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ELY - Q3 2014 Callaway Golf Earnings Conference Call

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OVERVIEW:

Co. reported 3Q14 consolidated net sales of $169m, operating loss of $3m and loss per share of $0.01. Expects 2014 net sales to be approx. $890m and fully diluted EPS to be $0.15-0.18.

CORPORATE PARTICIPANTS

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Chip Brewer *Callaway Golf Co - President & CEO*

CONFERENCE CALL PARTICIPANTS

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Scott Hamann *Keybanc Capital Markets - Analyst*

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PRESENTATION

Operator

Good afternoon. My name is Ian and I will be you conference operator today. At this time I'd like to welcome everyone to the Q3 Callaway Golf Earnings Conference Call.

All lines have been placed on mute to prevent any background noise. After the speakers' remarks there will be a question and answer session. (Operator Instructions. Thank you.

Brad Holiday, you may now begin your conference.

Brad Holiday - *Callaway Golf Co - CFO*

Thank you, Ian. I would like to welcome everyone to Callaway Golf Company's Third Quarter 2014 Earnings Conference Call. Joining me today 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 and we 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 relating to the estimated 2015 or 2014 net sales, sales growth, gross margins, operating expenses, pretax income, tax provision, earnings per share and profitability, future industry or market conditions or market share gains, the success of the Company's future products or the Company's recovery and brand momentum, future operating efficiencies or investments 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 31st, 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 on a consistent and comparable basis, we will provide certain non-GAAP information. This information, as applicable, excludes charges related to the Company's prior cost reduction initiatives and the impact of the businesses that were transitioning to a third-party licensed model.

We provide certain of the Company's results in a constant currency basis which essentially applies the prior period exchange rates to the current period results. For comparative purposes the non-GAAP income and earnings information assumes a 38.5% tax rate.

We also provide information on the Company's earnings excluding interest, taxes, depreciation and amortization expenses and impairment charges. This non-GAAP information may include non-GAAP financial measures within the meaning of Regulation G.

The information provided on the call today and the earnings release we issued today include 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 Relation 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 Co - President & CEO*

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

Q3 was another excellent quarter for our Company. Despite challenging market conditions, Callaway Golf Continued its trend of improved market share, tour success and operating efficiencies. On the strength of this performance we are raising our guidance for the year. I believe this is clear evidence that our turnaround plan is working and I'd like to start by thanking the Callaway Golf Team for their hard work and commitment to turn 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.

Turning to our results, Callaway Golf's total revenues for the quarter were down 5% but are up about 5% year-to-date. We believe our year-to-date performance is significantly better than the industry overall.

The US had a strong quarter with revenue growth of 11% and is now up 6% year-to-date. On a constant currency basis Europe was down 14% and Japan was down 23% for the quarter reflecting challenging market conditions and shift to new product launch timing.

All three of these large markets are showing year-to-date constant currency revenue growth and are expected to show further growth for the full year. In addition, we have had strong revenue growth this year in important mid-sized markets such as Korea and Australia.

During Q3 we launched the Big Bertha V series driver which has met our sell through expectations thus far and has notched an impressive five wins on major tours over the last three months. We also launched the Big Bertha Beta woods in Japan which are off to a strong start and should allow us to improve our position in the super-premium area of that market.

Importantly, our market share continues to show growth year-to-date. Looking at our largest markets, in the US our total hard goods share through September was at 18.8%, up 360 basis points year-over-year.

Japan through September was at 14.7%, up 20 basis points and the UK through August was at 18.3%, up 370 basis points.

Highlights include us regaining the number one position of hard goods brand in Europe for the last five consecutive months sustaining our position of number one selling American brand in Japan and earning the number one selling fairway wood brand in the US for July, August and September. We also sustained a number one putter position worldwide.

It's been a while since Callaway has contended for so many number one positions. We are proud of this progress and believe it bodes well for our future. On top of this our operating efficiencies, as evidenced in our gross margin as well as our overall cost management, continue to show excellent progress.

Looking forward, the industry outlook for Q4 is improving thanks to new product launches from both us and others which are expected to attract consumer attention. Our internal expectations mirror this outlook and as a result we are increasing our full-year earnings guidance to earnings per share of $0.15 to $0.18, up from $0.12 to $0.16 previously.

We are reiterating revenue guidance of approximately $890 million which if realized would be at constant currency growth rate of 7% for the year and 11% for Q4.

During Q4 we will be launching the Big Bertha Alpha line of drivers which join our Big Bertha V series line to make up our most premium wood offering for 2015. By utilizing our advantage of multi-material technology we are creating three past editions which provides a sophisticated fitting based approach to performance in our most premium brand.

We are also launching the Big Bertha line of irons and hybrids in the western markets as well as the Big Bertha Beta irons and hybrids in Japan. Both of these iron sets feature a new 360 degree cup-faced construction similar to what we've used in our fairway woods and hybrids over the last few years which greatly increases ball speed and overall performance.

Our internal testing shows up to two clubs longer overall distance with no negative trade-off. We're excited about these launches and we believe this new cup-faced technology in irons is technically superior to anything in the market and should open up new growth opportunity for us in this important category going forward.

Looking further forward, we are expecting 2015 revenue growth of approximately 1% to 2% on a consolidated basis driven by constant currency revenue growth of 5% to 6% in our four channels. Factored into this estimate is continued market share growth and improved market conditions offset by foreign exchange changes, anticipated retailer conservatism during the first half of next year, a strategic shift in launch timing for our premium wood business which will negatively impact next year's Q1 comparison but benefit the Company in the long run and a reduction of close-out volume year-over-year.

We are not prepared to provide earnings estimates at this point other than to say we do expect further improvements commensurate with the level of revenue growth as well as continuing our improvements in operating efficiencies offset by normal cost inflation in further strategic investments back into our tour and marketing.

As has been our practice, we will provide more detail on 2015 during our January calls.

Returning to the present, our 2014 year-to-date performance and Q4 guidance would result in the first full-year net profits since 2008. Highlights include significant market share gains in all key markets. In the US alone our hard goods share has increased 35% since 2012.

These share gains have been driven by clear ability to drive innovation, a strengthening position on tour and improved marketing which has also supported a marked improvement in our overall brand rating. We have combined these revenue drivers with improved operating efficiencies including both gross margin improvement and operating leverage. As a result, we are confident that we are headed in the right direction and optimistic for our future.

Our turnaround plan is absolutely on track and other than external factors we have been exceeding our initial expectations, especially relative to market share growth and operating efficiencies. I look forward to continue to keep you up to date on our progress and I appreciate your interest and support. Brad, over to you.

Brad Holiday - *Callaway Golf Co - CFO*

Thanks, Chip. Our results through the first nine months were as follows. Consolidated net sales were $752 million, an increase of 5% compared to a $716 million last year. Sales were adversely impacted by $4 million due to changes in foreign currency rates compared to last year.

On a constant currency continuing business basis which excludes Europe's 2013 apparel sales, year-over-year sales growth would have been 7%. Regionally sales increased 6% in the US to $372 million while our international sales were $381 million, an increase of 4% on an as reported basis and 6% on a constant currency basis.

Details by region are included in the attachment to today's press release. Gross margins improved 280 basis points to 43% compared to 40% last year. The majority of the improvement was due to favorable pricing and sales mix as well as improved operating efficiencies partially offset by the adverse impact of foreign currency rates. Included in 2013 results were restructuring charges of $7 million.

Operating expenses were $251 million, flat compared to last year despite incremental investment in tour and marketing which were offset by tight cost management and the positive impact of FX rates.

Included in 2013 results were $3 million of cost reduction charges as well as $4 million charge for bad debt.

As a result of these factors, our cumulative operating income improved 100% to $70 million compared to $35 million last year. We had other expense of $9 million compared to $1 million of other income last year. This $10 million swing from income to expense was due primarily to the impact of changes in currency rates on all outstanding hedging contracts which for accounting purposes are revalued using current rates at the end of each quarter.

Cumulative net income increased 88% over last year to $58 million and earnings per share increased 83% to $0.66 on 93 million shares compared to $0.36 in 2013 on 87 million shares.

For the third quarter, consolidated net sales were $169 million, a decrease of 5% compared to $178 million last year due to continued industry softness and a shift in product launch timing, a majority of which was related to Asia specific product launch during the third quarter of 2013.

Regionally sales increased 11% in the US to $75 million while our international sales were $94 million, a decrease of 15% on an as reported basis due primarily to Japan which declined 28% due to a shift in new product launch timing and a weaker yen.

Gross margins improved 540 basis points to 39% compared to 33% last year. This improvement was due to less promotional activity compared to last year, a favorable sales mix and operating efficiencies. Included in 2013 results were restructuring charges of $1 million.

Operating expenses were $68 million, a decrease of 11% compared to 2013 due to a reduction in bad debt expense, a decrease in stock compensation expense due to a lower stock price and lower marketing expense due to a shift in new product launch time. Included in 2013 results were $1 million of cost reduction charges.

We incurred an operating loss of $3 million for the quarter which was a significant improvement compared to a loss of $17 million last year. We had other income of $2 million compared to other expense of $3 million last year. This $5 million swing to income was due primarily to the impact of changes in currency rates on all outstanding hedging contracts.

We had a loss per share of a penny for the quarter on 78 million shares which was a significant improvement compared to a loss per share of $0.32 last year on 73 million shares.

Through the first nine months we had sales growth compared to last year on a majority of our product categories as follows; wood sales were $234 million, an increase of 6% compared to last year due to the successful launch of our Big Bertha and X2 Hot products earlier in the year as well as our most recent introduction of the V series models.

Iron sales were $162 million, an increase of 9% due to the success of our new premium Apex Irons and Mac Daddy 2 wedges as well as a small amount of our new Big Bertha Irons which shipped during the quarter.

Putter sales were $72 million, a decrease of 2% due to no major product launches this year.

Golf ball sales were $117 million, an increase of 5% due to this year's launch of our premium Speed Regime line of golf balls and the success of our Low Compression Super Soft line of golf balls. Overall profitability for this category has increased significantly as a result of this revenue growth along with improved operating efficiencies.

Accessories and other sales were $168 million, an increase of 3% compared to last year due to an increase in sales of package sets, headwear and golf bags partially offset by decline in apparel sales due to the transition of the Company's European apparel business to a licensing model at the beginning of the current year.

Turning to our balance sheet, we ended this past quarter with cash of $33 million, a slight decrease compared to $37 million last year. We had no outstanding borrowings on our ABL credit facility. Average available liquidity for the first nine months was $78 million. Also, our trailing 12-month EBITDA improved to $44 million, an increase of $36 million compared to $8 million for the same period last year.

Our consolidated net receivables were $143 million, a decrease of 9% compared to last year due to lower third quarter sales with DSOs improving by three days to 78 days compared to 81 days last year. We remain comfortable with the overall quality of our accounts receivable.

We continue to see benefits in inventory management as a result of internal process improvements with inventory levels trending positively from increases of 22% and 12% respectively in the first and second quarters compared to last year to a decrease of 3% to $186 million at the end of the third quarter. The first half increases were due to the slow start of the season and improvements in our internal forecasting process that allowed us to react quickly and bring inventory back in line. We remain comfortable with the quality of our inventory at this time.

Capital expenditures for the nine months were $9 million and we estimate full-year to be approximately $14 million, slightly lower than our previous guidance of $15 million.

Depreciation and amortization expense was $16 million year-to-date and it's estimated to be approximately $22 million for the year, an improvement compared to our previous guidance of $25 million.

During the quarter we purchased $1 million or 132,000 shares of stock as part of our $50 million share repurchase plan approved in August. While we don't as a policy provide any future forecast on share repurchases, any decision we make to repurchase stock in the future will be based on market conditions, other potential uses of cash as well as any regulatory and legal requirements.

Now with regards to our business outlook given third quarter results, we are adjusting our annual guidance as follows; net sales are estimated to be approximately $890 million. On a constant currency continuing business basis this represents an increase of 8% compared to last year in addition to the 14% growth we achieved in 2013.

Gross margins are estimated to be approximately 41%, slightly lower than our last estimate of 41.7% due to unfavorable FX rates. Our current forecast is still a significant improvement compared to 37.3% last year due to improved operating efficiencies, better pricing and sales mix and a decrease in charges related to cost reduction initiatives.

Operating expenses are estimated to be approximately $336 million for the full year, an improvement of $9 million compared to our previous estimate of $345 million due to favorable impact of FX rates and lower stock compensation expense associated with our current stock price.

Pretax income for the year is now estimated to range from $18 million to $20 million with a corresponding tax provision of approximately $5.6 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 now estimated to range from $0.15 to $0.18 based on 78 million shares outstanding compared to a loss of $0.31 on 72.8 million shares in 2013.

We would now like to open the call for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). And your first questions comes from Lee Giordano with CRT Capital.

Lee Giordano - *CRT Capital Group - Analyst*

I was hoping you could give us an update, Chip, on what you're seeing out there in the promotional environment overall and I guess overall in what you're seeing in terms of rounds played and any new trends in the industry, and then also maybe update us on the inventory levels in the channel as well. Thanks.

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

Yes, good questions. The market was promotional during Q3, Lee, but at a level that we had anticipated and the outlook going forward is starting to improve a little bit. I'm optimistic that Q4 is going to be a stronger quarter for the industry. There will still be some promotional activity. There always is but the levels seem to be mitigating to a degree and commensurate with that inventory levels out in the field are improving. They were a big issue for the industry going into the year and I think the trade has made good progress working through that. Not all the way through it yet but good progress and lessening issue.

Rounds played were down significantly earlier in the year, particularly in the Americas. That was poor early weather and they have improved slightly more recently and so again what we're seeing is, I believe, is a return to more normalized market conditions.

Lee Giordano - *CRT Capital Group - Analyst*

Great, that's helpful and then just secondly, you talked in the press release about a strategic change in product launch timing for next year. Can you just describe exactly what that refers to? Is that their earlier launch of the Big Bertha Alpha 815 or is there something else? Thanks.

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

No that's exactly what it is, Lee. We made a decision internally to segment our launches and shift the timing of the Big Bertha Super Premium product launch away from the timing in Q1 where it would overlap with our other big launch which is their X line-up. And we think that there are benefits to that over the long term. It will allow us to focus on them more individually.

If you look at history, when you launch a premium and super premium at the same time, it's sometimes challenging to provide appropriate focus to both and usually only one cuts through. So we looked at that, said that we think there is a better way and we've made that move this year and the entire Big Bertha driver line-up was effectively shifted into Q4 of this year. And so that's exactly what is referring to and we think that's going to be a positive for the long run.

Lee Giordano - *CRT Capital Group - Analyst*

That's helpful and then my last question is on FX rates for 2015 can you just talk about the hedging program you had in place for next year? And it looks like sales may be hit but would the bottom line also be hit by the changing FX for next year? Thanks.

Brad Holiday - *Callaway Golf Co - CFO*

Hi, Lee, this is Brad. Yes right now the guidance we provided just assuming spot rates where we are roughly middle of this month. Our hedging program really occurs in the very early part of the year when we will take a look at the currency rates relative to where we're guiding and where we think our year is going to turn out in terms of our budget and our forecast. And what we try to do then is lock in a majority up to probably 70% in all major currencies just to try to reduce the volatility.

So the problem you get into is when you do hedging if we started to hedge today giving the accounting rules of marking-to-market, if you saw a big swing, which we did a year or so ago, you would take all the gains or losses and still this year you wouldn't get any benefit next year. So our plan is really first week or so Japan will lock rates in all the major currencies.

Lee Giordano - *CRT Capital Group - Analyst*

First week to January?

Brad Holiday - *Callaway Golf Co - CFO*

In January.

Lee Giordano - *CRT Capital Group - Analyst*

Great, thank you. That's helpful, thank you.

Operator

Scott Hamann, Keybanc Capital Markets.

Scott Hamann - *Keybanc Capital Markets - Analyst*

Just a couple questions on the 2015 preliminary guidance you put out, just kind of thinking about the leverage that you would anticipate getting on those sales, I know there's a lot of kind of puts and takes and then gross margin potentially a little bit lower than you had anticipated this year due to some clearance activity and then OpEx talking about pulling forward some tour spend this year and hopefully seeing leverage next year. Can you kind of talk about what your expectations should be for a leverage profile and operating margin basis next year and just maybe high level with some of the puts and takes to think about would be?

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

Sure, Scott, but only in a big picture basis at this point, we're not at a point now where we're going to be able to provide much guidance or insight on the earnings side of next year other than, as we said, we do expect further improvement in earnings. It will be we anticipate there will be some improvements more than our revenue growth but revenue growth should be factored into that as well as FX and further investments etcetera.

You have seen us improve our operating efficiencies. We expect to be able to continue to be able to do that next year but we're also expecting to continue to make investments into tour and marketing in 2015 so unfortunately I don't think I can provide you much more than the puts and takes at this point which I believe you already are aware of.

Scott Hamann - *Keybanc Capital Markets - Analyst*

But, Chip, would you think it's unrealistic to get the kind of operating leverage next year that you saw this year based on where your guidance is right now?

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

The in terms of our -- you know, I am not going to be able to quantify but that so we expect to continue to improve our earnings next year. We expect that we've got ability to drive both gross margin improvements but in terms of quantifying those at this point, that's ahead of where we are right now.

Scott Hamann - *Keybanc Capital Markets - Analyst*

Okay and then in just looking at third quarter, fourth quarter this year, it seems like sales might have shifted a little bit more into third quarter versus fourth quarter. You talked about them being kind of even I believe last quarter and then similarly it looked like some of the operating expenses were a little bit light this quarter. Is there a shift kind of going on maybe around the product launches that may be shifting some of those expenses into fourth quarter?

Brad Holiday - *Callaway Golf Co - CFO*

Yes. Hey, Scott, this is Brad. Yes sales shifted a little bit between quarters. I mean that just happens as we get kind of towards the end of quarter. Some stuff we might have available to shift and so we kind of look at kind of longer term so we're still comfortable really with the kind of second half sales. The OpEx kind of quarter-to-quarter once again we look at OpEx really on an annual basis if you will and our overall OpEx, as you noted, dropped about $9 million. You will see an increase in OpEx in fourth quarter, which is really aligning, if you will, our marketing spend against our new product launches. That's really the biggest movement but I think on an annual basis we saw some continued improvement, if you will, in OpEx compared to our last workout but I think second half came in reasonably close to what we had thought other than a little bit of shifting between the quarters.

Scott Hamann - *Keybanc Capital Markets - Analyst*

Okay and then just on your EPS guidance for the year, does that contemplate any additional currency hedge gains in the fourth quarter?

Brad Holiday - *Callaway Golf Co - CFO*

That assumes -- no. It assumes whatever spot rates are now so if the currency stays right where they are everything is built in and we would have technically mark-to-market all of our contract hedges at the end of the quarter. There might have been a little bit from the end of the quarter to the middle of roughly this month but not much.

Scott Hamann - *Keybanc Capital Markets - Analyst*

Okay thanks.

Operator

James Hardiman, Longbow Research.

James Hardiman - *Longbow Research - Analyst*

Thanks for taking my call. Just maybe, Brad, on that last question about the hedges, I guess when I do this math to get to your net income number or your pretax number, I need to sort of build in a pretty decent sized other income benefit. Am I doing that math right?

And then I guess the other piece, it also I think your guidance for the full-year suggests that gross margins are going to be down pretty meaningfully in the fourth quarter. It seems like the answer to most of these things is just currency but how should we think about that?

Brad Holiday - *Callaway Golf Co - CFO*

Well, I think if you take a look at kind of year-over-year margins, we are certainly up relative to last year, James, I mean significantly. I think if you take a look at other income, it will be better than it was last year. I think last year there were some improvements in currencies where our other income was really other loss, if you will, other expense and it was larger than we're anticipating at this point in time so you will see some shift there kind of year-over-year.

James Hardiman - *Longbow Research - Analyst*

So I just want to make sure I understand. Then year-to-date other income is an expense of close to $9 million so you're going to need to reverse the entirety of that to get closer to even in the fourth quarter, is that right? I mean it seems like there's a big hedge game there.

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

No. We're not assuming any -- the hedge gains or losses to speak of in our Q4 numbers.

Brad Holiday - *Callaway Golf Co - CFO*

Yes the way to look at that, James, is if you should take our contracts right now the remaining contracts they are right now mark-to-market at whatever the spot rates are. For all practical purpose we're at the end of the quarter, okay. If the currency does not shift between now and the end of the quarter and we're assuming just spot rates, there shouldn't be any gains or losses on that but it will be better than last year because we had some hedged losses last year in the fourth quarter. So does that make sense?

James Hardiman - *Longbow Research - Analyst*

It does. I guess maybe my math is just a little bit off here. So I guess sort of next question here I mean as we look to 2015 and we appreciate the color as early as it is, can you maybe speak to the commentary about retailer conservatism in the first half of next year? What are you seeing there? How are those conversations going? What do you think it would take for them to reverse course on that front or is that just sort of the new normal that we need to deal with here?

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

I think this is first of all just a short-term issue. The industry as a total and fortunately Callaway has been successful in bucking this trend, has struggled a little last few years and the retailers are struggling. They've been working to decrease inventories over the last two years, this year aggressively, and so they're going to be conservative or a little bit gun-shy going into next year and some of them are also still working on reducing their overall inventories although as I mentioned in one of the answers to the previous question they are making good progress against that and so I think there is a realistic probability that they will be a little bit more conservative than normal going into the year but what history shows is the sun shines like it usually does that time of year and we get average weather an things materialize that it will revert to a more normal situation pretty quickly but it will impact I think the beginning part of the season.

James Hardiman - *Longbow Research - Analyst*

Great and then last question, just on discounting this year and I know we always get ourselves into trouble as we sort of continually seek the normalized year but any sort of guidepost with respect to how much discounting hurt your numbers this year and I guess is there any hope that we won't have a similar set of circumstances as we get into the late spring and early summer of next year?

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

You know, there's no doubt that our results were injured by market conditions and aspects over the last few years and I can't quantify those all for you at this point but I'm sure they were significant impacts. I'm proud of this team and its ability to deliver good results and drive the change process that we've been able to do in face of that and I think that speaks volumes about the strength of our game plan and our abilities here. And yes I have a lot of hope going forward regarding both this business and the industry. The -- as I've stated previously, I think the majority of what we've seen are fairly normal issues and factors here. In other words, there was the excess inventory, a lot of excess inventory in the field, going into a year whereas the season started out very slow because of weather and that had a very predictable result.

We are not hearing anything leading us to anywhere near the same type of a conclusion going forward. We're hearing more and more talk from retailers and through those retailers of others in the industry being much more rational in their approach to how much inventory to create and to carry. Obviously weather tends to normalize so there are good reasons for optimism and I also think that we've demonstrated we can be successful with or without that, although I will go on the record as saying I'd like to try it with the wind at my back just for once to see what it feels like.

James Hardiman - *Longbow Research - Analyst*

That's very helpful. Thanks, guys.

Operator

Dan Wewer, Raymond James.

Dan Wewer - *Raymond James - Analyst*

First question, do you still think that an 8% operating margin rate for Callaway is achievable? No time line on that but is that still achievable and if so is the current 18%, 19% market share sufficient to give you the leverage you need to reach that 8% operating margin rate?

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

You know, Dan, we still think that a well-run golf company can achieve 7% to 8% operating margins and so therefore we're still holding ourselves against those goals. The timing of that has been impeded by FX and some of the market conditions. We aren't sure if -- what that market share number is that will drive those numbers. We will -- we could use more revenue and therefore that market share question is so tied together with market growth or what a normalized market would be that they're in effect inseparable but there's no question that we've been impeded by some of these factors. We think these factors are short-term and we haven't changed our goals but clearly they're taking a little longer than what they would have otherwise taken.

Dan Wewer - *Raymond James - Analyst*

And so back in 2008 I recall that Callaway's market share was in the high teen rate and it was sufficient to reach that 8% operating margin plus back then you had some low margin businesses that disposed. Do you think that you would actually be running at around that 8% rate if you did not have these insane promotional activities from some of your competitors and the weather challenges that we had in 2014?

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

2008, do you -- Brad, do you remember what our revenues were?

Brad Holiday - *Callaway Golf Co - CFO*

$1.1 billion.

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

$1.1 billion.

Brad Holiday - *Callaway Golf Co - CFO*

[$1.25 billion], something like that.

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

Put me at $1.1 billion. I'll--

Dan Wewer - *Raymond James - Analyst*

Yes but -- so back then you had [headwear] and apparel and GPS devices and--

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

A little bit, you know, they added roughly less than $100 million of that business that was in those categories and so the world has changed since 2008 and this industry as in most others, we're still very optimistic about our future. I think our track record speaks for itself directionally and but what obviously 2008 I wasn't here so it's a little bit hard for me speak from an accurate perspective on those but there are some pretty fundamental changes relative that time period.

Dan Wewer - *Raymond James - Analyst*

Just a couple of questions regarding competitors, first does it with the management changes at Nike Golf do you think that they are finally becoming serious about trying to significantly grow their share?

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

I think Nike has been serious about it and they're obviously an incredibly powerful company and I am not going to speculate on any impact of management changes there other than we've got a lot of respect for them and pay attention to them as we do all others.

Dan Wewer - *Raymond James - Analyst*

I guess you may not answer this one but the changes at Taylor Made, do you sense that they're going to increase their focus on margin this year, which would benefit everyone else in the sector? Or do you think that they're still really laser focused on market share and willing to promote to achieve that?

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

I don't think it's helpful for me to speculate on any individual company or management team. It is interesting that there's been so much change on the management side throughout the industry over the last few years. I think I can guess what it correlates with. Again, I am proud that this team has been able to buck that trend. I am confident that our team is continually strengthening and I like our chances going forward but I am very respectful of what I think is increasingly strong competition out there.

And the other point I'll just reiterate is I do think that there are some positive signs for the industry in total and the approaches that I am hearing being relayed through customers and in general out there so reason for optimism on that front but most of our issue is relative to our own abilities and our competition is certainly strengthening independent of any management changes. That is not intended to reflect on any management personnel and competitors past or future or in any way shape or form. They're just getting better and we are too.

Dan Wewer - *Raymond James - Analyst*

Okay and here's the final question. On trying to reconcile the -- this comment about 2015 full-year sales 5% to 6% in the core channel business but then kind of walk me down to the 1% to 2% consolidated. Is that all due to foreign exchange or are you saying 5% to 6% underlying growth but then you have to subtract out the fact that you made full forward so Big Bertha business in 2014?

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

Yes it's 5% to 6% in our core channel so the -- and core channels is a bit of a nebulous term but it certainly includes green grass, specialty retail and premium sporting goods. Those are core for us and we expect to continue to gain share next year and continue to grow at a reasonable clip in those markets. We are going to be impeded by FX if current spot rates prevail and we also have a reduction of close out that we refer to. Some of that reduction of close out is ongoing improvements in our operating efficiencies as we work down excess inventories in older products.

There was also a significant difference relative to this year in that we had a lot of products that had been under the RAZR trademark and we've used that RAZR trademark for multiple years here at Callaway. That was not a trademark we owned. We licensed that trademark. The license expired and we had until September of this year to sell that product or we could no longer sell it and so that caused an increase in closeout business this year that we will not anniversary next year.

Don't be -- it was a quarter issue. It wasn't per se an issue for the quarter; that has been a project that we've been working on here for a year. It certainly spread a lot throughout the year and you're always seeing in a turnaround as we improve our working capital efficiencies you're going to see us diminish the amount of closeouts but there was a more marked change relative to it's going to be impactful for this year over next. Unfortunately we're not going to quantify that for you at this point but it's other than just to let you know that's part of the story.

Dan Wewer - *Raymond James - Analyst*

Okay well I appreciate all the time spent. Thank you.

Operator

Andrew Burns, D.A. Davidson & Co.

Andrew Burns - *D.A. Davidson & Co. - Analyst*

Good afternoon. Hey, Chip and Brad, congratulations on year-to-date performance. I was hoping that we could spend a little bit more time on the retail conservatism you highlighted, trying to get a sense of how significant this phenomenon is and on the last call you talked about the potential for some long-term inventory discipline emerging in retail. When you highlighted the retail conservatism it sounded more like a short-term phenomenon on this call. I am just trying to just figure out the sort of the magnitude and time line here.

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

Andrew, I think it was worth mentioning but I wouldn't think it's hugely significant so what you're seeing in general is just that there was excess inventory in the world and as people pull that inventory down, it has a near-term effect and we have -- believe some of that continued through the first buying period of next year so all we're trying to do is articulate that same fact they have made good progress. I'm pleased with what I'm hearing from our largest customers in terms of how much progress they've already made on addressing inventory issues and so it's worth noting but I would not dwell on that point. It will lead to a little bit of year-over-year comparison issue potentially for the industry in Q1 but not a dramatic thing.

Andrew Burns - *D.A. Davidson & Co. - Analyst*

Great, thanks for the color there. And then sort of a higher level question in terms of the cadence of new products launches, this fall we've got the Bertha launches that you also have the Nike Vapor, the Taylor Made RSi's. It seems like with each sort of off season each fall this becomes a more important period for product launches. Is that just how it will be going forward? Could you comment on that?

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

You know, I think that the fall is a reasonable time to launch. There have been successful launches in the fall for many years. Ping and Titlist are launching in the fall. They do that every two years. This is one of those years and so -- and we made a strategic change in launch timing so there's more chatter about it in the blog than among the enthusiast community. I'm not sure how dramatic the change really is because from time to time in the past Callaway has launched in this time period. From time to time in the past Taylor Made has launched in this time period. Ping has alternated between this time period and Q1 in the past. It's there's not a from my viewpoint I'm not sure it's a dramatic a change as others are viewing but there is definitely a heightened sensitivity in the channel and among the enthusiasts regarding inventory and launch cadence and hence it's getting a lot of conversation.

Andrew Burns - *D.A. Davidson & Co. - Analyst*

Okay thank you; good luck.

Operator

Casey Alexander, Gilford Securities.

Casey Alexander - *Gilford Securities, Inc. - Analyst*

Most of my questions have been answered but as it relates to the statement that change in product launch timing will adversely impact the first quarter 2015 sales, I mean do you have a range of values for that in terms of some sort of a range of how you expect the first quarter to sort of compare to last year? I mean the one thing I do know is the analytical community left to their own devices will screw it up without something that gives them at least some definition.

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

Yes, Casey, that's a great question and you'll have to defer that one. We'll come back to you and give you some color on that when we give the rest of the annual guidance in January so you're ahead of both desire and abilities to nail that down. We did just want to call out that there could be some comparative thinking relative to Q1 that will have to happen at some stage.

Casey Alexander - *Gilford Securities, Inc. - Analyst*

Okay secondly, how does the change in the tour schedule affect one, product launch; two, tour signing contracts? And does it negatively affect the ability to get guys to change midseason whose contracts are on an annual basis?

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

It is a little bit, Casey, so it's awkward. You know, you identify some interesting points so the offseason is mighty short. It's like Christmas week now and the buyers sometimes they want a change and their contracts aren't up and the contracts are still mostly or almost entirely on annual basis so it creates some tension points at that you identified there. We're working through it because we are continually building momentum on tour and as I've been up front, we're continually investing there and I expect to continue to do that into 2015. Has not impeded our ability to achieve our goals but it requires a flexibility and deftness of touch because you get somebody coming off the web and they get off to a good run, they're not going to want to change clubs in the middle of the season that is just because the calendar switched from December to January but that's when the contract periods come up.

Casey Alexander - *Gilford Securities, Inc. - Analyst*

Yes well, I mean in fact the 2014 PGA or 2015 PGA tour season has already begun.

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

Yes that's exactly right and we have contracts with players that are currently wearing other headwear and playing other clubs that are going to be changing to ours in January and that is interesting.

Casey Alexander - *Gilford Securities, Inc. - Analyst*

Okay as it relates to the fourth quarter guidance, given the impact on operating expenses in the third quarter and looking at the amount of sales necessary to get to your sales figure, I'm coming up way, way short on the expenses necessary to get to $336 million and that you alluded it to aligning some marketing spend in the fourth quarter. I mean is it marketing? Is it tour contracts to get guys to switch? I mean because there's a lot of dough that isn't necessarily accounted for right now in the current year's run rate of operating expense and it doesn't get you to $336 million.

Brad Holiday - *Callaway Golf Co - CFO*

Yes it's marketing. They're all system comparative issues too in the current year-to-date numbers so as you -- at least as you compare year-over-year, which may not be relative for the math you're running, but what -- Casey, this is Brad. I think if you take a look at the second half, try to look at it because there are lots of puts and takes between quarters, I mean our expenses will be up more than they were last year offset a little bit by currency but in a pure dollar amount they'll be higher. But you have to balance both Q3 and Q4 because there are some puts and takes within the quarters so if you just take a look at the second half, I think it looks a little more reasonable but there is certainly some timing that goes on between quarters.

I mean just case in point if you take a look at just stock compensation expense with our stock price dropping a lot at the end of the third quarter, we got a big positive there but if you assume stock prices go back up to say at the beginning of the quarter, they'll be expensed there so it's a little bit of shimmy between quarters. So if you take a look at the second half I think you'll see that they're up slightly relative to last year and are getting a little bit of benefit from currency so they'd be up a little bit more consistent with some incremental marketing expense.

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

Yes and (inaudible).

Casey Alexander - *Gilford Securities, Inc. - Analyst*

(Inaudible).

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

Well, we'll nail this down a little bit more on the one-on-one later on.

Brad Holiday - *Callaway Golf Co - CFO*

Yes.

Casey Alexander - *Gilford Securities, Inc. - Analyst*

All right that's all my questions. Thanks very much.

Operator

Rommel Dionisio, Wunderlich Securities.

Rommel Dionisio - *Wunderlich Securities, Inc. - Analyst*

Yes thanks very much, good afternoon. You know, Chip, I wonder if you could just talk a little bit about pricing in the industry? I know you cite that as the last couple of quarters as being a real driver for gross margins and I was just seeing that I realize it's October. It's late in the season but I was seeing some of the [$499 drivers] or other than the season marked down. Are your -- do you think the industry can really break beyond that $399 premium price point drivers, $999 -- I wonder if you could just talk about that with some premium new products that are coming out?

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

Sure, Rommel, great question, yes I do. You know, that's one of the things that I am really proud of this brand and team's ability to change. The Apex irons were $1,100 set of irons but they were beautiful. They performed as advertised and they've sold through wonderfully. We have helped our gross margins by building wonderful products and also raising prices for those products commensurate with the value we're providing and we think that we'll be able to continue to do that within reason so you see a gradual shift in average selling prices.

One of the things that I am very proud of on this team is our average selling price in the field has gone up significantly over the last several years. Our turn rates are beating the industry average. Our inventory is in good shape and we're obviously gaining market share so the consumers seem to like it so we believe we can build value into the product and raise prices and still provide value to the consumer.

Rommel Dionisio - *Wunderlich Securities, Inc. - Analyst*

Great thanks very much.

Operator

John O'Neill, Imperial Capital.

John O'Neill - *Imperial Capital, LLC - Analyst*

Last quarter you indicated that you expected a similar contribution from new products in the back half of this year compared to last year. Is that changed now with the Big Bertha 815 or had you previously anticipated that?

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

We had previously anticipated the 815 but the interest in our new product has been positive so we're going to -- we would probably revise that and say it's going to be a little higher this year than next, than last year now. It's not because we added any launches. We didn't change anything in our strategy. It's because launches are being received well and despite the FX movement which would have changed our guidance adversely, we were able to hold the revenue guidance and raise the earnings guidance.

John O'Neill - *Imperial Capital, LLC - Analyst*

Right and then with respect to this year you mentioned you had a good benefit from pricing in mix, maybe just to dive into that a little more, if wood sales are up 6% year-to-date and irons 9%, how much of that might be volume as opposed to pricing or mix?

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

It's not because -- and it's not -- you know, we can't just raise prices. That would be a very short-term strategy with a very certain ending. What we're doing is leveraging R&D team and the marketing changes to build products that can justify higher prices. When we do that we're not afraid to charge for them in the consumers seem to enjoy the change.

John O'Neill - *Imperial Capital, LLC - Analyst*

And your share gains prove that it works so good job. Thank you.

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

Yes it really does and then you balance that with inventory management. It's a strategy that's different than others have used in this industry most recently and we like some opts.

John O'Neill - *Imperial Capital, LLC - Analyst*

Thank you very much.

Operator

Victoria Konstantinova, THB.

Victoria Konstantinova - *THB - Analyst*

Thank you for taking my question. I was real impressed by the 11% role in US given the whole industry [shifts] here. I mean can you give us more color on where is there any shift from the Q4 coming to this quarter and then how do you look at Japan and UK going forward?

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

Sure, Victoria, thank you. Yes I was very impressed with what the team was able to do in the US as well. No, no not a real shift between quarters in the US so it was all good operating performance and significantly beat the market because the market we believe was down so just a great job to that team. If you look at UK and Europe, wonderful job by that team over the last year or so; they've returned that business to the number one hard goods selling position which is an amazing job. That market had challenging market conditions during Q3. You see that in those numbers but we're optimistic going forward.

We expect to have a very good year there and Japan has just been an extremely well run business for us, again challenging in Q3 , very strong for the year and it's building on a 26% revenue growth last year so -- and then we have new product that we put out in the market recently with Big Bertha beta which is off to a good start there so the Japan market is probably not a growth market overall but our team is doing a great job and Europe, same story. We're pleased with what we've been able to accomplish and have a decent outlook through the bout.

Victoria Konstantinova - *THB - Analyst*

And how much of the Japan and European kind of decline was due to jus the market and the shift in product launches that you mentioned?

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

In Japan it was very -- in Q3 it was a lot of launch timing and in Europe it was a little bit launch timing and the balance market.

Victoria Konstantinova - *THB - Analyst*

So should we look at like Q4 and going forward that those markets are kind of recovered back to like [about] this territory?

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

Certainly on a constant currency, yes you should where we expect growth in those markets for the full-year and Q4.

Victoria Konstantinova - *THB - Analyst*

Great, thank you so much.

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

Thank you.

Operator

There are no further questions. I will now turn the call over to Chip Brewer, CEO, for closing remarks.

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

I just want to thank everybody for calling in. We're very pleased with our what we believe was a strong quarter. We'll look forward to updating you on the full-year and guidance for 2015 in January. Thanks very much for calling in.

Operator

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