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ELY - Q1 2014 Callaway Golf Earnings Conference Call

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OVERVIEW:

Co. reported 1Q14 consolidated net sales of $352m and 1Q14 EPS of $0.61. For 2014, expects net sales to be $880-900m and fully-diluted EPS to be $0.12-0.16.

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PRESENTATION

Operator

Good afternoon. My name is Mike and I will be your conference operator today. At this time, I would like to welcome everyone to the first-quarter 2014 Callaway Golf earnings conference call. (Operator Instructions)

I will now turn the call over to Brad Holiday, Chief Financial Officer. You may begin your conference..

Brad Holiday - *Callaway Golf Company - CFO*

Thanks, Mike, and we'd like to welcome everybody to the call today. Joining me is Chip Brewer, our President and CEO. During today's conference call, Chip will provide some opening remarks. I will provide an overview of the Company's financial results for the quarter. And we will then open the call for questions.

I would like to point out that any comments made about future performance, events, prospects or circumstances, including statements related to estimated 2014 second-quarter or full-year net sales, sales growth, gross margins, operating expenses, pretax income, tax provision, earnings per share, future market conditions, the success of the Company's future products or the Company's recovery, brand momentum, financial performance and shareholder value, as well as the collectability of accounts receivable and the Company's estimated 2014 capital expenditures and depreciation and amortization expenses, are forward-looking statements, subject to safe harbor protection under the Federal securities laws.

Such statements reflect our best judgment today, based on current market trends and conditions. Actual results could differ materially from those projected in the forward-looking statements, as a result of certain risks and uncertainties applicable to the Company and its business. For details concerning these and other risks and uncertainties, you should consult our earnings release issued today, as well as Part 1, Item 1A of our most recent Form 10-K for the year ended December 31, 2013, filed with the SEC, together with the Company's other reports subsequently filed with the SEC from time to time.

In addition, during the call, in order to assist interested parties with period-over-period comparisons of the underlying performance of the Company's international operations, we provide certain of the Company's results on a constant-currency basis, which essentially applies the prior-period's exchange rates to the current-period results.

This information may include non-GAAP financial measures within the meaning of Regulation G. The earnings release we issued today includes a reconciliation of such non-GAAP financial measures to the most directly comparable financial measures prepared in accordance with GAAP. The earnings release is available on the Investor Relations section of the Company's website at www.callawaygolf.com.

I would now like to turn the call over to Chip.

Chip Brewer - *Callaway Golf Company - President & CEO*

Thanks, Brad. Good afternoon, everyone, and thank you for joining us for today's call.

Q1 2014 was another solid quarter for Callaway Golf and further evidence that our turnaround plan is working. I'd like to start by thanking the Callaway Golf team for their hard work and commitment to turning this business around. This team has done a remarkable job changing this business for the better, and I want them to know how much we all appreciate their efforts.

For the quarter, our revenues were up 22% and we showed growth in almost all markets and categories, with increases in both unit volume and average selling price, as well as gross margin. Woods, irons, and golf balls all surged during the quarter, with increases of 33%, 29%, and 24%, respectively.

Highlighted growth regions include Japan, with a constant currency growth rate of 51%; Korea, with a 63% growth rate on a constant currency basis; Europe, with a 25% growth rate on a constant currency basis; Canada, 32% on a constant currency basis; and the US at 16%. This sales growth shows the trade's increasing confidence in our company's direction.

In concert with this revenue growth, we grew our market shares impressively in almost all key categories and markets. In Japan our Q1 year-to-date hard goods market share was 14.8%, up 260 basis points year over year. In the UK it was 17.8%, up 650 basis points year over year. And in the US we ended Q1 at 19.3%, up 510 basis points year over year.

These worldwide market share gains were based on overall brand momentum and the strength of the launch period for our X2 Hot and Big Bertha products. We also benefited from the fact that our largest competitor did not launch any product during the same period.

This worldwide growth, combined with our improved operating efficiency, led to strongly improved financial performance, with our year-over-year Q1 income from operations up 54% to $62 million. Brad will outline more of the Q1 financial performance in his comments shortly.

Looking on the product front, trade and consumer reaction to our 2014 lineup has been positive. There is particular interest in the segment regarding Big Bertha, Apex, and SuperSoft products. Encouragingly, I believe we are in the process of reestablishing ourselves as the performance and technical industry leader in many categories.

On the tour front, over the last few years we've made incremental investments in young talent such as Harris English, Chris Kirk, Gary Woodland, Rio Ishikawa, Patrick Reed, and Matt Every. We've in turn been rewarded with significant increased exposure. In this venue we are now perceived as a brand with momentum and we believe this is gradually spilling over in the marketplace.

On the marketing front, the team continues to do an excellent job, both in digital and traditional media environments. For 2014 we have particularly enjoyed the opportunity to bring back iconic brands, such as Big Bertha via a mix of historical elements such as the inclusion of Sir Isaac and the tag line, you can't argue with physics, along with a contemporary performance message and an edginess that we believe golfers find appealing.

Importantly, during Q1, third-party brand research once again showed that our overall brand rating, as well as consumer purchase interest in our products, are moving in the right direction. This brand momentum is critical for us and serves as a foundation for our continued turnaround and future growth.

Looking forward, as evidenced by our recent results, we are now clearly seeing the benefits of the many changes we have made over the last few years and thus remain optimistic. However, in the short term we are anticipating very challenging market conditions for the second quarter and possibly the balance of the year.

The golf market has been slow to open in many regions, including our largest region, the United States, which has experienced unfavorable weather in many parts of the country. In addition, overall retail inventory levels are high industry-wide and we anticipate a heavy promotional environment while the industry works through the excess inventory.

As a result of all of this, we are maintaining our full-year guidance but, if the golf market does not open shortly, or the promotional activity is heavier than we anticipate, we would expect to be at the low end of our earnings guidance.

In closing, Q1 was another strong quarter for Callaway Golf, which reinforces our belief that our turnaround plan is working, and that we're laying the proper foundation for a sustained recovery. We believe that over the long term, weather and market conditions will normalize and that our business plan, combined with the strength of our brand and the quality of our people, will lead to steadily improved financial performance and long-term shareholder value.

I look forward to continuing to keep you updated on our progress and appreciate your interest and support.

Brad, over to you.

Brad Holiday: Thank you, Chip.

Consolidated net sales for the first quarter were $352 million, an increase of 22% compared to $288 million last year. Sales were adversely impacted by $6 million due to changes in foreign currency rates compared to last year.

Gross margins for the first quarter improved 160 basis points to 47% compared to 45% last year. A majority of the improvement in gross margin percentage was due to a more favorable sales mix, price increases, as well as the positive impact of several supply chain initiatives implemented last year. Included in 2013 results were restructuring charges of $2 million.

Operating expenses were $103 million, an increase of 14% compared to last year, due to increases in marketing support for new products launched during the quarter, an increase in stock compensation expense associated with a 54% year-over-year increase in the stock price, and incremental tour investment. Included in the 2013 results were $1 million of cost reduction charges.

Operating income improved 54% to $62 million for the quarter compared to $40 million last year.

We had other expense of $5 million for the quarter compared to $4 million of other income last year. This $9 million swing from income to expense was due primarily to the impact of changes in currency rates on all of our outstanding hedging contracts which are marked to market at the end of each reporting period. This resulted in a $3 million charge on hedging contracts this year compared to a gain of $8 million in 2013.

This quarter earnings per share increased 30% to $0.61 on 93 million shares compared to $0.47 in 2013 on 92 million shares.

On a product category basis, first-quarter woods sales were $130 million, an increase of 33% compared to last year (technical difficulty) the successful launch of our new Big Bertha and X2 Hot products.

Iron sales were $73 million, an increase of 29% compared to last year due to the success of our new X2 Hot irons, as well as our new premium Apex irons. Putter sales were $32 million, a decrease of 1% compared to last year due to lower unit volumes, as two new models were introduced last year compared to only one new model this year. This lower volume was partially offset by an increase in average selling prices.

Golf ball sales were $53 million, an increase of 24% compared to last year, due to the launch of our new premium Speed Regime line of golf balls and the success of our new low-compression SuperSoft line of golf balls. Overall profitability for this category more than doubled as a result of this revenue growth, along with manufacturing and supply chain initiatives implemented last year.

Accessories and other sales were $64 million, an increase of 10% compared to last year, due to an increase in sales of [packaged sets,] golf bags, gloves and headwear, partially offset by a decline in apparel and footwear sales due to the transition of North American and European apparel and footwear business to a licensing arrangement.

Turning to our balance sheet, we ended this past quarter with cash of $24 million compared to $28 million last year. Borrowings on our ABL credit facility increased to $141 million compared to $79 million last year, due to an increase in networking capital to support anticipated sales growth.

Average available liquidity was $72 million and increased as the Company exceeded the fixed charge coverage ratio covenant. Additionally, the average interest rate decreased by 25 basis points permanently, due to the Company achieving trailing 12-month EBITDA of greater than $25 million.

Our consolidated net receivables were $289 million, an increase of 13% compared to last year, due to the increase in net sales. DSOs improved by 6 days to 75 days compared to 81 days last year, and we remain comfortable with the overall quality of our accounts receivables.

Net inventories were $246 million compared to $202 million last year. A majority of this increase was planned and was due to higher levels of inventory to support a forecasted increase in sales and a distance policy change in how we distribute to one of our key accounts. The balance was due to the delay in the opening of the golf season and, as a result, lower than expected industry sales growth in the US and UK. We are comfortable with the quality of our inventory at this time.

Capital expenditures for the quarter were $4 million and we estimate full year to be approximately $15 million consistent with our previous estimate. Depreciation and amortization expense for the quarter was $6 million and it's estimated to be approximately $25 million for the year, consistent with our previous estimate.

Now, with regards to guidance, as stated in our press release issued earlier today, we are maintaining the annual guidance issued on our last conference call, with one caveat. If weather conditions continue to delay the opening of the golf season, or if the promotional activity is heavier than we currently anticipate, we would expect to be at the low end of this earnings guidance range. That said, there are a couple things to take into consideration relative to first-quarter results in context with estimated second-quarter results and our full-year guidance.

Our first-quarter results were strong, with an increase of 22% in net sales compared to last year, slightly better than we had expected. This increase is due to continued brand momentum and the trade's excitement about our new 2014 product line. While some of the first-quarter increase was factored into our annual guidance provided in January, what we didn't anticipate at that time was the slow start to the season and the resulting increase in retail inventory levels and promotional activity.

For these reasons, we believe second quarter will be adversely impacted and estimate at this time that sales will be flat to down 5% compared to last year, and that earnings per share will be breakeven to slightly profitable. So, based on the first quarter exceeding our expectations and the risk to the second quarter, we are maintaining our annual guidance at this time.

For net sales we are still projecting annual sales of $880 million to $900 million. Gross margins are estimated to improve to approximately 41.7%, plus or minus 30 basis points compared to 37.3% last year, due to the full-year positive impact of the many supply chain initiatives put in place last year, as well as the improved sales mix of premium products, partially offset by higher costs associated with new technology in our 2014 products. However, as I already mentioned, a higher level of competitive activity over the balance of the year would adversely impact those estimates.

Operating expenses are estimated to be approximately $345 million for the full year compared to $326 million in 2013. This increase is due to a planned increase in investments in tour and marketing, higher variable sales-related expenses associated with the projected increase in sales, as well as modest increases in cost of living and inflation.

Pretax income for the year is estimated to range from $15 million to $19 million, with a corresponding tax provision of approximately $6.5 million. This compares to a pretax loss in 2013 of $13.3 million, with a corresponding tax provision of $5.6 million.

Fully-diluted earnings per share is estimated to range from $0.12 to $0.16 based on 78 million shares outstanding compared to a loss per share of $0.31 on 72.8 million shares in 2013.

That concludes my remarks and we would now like to open the call for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Scott Hamann; KeyBanc Capital Markets.

Scott Hamann - *KeyBanc Capital Markets - Analyst*

Just in terms of the guidance, I'm trying to reconcile what appears to be very, very good retail sell-through numbers, almost matching what your sell-in numbers were across the globe and the implication that there really isn't going to be any sales growth for the balance of the year. So I just want to understand, I guess, at retail did something change in the month of April that made the outlook a little bit less favorable? And then in terms of the promotions, has something picked up there that we might not be seeing yet that you expect to adversely impact the business here in the next couple months?

Chip Brewer - *Callaway Golf Company - President & CEO*

No, Scott. I don't think there's anything new that you're not aware of. The markets in general did get off to a little bit slower start for the year, probably weather driven. I don't think that's a surprise to anybody on the call or around the markets. And there has been a higher than anticipated promotional environment which did start in Q2, but I assume it's fairly widely known now.

So, those factors are what creates the uncertainty and are being incorporated into the guidance for the balance of the year, despite what is clearly a very strong start to the year and very good directional performance from brand strength and market shares, et cetera.

Scott Hamann - *KeyBanc Capital Markets - Analyst*

Okay. And just to understand these international markets, I mean, the share gains were big, but the industry -- I mean, domestically here in the United States, the industry was only down a touch year over year. So, were the markets internationally worse overall?

Chip Brewer - *Callaway Golf Company - President & CEO*

The markets internationally -- UK was roughly comparable to the US, just down a touch. As you correctly identified, Datatech called the US market down I think only 1%. Many of the communications and customer contacts I am having would put that number into question. It could be a larger number than that, and I'm not sure how to reconcile those two. But you're correct, Datatech says 1% down in the US.

Japan and the Asian markets are up very slightly. So in context of a market condition that we called -- going into the year we said we thought markets would be up 2% to 4%, or the industry would be up 2% to 4%. We're coming out of Q1 a little worse than that, not tragically so. And the promotional environment is a little higher than what we'd anticipated as well.

Scott Hamann - *KeyBanc Capital Markets - Analyst*

Okay. And then just finally, to kind of tie this together, if you were to continue to see stable markets with the market share gains that you've seen in the first quarter, you would absolutely have optionality on the upside to ship more product over the next couple quarters. Correct?

Chip Brewer - *Callaway Golf Company - President & CEO*

Correct.

Scott Hamann - *KeyBanc Capital Markets - Analyst*

Okay. Thank you.

Operator

James Hardiman; Longbow Research.

James Hardiman - *Longbow Research - Analyst*

Couple questions here. So you talked a number of times about the elevated inventory levels for the industry. Can you maybe sort of compare and contrast where you are in terms of retail-level inventories and where the industry is? Obviously, it sounds like your retail sales were fantastic. So, I guess I'm trying to get at is, did you actually over-ship the first quarter, or is that mainly that all of your competition did and so you're now faced with the promotional fallout there?

Chip Brewer - *Callaway Golf Company - President & CEO*

Okay. That's a good question, James. I would not character- -- I don't believe we over-shipped, per se. We had a great quarter. Our market share gains are significant, and this is on trend for if you look at the body of our work over some period of time, with certain quarters being higher or lower than others. But we've been growing this business and gaining share now for some time.

If you look at the industry in total, it is slightly over-inventoried right now. Our position relative to the industry in total in the field is better than the industry in total. However, our field inventory is higher than it was last year, and slightly higher than we'd like it to be. Some of that is the fact that we had a very good quarter, because even though we are up significantly in market share in Q1, Q1 is a low index quarter. So if you're up 22% in revenues, even if you're up 30% in market share, you're going to carry inventory into Q2, which makes it a higher field position than where you were before.

So the industry in general got off to a little slow start. Our inventories are better than the industry, not -- a little bit, but also a little higher than last year. And as the markets open up, we're going to be watching attentively. There's obviously some level of uncertainty out there, given the market conditions as they currently exist.

James Hardiman - *Longbow Research - Analyst*

Got it. And then, along those same lines, obviously you spoke to the higher promotional environment. When I sort of put that next to all the market share gains that you guys had, I guess it sort of begs the question, do you think that some of this elevation in promotion is a response to some of the market share gains that you have had?

And I guess a lot of this speaks to whether there's just too much competition in the industry and promotions are just a natural result of somebody taking a lot of share. And you guys did that. Or do we think it's all just a weather thing and it'll pass if the weather improves?

Chip Brewer - *Callaway Golf Company - President & CEO*

Good question. We're obviously wondering those same things ourselves. My guess at it -- it's the combination of the two. So we have significant market share gains, which means -- so we took that from somebody. And at the same time, the industry started slow. So that party had a double whammy. And that probably leads to promotional activity that would be more than normal. Because, clearly, by definition market share gains would cause a shift which there will, at some point, be a reaction to. And that would be any industry.

So I think it's the two combined that probably led to a higher level of promotional activity than what we had anticipated. And I think it's a slightly higher level of promotional activity at this point than was there last year as well. But that doesn't by definition mean that it will be that way in May or June or July. It's got a lot of room between now and then to see how that unfolds.

James Hardiman - *Longbow Research - Analyst*

Makes sense. And then, just lastly, a quick housekeeping question here. Brad, can you help us with just the phasing of the tax provision over the course of the year? I think there were some -- I think the Street was generally a little bit off in terms of how we were modeling first-quarter tax. And if you talked about I think $6.5 million for the year, how does that phase over the course of the year? And if we assume that your second-quarter guide of breakeven is right, what does that assume for a tax expense?

Brad Holiday - *Callaway Golf Company - CFO*

Well, the way we had said it in the original earnings call in January on guidance was that it would sort of flow with how international -- we said look at international sales, because profitability would flow about the same and the tax provision we're talking about is really related to international. So however you've laid out the seasonality for international is about how the taxes would flow by quarter. Did that help, James?

James Hardiman - *Longbow Research - Analyst*

It does. Can you just sort of help us with maybe what does that -- I mean, obviously you have sort of a number for 2Q. Care to share that tax number with us, what's built into your number?

Brad Holiday - *Callaway Golf Company - CFO*

You know it's $6.5 million for the year. You know what the first quarter was. So you've got to figure that the second quarter is going to be a [bulk] majority, probably higher than the first quarter. And then it starts to tail off in the back end of the year for international. We're not giving specific quarter by quarter. We were just trying to have you align it more with what percent the international revenues are in the full year. I think that would get you close.

James Hardiman - *Longbow Research - Analyst*

Got it. Great. Thanks.

Operator

Dan Wewer; Raymond James.

Dan Wewer - *Raymond James & Associates - Analyst*

So, Chip, as I recall in your industry 1 percentage point of market share is worth about $50 million of revenues. And given these impressive gains, 500 basis points in the US, 650 in the UK during the first quarter, but then trying to reconcile that against no revenue growth for the balance of the year, I guess either, A, we're assuming the market size really collapses or, B, that you give back a lot of this market share gain. But it's hard to see how that happens, given the strong response that we're getting here for all of your product categories this year. So how should we go about reconciling that?

Chip Brewer - *Callaway Golf Company - President & CEO*

Dan, we're struggling with the same issues, to be candid. So our guidance is our best estimates at this point as it always is and has to be.

We would expect to give back some portion of the market share from its Q1 period through the balance of the year. And we got off to a phenomenal start. We're astronomically high, or impressively high, market shares right now. We had the benefit of launching in a slow quarter when there wasn't other -- well, our largest competitor in the golf club market did not launch at that point in time. And it was also a very low index month. So we commanded a very high percentage of the people that were going to be driving through snowstorms to buy clubs in February, drove through snowstorms to buy Big Bertha. And that speaks volumes for us.

But it also creates interesting numbers. And we think that the most important thing over the long term is to focus on the fact that we're continuing to show the ability to gain share, to grow the business. But I would anticipate some level of decline in the overall market share relative to the first-quarter numbers. I would anticipate market share gains over the full year and relative to the market in total a lot of uncertainty right now. It could go multiple ways, in my crystal ball on that one.

Dan Wewer - *Raymond James & Associates - Analyst*

On the reduced revenue outlook for the balance of the year, is that all in the US market? I'm not aware of any weather issues in Japan or Europe.

Chip Brewer - *Callaway Golf Company - President & CEO*

If you look at the markets in total, like look at Japan again, Dan. I mentioned what our growth was in Q1 on a constant currency basis. And you're familiar that Japan is a pretty significant market for us. We grew at a 51% pace on a constant currency basis in Japan. The market didn't grow at 51%. So we're going to work through that as we go through the year, and that should be factored into your consideration. Korea, 63% growth.

Dan Wewer - *Raymond James & Associates - Analyst*

[Be a] difficult comparisons. But it sounds like -- are you reducing your revenue targets for those regions compared to this conference call one quarter ago?

Chip Brewer - *Callaway Golf Company - President & CEO*

For the full year or for the --

Dan Wewer - *Raymond James & Associates - Analyst*

For about the next three quarters.

Chip Brewer - *Callaway Golf Company - President & CEO*

We are tempering -- we don't break it out by quarter for you. So in the total company we exceeded our Q1 number by, we'll call it, slightly. And we are now a little bit more conservative for the balance of the year and holding the full year.

Dan Wewer - *Raymond James & Associates - Analyst*

I think the final question I have right now regards promotional activity. You note that it's actually a little bit heavier than a year ago. But as I recall, last year, Chip, it was TaylorMade that was the first to take the prices on their premium drivers down about -- was it $100? And Callaway didn't respond until several weeks later and your first cut was only $50. But I haven't seen those type of promotions at the retailers that we visit. So --

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Chip Brewer - *Callaway Golf Company - President & CEO*

Well, right now there a buy one/get one on a brand new product that was in the field, which is a much more significant promotion than last year's small promotions that occurred in April. And you're right, last year we followed another party who led some discounting. But we followed a few weeks behind them. Right now we have not followed up any promotions.

We're not going to be completely immune from the promotions that are occurring out there, but we think that the best interests of this business in the long term for our brand strength and, in particular, to protect our strong distribution partners at GreenGrass, the PGA Professionals and other GreenGrass channel partners whose markets are just opening up now -- I mean, they're just getting out from under snow, unpacking brand new Big Bertha drivers, and X2 Hot product -- is not to follow on what are some aggressive discounting and promotions out there.

We're not going to be immune from that forever. We're going to continue to have to balance near and long term. But there has been no reaction from Callaway at this point. Others have moved more aggressively than they did last year and at least as early. And we've got to factor all of those decisions into the guidance that we gave you.

Dan Wewer - *Raymond James & Associates - Analyst*

Right. And I promise this is my last question, but just following up on that, I know Ed Stack was sounding more bearish on the golf industry. Are you -- and some of the promotions actually the retailer's going to the brands and asking for margin protection.

Chip Brewer - *Callaway Golf Company - President & CEO*

Yes. Not in any different way than has been part of this business since I've been in it, for 15 years now. So there's no new change here or there. To a degree one way or the other we partner with our trade partners when we have to change pricings, et cetera. And that's been part of standard operating procedure for as long as I've been around.

Dan Wewer - *Raymond James & Associates - Analyst*

Okay, great. Look forward to seeing you at your Investor Day. Thanks.

Operator

(Operator Instructions). Casey Alexander; Gilford Securities.

Casey Alexander - *Gilford Securities - Analyst*

Given that so much of this is weather related, would you expect the second quarter to have a greater effect on balls than it does on clubs?

Chip Brewer - *Callaway Golf Company - President & CEO*

Yes, I would, because of the consumable nature of it. So, yes, I would think that would be true.

Casey Alexander - *Gilford Securities - Analyst*

And, Brad, at the risk of having you repeat yourself, could you walk me through the market shares that you've just released? I didn't quite get them all.

Chip Brewer - *Callaway Golf Company - President & CEO*

Casey, Chip. I'll give it to you, because it was in my comments. So Japan, Q1 hard goods market share dollars was 14.8%, up 260 basis points; in the UK 17.8%, up 650 basis points; in the US Q1 Datatech hard goods dollar share 19.3%, up 510 basis points.

Casey Alexander - *Gilford Securities - Analyst*

Okay, great. Let me ask you sort of a strategic question, in that is there anything about the industry's inventory position or the promotional environment that changes your micro-launch strategy?

Chip Brewer - *Callaway Golf Company - President & CEO*

No. I don't know that it changes it. It's nice to [have it changing] because it gives me more levers going into the second half of the year, that I can move some timing around if need be or if the opportunity exists. So, we're not changing it but we're fine tuning as market conditions evolve. And the micro-launch strategy is alive and well and has been and will be part of the game plan going forward. So it exists for situations just as the one we're in.

Casey Alexander - *Gilford Securities - Analyst*

Okay, great, thanks very much. Appreciate your taking my questions.

Operator

Rommel Dionisio; Wedbush Securities.

Rommel Dionisio - *Wedbush Morgan Securities - Analyst*

Chip, I appreciate your candor on the promotional environment and I wonder how the environment [impacts] your advertising expense for second quarter. If you were to be more aggressive on promotions, would you take dollars out of advertising or keep advertising campaigns in place? I wonder if you could just give us a little more color on your response there.

Chip Brewer - *Callaway Golf Company - President & CEO*

We're keeping advertising right where it's been, which is up slightly this year. And we're still very bullish about our business, Rommel. We had a great Q1. Our Q2, we're guiding a little bit lower than we expected. Our Q1 was a little bit higher. The overall direction of this business is right on track in our view of the world. And we're going to -- if there are further opportunities that we believe will deliver a higher ROI, we'll continue to invest in them, including on incremental marketing.

But right now Harry and the team in the marketing side are all systems go and we've got some exciting things in the works. And, again, we absolutely understand the confusion of all where these metrics are moving, and some of them seem contradictory. But if you take a step back and look at the big picture, we're delighted with it.

Rommel Dionisio - *Wedbush Morgan Securities - Analyst*

Okay. And just a quick follow-up. Given your initial success in the Big Bertha launch, seems like a great launch, how do you feel about maybe line extensions, whether that's fairway woods, hybrids, irons going forward using that trademark to extend that line?

Chip Brewer - *Callaway Golf Company - President & CEO*

We've been really excited about the reaction to Big Bertha and the launch of that product. We think it's a phenomenal product. It's having success on tour, feedback from the consumers, et cetera. So it wouldn't be unlike us to look at opportunities to continue to grow that franchise. And we're also going to make sure we protect it, and only do the best products in Big Bertha and being less promotional with that product, being more premium, all fits into the mix. So you're point is well taken and we're not going to comment further on that, but we'll certainly give it some consideration.

Rommel Dionisio - *Wedbush Morgan Securities - Analyst*

Good. Thanks very much.

Operator

[Neel Tanna]; Yost Capital.

Neel Tanna - *Yost Capital Management - Analyst*

My quick question is, if you look at the implied guidance for Q2, I'm just trying to understand it, with, like, [assume] negative 5% to get the flat EPS guidance. That would kind of imply the margins would be falling 400 to 500 basis points. How do we think about that? Or should we more be thinking about the full year, relative for the full-year gross margin guidance?

Chip Brewer - *Callaway Golf Company - President & CEO*

Neel, it's Chip. Hold on just a second. Yes, it would drop relative because all the promotions we would assume the costs we'd get in Q2, depending on how competitive the environment gets. It would still be better than last year, but it would certainly be down from first quarter. Because, remember, everything in the first quarter is also in at full price and there would be some promotional expense we'd have to absorb in Q2.

Neel Tanna - *Yost Capital Management - Analyst*

Right. I think last [year] it was about 40%. So that would -- would it be better year over year?

Chip Brewer - *Callaway Golf Company - President & CEO*

Yes. Yes, it would.

Neel Tanna - *Yost Capital Management - Analyst*

Where do you think Q2 inventory levels end?

Chip Brewer - *Callaway Golf Company - President & CEO*

I think that we obviously have a lot of uncertainty, Neel, on Q2. If that hasn't come through -- I bet it has come through. But the inventory levels with decent market conditions should be fine coming out of Q2. And if Q2 goes better than expected, then it will be better than that, and worse it could be high. But right now the inventory situation isn't, even for the industry, or certainly us, which is better than the inventory, it's not -- I don't want you over-read into that. I don't think this is a long-term issue. This is just an issue that is tied into the Q2 expectation.

Neel Tanna - *Yost Capital Management - Analyst*

I mean, great work guys. And then, lastly, look forward to the Analyst Day. Appreciate all the hard work.

Chip Brewer - *Callaway Golf Company - President & CEO*

Thanks, Neel. Appreciate it. We're looking forward to getting out there and having you meet some of the team.

Operator

There are no further questions at this time. I will turn the call over to Tony Thornley for closing remarks.

Brad Holiday - *Callaway Golf Company - CFO*

How about Chip Brewer? Here's Chip.

Chip Brewer - *Callaway Golf Company - President & CEO*

Tony's not here today. (Laughter) So I'll take it. This is Chip. I want to just thank everybody for calling in and your interest in the Company. We're really pleased with our results and look forward to seeing many of you in New York in May for our Investor Day. Thanks very much.

Operator

This concludes today's conference call. You may now disconnect.