CRYPTOBOURBON AND THE FAR REACHES OF WHISKEY FINANCE

BY TOM JOHNSON

The grounds of Wilderness Trail Distillery in Danville, Kentucky, are deceptive in the way most new bourbon distilleries are deceptive: They hide their youthful modernity beneath a veneer that recalls the rough-hewn lore of America's whiskey tradition. You could tour Wilderness Trail, sample its products, and pose for selfies in front of the 19th Century farmhouse that anchors the sprawling campus with no inkling you were standing at the cutting edge of whiskey finance—but you would be.

In 2021, an investment company called Wave Financial announced it would buy up to 25,000 barrels of new-make bourbon from Wilderness Trail. Wave is based literally and figuratively as far from Kentucky's distilleries as you can get and still be in the Lower 48, in a starkly modern Los Angeles high-rise that has charging stations for electric cars and views of glistening Santa Monica Bay. Before announcing its purchase from Wilderness Trail, Wave had never dabbled in beverage alcohol.

"We were in the process of creating some funds to invest in hard assets," said Benjamin Tsai, cofounder of Wave and portfolio manager of its whiskey investments. "We looked at many different asset classes: clean water, carbon credits, Japanese racehorses, Picassos...and we found whiskey to be an interesting investment profile."

Whiskey interests Wave and a growing pack of other financial speculators because it predictably gains value as it ages. Wave's prospectus for its bourbon fund says barrels of new make purchased for $1,000 have historically sold in five years for $3,000 to $5,000—an increase that works out to a 35-percent internal rate of return. More attractive still, for an investment with such a potentially stratospheric payoff, is whiskey's limited downside. Bourbon, like real estate, will continue to exist even if financial markets collapse and thus will be worth *something* even in the worst case.

"There are a lot of customers buying barrels of new fill as speculation," said Simon Burch, CEO of Green River Spirits, which produces 80,000 barrels per year of the sort of whiskey that is in high demand by financial investors. "It's all super-confidential."

Investors like Wave are becoming important drivers of some of bourbon's fast growth. Traditionally, distilleries have paid for production by borrowing against their inventory, paying interest on the money they need for production, storage, and aging. That kind of borrowing has worked well in the slow-growth past, but it limits the pace of growth by tying available capital to what the distillery is selling today, rather than what it might sell years in the future.

"For a distillery that's trying to project growth, it becomes cost-prohibitive when you're tying up capital for that long," said Tracy Sheppard, who runs alcohol-related investments for Live Oak Bank in North Carolina. "This industry has a huge need to help recapitalize inventory."

That's where investors like Wave come in.

There aren't many distilleries growing faster than Wilderness Trail. Refer to it as a "craft distillery" and its founders will remind you that in only eight years they've become the 14th-largest distillery in the country. They have more than 100,000 barrels in inventory and are building new rickhouses that will hold 150,000 more. While their retail sales are reportedly strong, they are not proportional to the distillery's quickly expanding infrastructure and production. All that high-intensity growth is being paid for by producing and aging whiskey for other brands and, more to the point, for purely financial players like Wave Financial.

"We're first and foremost interested in creating our own

"We looked at many different asset classes: clean water, carbon credits, Japanese racehorses, Picassos... and we found whiskey to be an interesting investment profile."

—Benjamin Tsai, cofounder of Wave, and portfolio manager of whiskey investments

brands," said Pat Heist, cofounder of Wilderness Trail, "but we do a good bit of contract production for people who are investing."

Michael Shoer, who helped create the Victory Fund in Atlanta to invest in whiskey, says the hardest part is staying on the right side of whiskey's complicated regulations.

"How do we create a compliant investment vehicle," he asked, "when the law forbids anyone who's not [licensed] to be involved?"

There are a lot of answers to that question. Most are hidden in private placement memoranda available only to "accredited investors," a category defined in securities law to inhibit the kind of unregulated stock offerings that were once used to swindle naïve senior citizens out of their retirement accounts. Individuals with an annual income of over $200,000 or a net worth over $1 million are accredited, under the law, to take chances the general public isn't allowed to take.

The extreme example of the kind of financial creativity unleashed by that loophole is Wave Financial's deal with Wilderness Trail. Wave has set up a licensed entity that owns the bourbon the company buys. Rather than selling shares in that entity, Wave will "tokenize" the whiskey into a custom-made cryptocurrency to be traded on the same exchanges as Bitcoin. Unlike shares in conventional private offerings, which can only be traded among accredited investors, the tokens can be traded freely by their owners in increments as small as a few dollars. And then, when Wave judges the time to be right, the bourbon will be sold back into the market, and the money—including, hopefully, an impressive profit—distributed to token holders.

The first portion of Wilderness Trail bourbon bought by Wave in 2021 was 2,500 barrels. (Wave is buying from other distilleries as well.) When asked who the eventual buyers of that whiskey might be, Tsai mentioned Asian markets and non-distilling producers, but also came back to Wilderness Trail itself. Though the bourbon is owned by Wave, it is aging in Wilderness Trail's warehouses—right where it would be if Wilderness Trail still owned it. Wilderness Trail cofounder Heist agreed that the whiskey provides the distillery with a strategic reserve without tying up the company's capital, and said they might want to buy it back if there's sufficient demand for Wilderness Trail whiskey in five years.

"We look at that [inventory] as something we might be able to use," he said.

In the meantime, the roughly $2.5 million that Wave paid for the Wilderness Trail whiskey and the rent they are paying to store it in Wilderness Trail's rickhouses will help finance the growth of Wilderness Trail's own brands. The result will be more whiskey, which works well for everyone as long as demand for bourbon continues to soar.

"At some point, the industry will over-supply itself," said Louis McIntire, a relationship manager for CoBank, which finances the purchase of grain for whiskey production. "When the outside investors come in, they distort the market big-time. They change the fundamentals every day."

For now, McIntire and everyone else interviewed for this article agrees that demand for bourbon is nowhere near slowing down and that new sources of capital are most welcome. The time horizon for the investment groups buying up new make is generally around five years—a point at which, theoretically, supply will jump as both the speculators and the distilleries they are re-capitalizing start to bring their whiskey to market. By then there may well be enough worldwide demand that a few hundred thousand extra barrels won't make much of a difference. But you never know. +