether you are operating with physical locations or operating remotely, one thing that holds true is you must have enterprise software to make it work.

TWST: Looking a little bit more short term, have you made any adjustments to the investment strategy because of COVID?

Mr. Zook: Yes, we have. We launched two new funds at the start of April to specifically take advantage of the dislocation that has occurred. From there, we also looked at the opportunity set in the credit markets and the dislocation between what is happening in the public markets, which since the Federal intervention have generally traded as though nothing is wrong, and the private markets, where we have seen companies like **Chuck E. Cheese** and **GNC** filing for bankruptcy in the last few days. We see this enormous opportunity in the private markets over the next two to three years to deploy capital in operating businesses that are going to be distressed and need to be restructured.

The debt markets are certainly part of that equation, but we feel there is a material opportunity to benefit from the recovery on the other side of this crisis from acquiring really high-quality companies that were simply in the wrong place or the wrong industry or the wrong sector when COVID hit. Whenever those return to normal, there will be enormous wealth created from owning those assets. However, most people will choose to not own those assets because they are too volatile and there is too much uncertainty around them. We understand that.

We are in the process of partnering with a very well-known international player that will give us the ability to invest with one of the preeminent experts in buying distressed assets across Europe, North America, Latin America and South America. Through this strategic partnership, we should be able to buy small to midsize businesses that simply got displaced from COVID under the weight of their balance sheets but still have excellent operational capabilities.

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Every single recession has a playbook that you can utilize to navigate through the turmoil. The causes of each recession are always different and unpredictable, and I certainly do not know anyone that was forecasting that this recession would be caused by a virus, but there is almost always a playbook that can be utilized to maximize the opportunity set from a recession. Each recession has its own unique characteristics, but they generally follow a somewhat predictable pattern.

In this particular situation, we are following that playbook but recognize that things are likely to happen slower because of all the stimulus. Therefore, we are putting capital in place over the next six to nine months that will be ready to buy those companies that are truly great businesses with troubled balance sheets, restructure them and then, as the economy recovers over the next three to five years, hopefully sell them at enormous increases in value. We have a great partner that we are looking forward to announcing sometime in the next couple of months to do just that.

All the way on the other spectrum are the truly revolutionary industry disruptors like **ICON** in Austin, Texas, in which we invested. **ICON** is the first company in the U.S. to print a home with a 3D printer. Think about the ability for that to disrupt the way construction is done in the future, and think about the amount of good that can be done by providing low-cost, quick shelter for people that may not have it. The impact on the homeless population, those who have been displaced because of natural disasters, the military, across the oil and gas sector, etc., will be material.

ICON is expected to be able to print a 4,000-square-foot custom home with a 3D printer within the next several years at a fraction of the cost of building in a traditional manner. The homes are made from concrete, so they are durable, sustainable and have significant ESG benefits as well. **ICON** is the definition of doing good while potentially also doing very well.

Disruptive technology for us spans from the largest enterprise software businesses in the world all the way down to something like an **ICON** and everything in between, whether it be cloud-based computing, cybersecurity, etc., and makes up our second-largest theme to the growth of private equity as an asset class.

TWST: How and why do you exit an investment?

Mr. Zook: It is dependent on a myriad of factors. You exit an oil and gas royalty for different reasons than you would exit a business that you bought that was distressed. Ultimately, valuations matter, and over the last several decades, people have gotten complacent and chosen to focus more on the trend than the valuations. The trend is incredibly important, but at a certain point, valuation and math will take over as to whether an opportunity set can continue.

So if you buy a company because you really believe that company is going to grow its earnings by 100% over the next three years, and you believe the valuation is going to stay the same, then you believe you are going to double your money over the next three years. If you have good reason to reevaluate your expectations around valuation or earnings, then you should sell the position because your thesis was based on your initial expectations, and if those no longer hold true, why own that name?

The vast majority of people never have a good reason why they make an investment. Therefore, it is difficult for them to exit. This has held true over every type of investment and time frame that you look at. The buy decision is actually the easy decision. The sell decision is the hard decision. But if math is your guide, it becomes much easier.

Valuation must be your driver if you are a fundamental investor. If valuation is why you bought in, then you should set a valuation target in advance and maintain the discipline to step aside when it hits that valuation or sooner if your expectations change.

TWST: Is there anything you will not invest in?

Mr. Zook: We will invest in anything, anywhere, anytime. We invest in the currency markets, the commodities markets, the equity markets, the private markets and public markets, the fixed income markets. It really does not matter to us. We deploy capital wherever we see the best opportunity set.

We tend to avoid negatively asymmetric opportunities where if things go well, we do OK, but if things go poorly, we see material losses. To be clear, we do not mind taking enormous risk as long as there is enormous opportunity for upsized return as well. But if somebody says, "This is going to make one and a half times your money, most of the time, but if it goes bad, you are likely to lose everything," that just does not appeal to us. So that is the way we approach the world.

This is something a lot of people say and very few people do. We never start by focusing on the opportunity set. When we are evaluating something, we always start with the risk. We ask ourselves what the worst-case scenario is, because we know if we can live with the worst-case scenario, the upside will take care of itself.

"So we are unequivocal about knowing what that downside looks like, and we are emphatic about looking at everything on a risk-adjusted basis compared to that worst case. Ultimately, we do not mind taking enormous risks, but we want the positively asymmetric opportunity to get really well paid if things go according to plan."

Stick to your methodology. If you are purely a technical trader and get in for a technical reason, get out for a technical reason. Do not decide that you got in for a technical reason and then shift focus to fundamentals. That is a bad combination. Ultimately, you must have a reason for buying, design your exit when you enter the position and identify what will cause you to exit the position, either because you admit you are wrong and something has changed or because it has done well and your thesis has played out.

Sometimes the best investments, as Mr. Buffett might say if he was on this call, are the ones that you never plan to sell. Well, that is easy to say and incredibly hard to do, and very few people have the discipline to invest like that and weather the associated volatility. But in both the public market and the private market, if math is your guide, then there is a logical time and place when one would say, "It makes sense to either sell part of the position or sell all of the position because of where valuations are today."

That is why we have not invested in large-cap buyout funds over the last four years; they were paying record EBITDA multiples and using record levels of debt. However, circumstances have changed, and those are now the exact situations that we are likely to be able to buy over the next couple of years at historically low valuations and use low levels of debt to make outsized rates of return.

So we are unequivocal about knowing what that downside looks like, and we are emphatic about looking at everything on a risk-adjusted basis compared to that worst case. Ultimately, we do not mind taking enormous risks, but we want the positively asymmetric opportunity to get really well paid if things go according to plan.

TWST: So what are you watching for the rest of the year and as we head to 2021?

Mr. Zook: The speed of the recovery is going to drive things more than anything else. If we end up having to shut the economy down or we end up having a much more tepid recovery than this market has estimated, then that will drive things dramatically lower from here. Consumers have been forced to save a lot of money, leading to pent-up demand. As a result, they may go out and spend a lot of money in the second half of 2020, and that is what the market is anticipating.

We will watch that recovery and focus closely on employment numbers because those statistics will drive long-term demand and spending power. Specifically, we will focus on how confident employers are in their businesses to add staff back and potentially expand from here.

On top of that, of course, the 2020 presidential election will be a critical event for markets and for the economy. We will look at the control of Congress and look at the control of the White House, as that will give us a good indication of what fiscal and monetary policy will look like over the next at least two years until we have midterm elections in 2022.

Another important component is if and when we will see a viable vaccine for COVID. We are very confident that we will. What we are less confident about is the timing. It is possible that we could have some form of vaccine by October or November that would be available likely in limited quantity for health care and front-line workers, based on sources from the medical community. We believe that we will most likely not have a full-blown vaccine for the mass of the population until February, March or April, and that will be a big deal because it will change behaviors dramatically, and it will increase consumer confidence in going out and resuming normalcy.

We will also be watching closely how employer behavior changes regarding office space and how the workforce will change over time. There is no question that every company is reevaluating today how many square feet that they need and what changes they will make to normal operations given the shift toward remote policies in the last six months. We may not know what that looks like until probably mid-2021. But there will be subtle indicators all along the way that we will see particularly in places like New York and the other major metropolitan cities like Houston.

We will begin to see what employers plan to do by the time we get to Labor Day, because while summertime is generally a less busy time of the year for most employers, after Labor Day employers generally need to have a plan for the last four months of the year, which tend to be some of their busiest times. We will watch carefully to see how companies respond into the second half of 2020.

TWST: Given all of that, what advice would you give investors or would-be investors right now as we finish up the year?

Mr. Zook: The advice that I would give to investors right now is that valuations matter, and do not forget it. Be very selective at this time because uncertainty is heightened, and you want to make sure if you own something, that you own it at a valuation you feel confident about over the next two to five years on the other side of this cycle. People tend to buy things just because they are going up and do not really have a strong conviction as to why they own it. Then, if the market does resume a downtrend, they will panic, and they will sell and lose significant dollars because they were not disciplined when they entered.

It is no fun sitting in cash. It is no fun sitting in conservative investments when everything is going up around you at a lot faster rate. But it a lot more painful to lose a bunch of money because you lose your discipline. So focus on valuations, focus on longer-term expectations for businesses, and avoid being caught up in the herd mentality that tends to take stocks up or down based on the psychology at the moment.

From there, it is absolutely critical that investors that are able to do so look to the private markets for exposure for a portion of their portfolio because the valuations in the private markets now are generally very attractive compared to the public markets. In some cases, the valuation gap between private and public markets is bigger than it has ever been.

TWST: Thank you. (LMR)

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