

---

---

# HORIZON RESEARCH GROUP

---

---

---

## Anheuser-Busch: Surviving Prohibition

---

*Originally published in the Devil's Advocate Report Compendium October 2010*



*Exclusive Marketers of  
The Contrarian Research Report*

PCS Research Services  
125 Maiden Lane, 6<sup>th</sup> Floor  
New York, NY 10038  
(212) 233-0100  
[www.pcsresearchservices.com](http://www.pcsresearchservices.com)



---

### Horizon Research Group

Steven Bregman	Thérèse Byars	Peter Doyle
Michael Gallant	Matthew Houk	David Leibowitz
Eric Sites	Fredrik Tjernstrom	Steven Tuen
	Murray Stahl	

---

## Anheuser-Busch *Surviving Prohibition*

Some general questions that are worth a short seller's consideration include asking what happens to a company when its primary product has a precipitous decline in sales within a short time frame, and how robust and resilient can a company be in that situation. One of the few historical examples of such a company is Anheuser-Busch, and it is worth studying. This example is designed to humble the short seller, because companies, especially if they are well capitalized, can be very resilient. It's difficult to find what's known as an existential short, meaning a company that will ultimately destroy itself and descend to zero. The outcome is less certain for a company that is simply overvalued. Nor is it certain for a company that has previously overstated its earnings and then has its share price decline after it states them properly. In the case of Anheuser-Busch, the challenge facing it in 1919 was that the Volstead Act made all alcoholic beverages illegal, including beer.

Anheuser-Busch was founded in 1852 by Eberhard Anheuser in partnership with his son-in-law, Adolphus Busch, which is why it's called Anheuser-Busch. It's amazing how long the product life cycles are for some of its popular products. For example, I was astonished to learn that Michelob was introduced in 1901. I thought it was a much more recent product, but it certainly wasn't.

One of Anheuser-Busch Corporation's problems, although not the most grievous one, was that it was founded by German immigrants and was, thereby, identified with Germany in the minds of the American public. As a result, during the First World War, the company had a serious customer relations problem, because it was deemed by some to be unpatriotic to drink Anheuser-Busch beer. Fortunately for the company, it was a problem that was fairly easy to remedy. It was decided that a small portion of its revenue would be used to buy Liberty Bonds during the First World War, and the public accepted that gesture. Apart from some bad publicity and a few disparaging newspaper editorials, the company suffered no permanent damage. However, if one were a short seller during that era, one might have thought otherwise.

Another interesting part of the company's history happened during the Civil War, when the Federal government proposed an excise tax on all alcoholic beverages to help pay for the war. Anheuser-Busch opposed it on grounds that it was an abridgement of the liberties of Americans to pay a tax on their alcoholic beverages. The company's vigorous opposition to that tax did not appear to damage its reputation at all. The government, however, was not impressed by their argument.

---

# HORIZON RESEARCH GROUP

---

A much larger problem arose in 1919 with the passage of the Volstead Act and the Eighteenth Amendment of the United States Constitution, which established Prohibition. The proponents of Prohibition knew that to change the Constitution would require that two-thirds of the U.S. Congress and three-quarters of all the state legislatures endorse the change. The Amendment managed to pass, and its proponents hoped that its passage would make it part of the permanent American landscape. The various proponents of Prohibition feared that if it were a mere law, a new Congress could repeal it. As it turned out, they were correct, and it took until 1933 to repeal Prohibition via the Twenty-first Amendment.

By the way, the Eighteenth Amendment was very unusual, because it was one of only two that did not limit the authority of government to control its citizens. The Thirteenth Amendment, which abolished slavery, is the other. The only times that the government decided to use the Constitution to limit the freedom of its citizens' actions were to make it illegal to own slaves and to make it illegal to drink alcoholic beverages. Although one's conduct is certainly governed by federal and state statutes, its control is not enshrined in the Constitution.

What could Anheuser-Busch do when it became illegal to manufacture or sell beer? The company tried making different products, like ice cream. Although they were able to use some of their plant capacity, they had very little success from those endeavors. They made non-alcoholic beer, and it was successful in a product development sense, but not in terms of sales. The company had devised, even with the technology of the age, non-alcoholic beer, which they maintained was indistinguishable in its taste from alcoholic beer. They challenged customers to buy the non-alcoholic beer and offered a refund if the person legitimately felt there was a taste difference. Everyone agreed that there wasn't a taste difference, but they just didn't want to buy it. The forces in favor of Prohibition used this fact to their advantage when they advocated for maintenance of the Amendment. They claimed that lack of customer acceptance of the non-alcoholic beer, which had no discernible taste difference from alcoholic beer, meant that people weren't drinking beer for its taste and flavor; they were drinking it for another reason.

Since beer has a certain local product acceptance that soft drinks don't have, Anheuser-Busch did not choose to set up distilleries outside the United States in response to Prohibition. There are many versions of beer all over the world, and the company did not feel that it would be successful in exporting American Budweiser to Canada, the United Kingdom or other nations. It did, however, take advantage of a loophole in the Volstead Act. The Act made it illegal to manufacture, sell and transport alcoholic beverages, but it did not make it illegal to produce, transport and sell the raw materials needed to make them. In the case of beer, the raw material would be barley. The government certainly couldn't make barley illegal, nor could they make the milling of barley illegal.

---

# HORIZON RESEARCH GROUP

---

In the initial stages of beer production, barley is milled to create what is known as malt extract. The method of preparation is that the unfermented grain is milled, mixed with water and heated to allow enzymes to escape. If making beer, more water is added along with yeast. If it is then allowed to ferment, a pretty good beer can be made. Since it was not illegal to sell the unfermented malt extract, that's what Anheuser-Busch did. It was soon selling 6 million pounds of it annually. When you think of a mug of beer reduced to its volumetric content, it's primarily water, so six million pounds of malt extract, without the yeast, of course, would make an enormous quantity of beer. August Busch, who was then chairman of Anheuser-Busch, summarized it well. He said, "We ended up as the biggest bootlegging supply house in the United States of America." Amazingly, it was all legal.<sup>1</sup>

Let's reflect on this example from a short seller's perspective. Undoubtedly, short sellers would have been aware of the coming of Prohibition. It could not have been otherwise. They would have been aware of the first halting and inadequate attempts of the Anheuser-Busch Corporation to replace its massive loss of revenue. Although Anheuser-Busch was not a publicly traded company at the time, if it were, it's worth speculating on what might have happened: The short sellers would have been tempted to sell short the company's shares. It would hardly have occurred to anyone that Anheuser-Busch could have reinvented itself as a legal and legitimate-under-the-law bootlegging supply house.

There were many and various disciplines that one would have to be conversant in to adequately analyze the situation. It would not merely entail an understanding of the company, or awareness of the Volstead Act, but also a deep understanding of the law, the product, the processes by which the product is made and the lengths to which the public would go to drink beer. People manufactured their own beer, or patronized organized criminals to acquire it. One would never have imagined that Anheuser-Busch could become a successful enterprise, legal beyond reproach, by acting as a supply house to criminal organizations. That's a commentary on the resilience of corporations.

As an aside, when I began researching this topic, I was astonished to see how few books, or even articles, have been written on the Prohibition period. It was difficult to obtain information on such an interesting period. Prohibition was a great social experiment into whether or not the government can control people's behavior. Obviously, it couldn't, at least with regard to the consumption of alcohol, and it tells us something about investing.

---

<sup>1</sup> Daniel Okrent, *The Rise and Fall of Prohibition* (New York: Scribner's, 2010) 251.