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ELY - Q2 2016 Callaway Golf Co Earnings Call

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OVERVIEW:

Co. reported 2Q16 consolidated net sales of $245.6m, net income of $34.1m and EPS of $0.36. Expects 2016 net sales to be $855-880m and fully diluted EPS to be $0.40-0.50 on 95m shares outstanding. For 2H16, expects GAAP net sales to be $335-360m and EPS is expected to be negative $0.26 to negative $0.36. For 3Q16, expects GAAP net sales to be $170-180m and fully diluted EPS to be negative $0.10 to negative $0.15 on 95m shares outstanding.

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PRESENTATION

Operator

Good afternoon, my name is Jennifer and I will be your conference operator today. At this time I would like to welcome everyone to the Q2 2016 Callaway Golf earnings conference call.

(Operator Instructions)

Thank you. I'd like to turn the call over to Mr. Patrick Burke.

Patrick Burke - *Callaway Golf Company - Head of IR*

Thank you, Jennifer and good afternoon, everyone. Welcome to Callaway's second quarter 2016 earnings conference call. I'm Patrick Burke, the Company's Head of Investor Relations. Joining me on today's call are Chip Brewer, our President and Chief Executive Officer and Robert Julian, our Chief Financial Officer. Any comments made during the call about future performance, events, prospects or circumstances including statements related to estimated 2016 net sales, gross margins, operating expenses, pretax income, taxes and earnings per share, future industry and market conditions, the success of the Company's future products, future profitability or performance, the creation of long term shareholder value, the collectibility of accounts receivable and salability of inventory, estimated 2016 capital expenditures and depreciation and amortization expenses, growth from future corporate development opportunities, the future reversal of the Company's deferred tax valuation allowance to future tax rate and the ability to use the net operating loss carry forwards as well as other statements referring to future periods and identified by words such as believe, will, could, would, expect or anticipate 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 changes to or risks and uncertainties inherent in the Company's business or factors affecting the Company's business. For details concerning these and other risks and uncertainties, you should consult our earnings release issued today as well as part one, item 1A, of our most recent 10-k for the year ended December 31, 2015, filed with the SEC together with the Company's other reports subsequently filed with the SEC from time to time.

Also during the call, in order to provide a better understanding of the Company's underlying operational performance, we will provide certain of the Company's results and projections on a constant-currency basis. Which essentially excludes all foreign currency gains and losses recorded during the applicable period and applies the prior-period exchange rates to the adjusted current or future period financial information as though such prior-period rates were in effect during the current or future period.

We will also provide information on the Company's earnings excluding interest, taxes and depreciation and amortization expenses and excluding the gain or proceeds from the sale of a portion of the Company's Top Golf investment. This information may include non-GAAP financial measures within the meaning of Regulation G. The information provided on the call today, and the earnings release and related schedules we issued today, include a reconciliation of such non-GAAP financial information to the most directly comparable financial information prepared in accordance with GAAP.

The earnings release and related schedules are available on the Investor Relations section of the Company's website, www.CallawayGolf.com. I would now like to turn the call over to Chip.

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

Thanks Patrick. Good afternoon, everybody thank you for joining us for today's call. Q2 2016 was another strong quarter for our Company. We continue to be pleased with our operating performance including revenue growth that we believe significantly outperformed industry conditions, year-over-year increases in gross margin earnings per share and further strengthening of our brand and market-share positions on a global basis.

We remain the clear global leader in golf clubs and we are building momentum in our golf ball business. More recently, we announced the commencement of our Japan apparel JV, which kicked off July 1. This JV is a good example and start for our growth initiatives outside our core.

Our strategy is to continue to improve our core business while also strategically developing profitable growth in tangential areas. We believe we are tracking well against these objectives and that they will drive long-term shareholder value.

Let's start by taking a deeper look into our operational performance for the quarter. In the US, our revenues were up 4.3% despite soft market conditions. Our year-to-date hard goods market share through Q2 was 22.4%, up 100 basis points year over year, led by strength in our XR16 driver, Apex irons and golf balls. We both sustained our leadership position in clubs with 25.1% share year to date and strengthened our brand momentum position in golf balls.

Our green-grass business was a particular highlight for the quarter delivering double-digit year-over-year growth. We're very pleased with and proud of our US business performance over the last several years. This business is now strong and well positioned. Market conditions in Asia were improved year over year and our Japan business had an excellent quarter delivering 25% revenue growth on a GAAP basis or 10.5% on a currency-neutral basis.

Our year-to-date hard goods share in Japan was 15.4%, down 80 basis points year over year, but improving during the quarter. With currency trends improving year over year in the early start of our Callaway apparel JV, we are optimistic that this region, and Japan in particular, will be a growth and profit engine for us in the coming years.

Turning to Europe, revenues were up 5% on a GAAP basis or 6.2% on a currency-neutral basis. For the quarter, our UK hard-goods share finished at 19.6% through May, up 110 basis points year over year. We are seeing strong results in both golf balls and drivers.

Our Pan-European hard goods market share through May was 21%, up 10 basis points year over year and we remain the number-one brand in that market. I believe our European team has built a formidable business and is also well positioned.

Moving to the operational side of our business, our cost management and overall operating efficiencies continue to drive upside in our business. Our gross margin improved 90 basis points year over year to 45%. This improvement is a result of strong operational performance in the manufacturing supply chain including marked growth in our custom club business product, product and marketing excellence which has driven sell-through, higher average-selling prices and less overall promotional activity.

Turning to the product front, our 2016 product range is performing at or above expectations in nearly every category. Our golf ball business grew an impressive 14.9% during the quarter. Our golf ball share in the US was 14.4% for June, plus 240 basis points year over year and is 12.9% year to date, plus 180 basis points year over year, thus delivering record share performance based on steady growth and distribution, sell-through and customer demand. All driven by a product platform that resonates both with elite players and weekend warriors alike.

Our irons and wedge business grew 7% during the quarter, led this year by Apex irons and MD3 wedges. In June, our US share for irons was 29.5% plus 250 basis points year over year and is 25.9% point year to date, thus building on our leadership position in the iron category. A position built on brand equity and powered by our Cup Face 360 technology. Last, but not least, our XR16 driver has delivered excellent growth and has been in the bag of three major champions already year to date.

Moving to strategy, continuously improving our core business has been the keystone of our strategy here at Callaway golf and we believe we have delivered nicely against this goal. For example, our trailing 12-month EBITDA, excluding the one-time gain for the sale of Top Golf shares this last quarter, has increased by 24%. This improved profitability along with the strong financial positions now allowing us to move into the second stage of our strategy, while continuing to focus on improvements in our core, will include strategically exploring business development opportunities both within our core business and in tangential areas. The announced JV with TSI in Japan is one excellent example of this. We believe there will be more opportunities like this one, not necessarily in the same space or markets, but similar, and that we are uniquely well-positioned to take advantage of them. We intend to be thoughtful and strategic in this endeavor; however, in due course, we believe this will add meaningfully to our growth and shareholder value.

For the balance of this year, we're reconfirming our previous full-year guidance based on the strength of our operating performance in the early start of our Callaway apparel JV in Japan. However for the second half, as mentioned in our press release, there is some greater-than-normal amount of risk associated with Brexit as well as the challenging Q2 market conditions primarily in the US and the potential impact on the specialty retail golf channel for the balance of the year. To the best of our ability, we have tried to incorporate these risks into our guidance. I'm only calling them out to highlight the fact that it's a little higher ambiguity than normal. It may or may not create a speed bump for us in the second half; however, either way, it is our belief that we will be able to manage through it to deliver results consistent with our guidance and, most importantly, create the long-term shareholder value we're focused on.

In closing, I am confident that Callaway Golf is in a most stronger position today than it has been in quite some time. I am proud of what we have accomplished over the last few years and optimistic for the future. Robert, over to you? Thank you, Chip.

Robert Julian - *Callaway Golf Company - CFO*

Today we are reporting consolidated Q2 2016 net sales of $245.6 million compared to $230.5 million in Q2 2015, an increase of 6.5%. The $15.1 million increase is attributable to the success of the 2016 product lineup as demonstrated by an increase in sales in every region and across all product categories, led by golf ball which grew 14.9%. The Company also continues to see improved average selling prices in nearly all product categories.

Gross margin was 45.0% in Q2 2016 compared to 44.1% in the prior year, an improvement of 90 basis points. This increase was driven by higher average selling prices in every major region and continued operational improvements.

Operating expense was $89.8 million in Q2 2016, an 8.0% increase compared to 2015. This increase was primarily due to timing of marketing expenses as we have made a conscious decision to shift marketing expenditures from Q1 and Q4 into Q2 and Q3. Operating expense, as a percent of revenue, was 36.6% in Q2 2016 compared to 36.1% in prior year. As a result of higher sales and improved gross margins, operating income increased 12.2% to $20.9 million in Q2 2016 compared to operating income of $18.6 million in Q2 2015.

Other expense was $2.5 million in Q2 2016 compared to $4.0 million in the prior year. This improvement was the result of lower net-interest expense related to the conversion of our convertible notes in 2015. Other income of $17.7 million was recorded in Q2 2016 for the Top Golf gain.

The Company generated net income of $34.1 million in Q2 2016 compared with net income of $12.8 million in Q2 of 2015 which represents an increase of over 166%. Excluding the $17.7 million gain on Top Golf, the Company increased net income by 28.3% to $16.4 million in Q2 2016. Earnings per share improved to $0.36 on 96 million shares in Q2 2016 compared to $0.15 on 95 million shares in Q2 2015. Excluding the Top Golf gain, Q2 2016's earnings per share were $0.18.

Turning now to the balance sheet, we ended Q2 2016 with cash of $68 million, compared to $27 million for Q2 of 2015, a 153% increase. Excluding the $23 million in cash from the Top Golf sale, our cash balance would've increased 65%.

Regarding our asset-based credit facilities, we had borrowings of $5 million at the end of Q2 2016, 87% lower than the $43 million of borrowings we had in 2015. Available liquidity, as of June 30, 2016, including cash, improved to $211 million, an increase of 56% versus prior year. Our consolidated net accounts receivables were $205 million at the end of Q2 2016, a decline amount of 7% compared to 2015.

DSO decreased to 76 days compared to 87 days in 2015. We remain comfortable with the overall quality of our accounts receivable at this time. Our inventory balance decreased by 12% to $151 million at the end of Q2 2016 compared to $171 million for Q2 2015. We remain comfortable with the quality of our inventory at this time.

Capital expenditures for Q2 2016 were $3 million compared to $4 million in 2015 consistent with our expectation. Depreciation and amortization expense was $4 million in Q2 of 2016 flat compared to Q2 of 2015. Our trailing 12-month EBITDA increased 70% to $66 million and includes Top Golf gain.

The Company also repurchased 244,000 shares of stock in Q2 of 2016 for $2.25 million in cash. On a year-to-date basis, the Company has repurchased 572,000 shares of stock for approximately $5 million in cash.

I'll now comment on our 2016 guidance. Regarding full year, we are confirming our previous full-year 2016 guidance. As a result, we estimate net sales will be in the range of $855 million to $880 million, an increase of $11 million to $36 million over 2015. Full-year 2016 gross margin continues to be estimated at 44.5%, an improvement of 210 basis points to full-year 2015.

Operating expenses are estimated to be approximately $348 million for the full-year 2016 and we reaffirm our pretax income estimate of $45 million to $55 million including the Top Golf gain. Our 2016 earnings-per-share estimate, on a fully diluted basis, remains in the range of $0.40 to $0.50 on 95 million shares outstanding. These figures include a tax provision estimate of approximately $6 million and the $0.18 gain on Top Golf. We continue to estimate our capital expenditures to be approximately $15 million and our depreciation and amortization expense to be approximately $18 million in 2016.

I would like to add a few comments here on the timing of our estimated second-half guidance by quarter. For context, we estimate second-half 2016 net sales on a GAAP basis to be in the range of $335 million to $360 million, an increase of 2% to 10% versus second-half 2015. We estimate earnings per share to be in the range of negative $0.26 to negative $0.36, an improvement of $0.01 to $0.11 versus second-half of 2015. However, we estimate that the second-half revenue and EPS will be more evenly split in Q3 and Q4 of 2016 than it was in 2015. As a result, we estimate Q3 2016 net sales on a GAAP basis, to be in the range of $170 million to $180 million ranging from a decrease of 3.3% to an increase of 2.4% versus Q3 2015. We estimate Q3 2016 earnings per share, on a fully diluted basis, to be in the range of negative $0.10 to negative $0.15 per share and 95 million shares outstanding, a decrease of $0.06 to $0.11 per share versus Q3 of 2015.

Net sales for Q3 2016 reflect the inclusion of revenue from our new Japan apparel joint venture and the Company's continued brand momentum partially offset by the timing of new fall product launches in Japan as well as some concern around Brexit and market conditions, as Chip mentioned earlier. The projected decline in Q3 EPS versus prior year is due to the timing of product launches, marketing spend and compensation expense.

Finally, I would like to mention that our current estimates for 2016 do not include any non-cash charges or benefits. For example, it does not include any change in the tax valuation allowance on our deferred-tax assets. However, if Callaway continues to demonstrate sustained profitability going forward, we expect that this value allowance will eventually be reversed.

At that time, this will generate a large non-cash income-tax benefit. It will also result in an increased to our overall estimated effective tax rate to approximately 38.5%. Of course, our cash taxes will continue to benefit from our after-tax NOL's of $96 million for some period of time going forward. That concludes our prepared remarks today. We will now open the call for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Our first question comes from Susan Anderson with FBR Capital Market.

Susan Anderson - *FBR Capital Markets - Analyst*

Hello, good evening, good job on the quarter. I was wondering if you can expand on your comments around the environment. Has it gotten a little bit tougher, this is more in the US for this part of it, than you originally thought? And then, maybe if you could talk internationally too and kind of what you are seeing out there and if you've seen any impact yet from Brexit.

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

Sure Susan, this is Chip, glad to do so. In the US yes, the primary channels were a little softer than we anticipated for the first half of the year. Some portion of that is weather. Other portions of it, we're a little bit at a loss to fully explain. If you look at Data Tech, it would suggest that the market was down significantly. Our results don't support that and our independent surveys and conversations don't support that it was down that magnitude, but it was softer than what we would've liked or had anticipated.

In Asia, the markets were improved year over year and then also helped a little bit by currency, particularly in Japan. And the European market was up slightly for the first half of the year at, or maybe even slightly above, but we will call it at expectations. So nothing dramatic one way or the other from a market-condition perspective, but some softness in the US, improved operating conditions in Asia, particularly Japan, and the European business that was about on par. The Brexit is obviously something that we're keeping an eye on and we have not yet seen any measurable impact from that.

Susan Anderson - *FBR Capital Markets - Analyst*

Okay. And then in the US, when weather improved in the quarter, did you see things bounce back a little bit?

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

Yes, we did see it bounce back a little bit, but overall the US market has underperformed expectations year to date and so we definitely have called that out as a risk. But having said that, our business has performed very well, both globally and in the US. So clearly, we've shown our ability to operate well in that market and our expectations remain high as consistent with our guidance. But there has been some choppy data out there relative to the US market.

Susan Anderson - *FBR Capital Markets - Analyst*

Okay, that is helpful. And then in the US also and internationally too, are you guys seeing -- I know had inventory had gotten cleaned up; are you seeing it build again at all, especially with TaylorMade struggling? It seems like they've been pretty promotional out in the stores lately. Is there any change there do you think; and, if so, particularly, as it relates to TaylorMade, do you expect it to impact your business?

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

I'm not going to comment on any specific competitors. As such, I will on the overall trend out in the marketplace. And inventories are significantly improved in the channel over a year ago, two years ago. That has been a long-term trend; that trend overall is continuing to move in the right direction. I would call it a reason for optimism. The markets overall are less promotional than they used to be. I think that that trend that I talked about of the general industry conditions improving, I still feel that that's true even though there was some choppiness in the US market in Q2.

Susan Anderson - *FBR Capital Markets - Analyst*

Got it. Last one on the golf ball, good job on the growth there. My question is, how much was this related -- I think you guys went into that number at Green Grass outlet stores this quarter. How much of it was related to that versus growth in other retail outlets?

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

We are showing growth across the board, right now, in the golf ball. We have done a good job of growing our distribution at Green Grass and that is very important to us; it is particularly important in this category. I think it is a testament to the brand, the sales team, but we are growing our golf ball business at Green Grass. We are growing the golf ball business at retail. We are growing it in the US and we're growing it internationally. So we see very positive trends really on all fronts on that business. It's good steady growth that we are excited about, but it's also going to be very focused on sustaining. So it is a nice story thus far.

Susan Anderson - *FBR Capital Markets - Analyst*

Sounds good. Good luck this quarter.

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

Thank you.

Operator

Your next question comes from Scott Hamann with KeyBanc Capital.

Scott Hamann - *KeyBanc Capital Markets - Analyst*

Thank you, good afternoon. In terms of the second-half guidance and the shift between three and four of quarter, is product-launch timing driving that or is there a third quarter incorporating a little bit of caution around some of these issues you highlighted? I'm just curious if anything has changed, maybe from where it was at the beginning of the year?

Robert Julian - *Callaway Golf Company - CFO*

Yes Scott, this is Robert. And just on the figures themselves, our second-half estimate for revenue is almost evenly split right down the middle between Q3 and Q4; and last year it was much more heavily weighted to Q3 and it's primarily due to the timing of product launches especially in Japan. Overall, we are showing growth, but I do think that there's -- whether something launches at the very end of Q3 or the very beginning of Q4, the timing is so close on that that it could make those types of shifts.

Scott Hamann - *KeyBanc Capital Markets - Analyst*

What is going on in Japan with respect to the timing there? I thought that was a pretty straightforward season?

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

The last year we launched a product, Scott, called Big Bertha beta in Q3 that is not launching this year; we are not anniversarying that launch in Japan in this year's Q3.

Scott Hamann - *KeyBanc Capital Markets - Analyst*

Okay. Great. Thanks.

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

Sure.

Operator

Your next question comes from Randy Konik with Jefferies.

Randy Konik - *Jefferies LLC - Analyst*

Quick question, the ant wear looks very well controlled on the balance sheet. Can you give us some thought process around the impact of customization increasing causing that, better turning in to or better management of inventory or efficiency with inventory? Just give us some perspective on where customization is out today. What impact, if any, is that having on the inventory control efficiency et cetera? That's my first question, thanks.

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

Sure, Randy, this is Chip. I think that customization and our ability to manage that supply chain of custom product fulfillment effectively is certainly helping inventory management. But this is also a culmination of continual improvement of a lot of areas in our business over several years now. The SNOP process and supply chain planning, the lengthening of product-life cycles, the increased sell-through and market share gains that we have driven and the ability to turn inventory quicker, both ours and channel's, through custom product, they are all contributing to that. And you see a very significant over a fairly long period now of improvement in working capital management and we've generated some cash flow from that accordingly. So it's net-net, I think, a better-run business.

Randy Konik - *Jefferies LLC - Analyst*

Got it. And then, the total around Green Grass relative to the specialty retail channels seems very different. On the Green Grass side, it seems like it sounds like very strong across-the-board, you feel pretty good about that channel. My question around the specialty retail channel, was there any kind of delineation between something like the performance seen at a Dick's versus a Golf Galaxy or something like that, meaning more broader-oriented specialty account relative to a golf-only kind of specialty retail organization? I'm trying to get a sense of if there's any kind of differences in trend of those types of retailers are what are the types of retailers in the specialty retail channel?

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

Randy, I'm not going to be able to comment on specific customers or channels in a lot of granularity there. We are growing our Green Grass business significantly. And that is really a testament to the brand and sales organization, but it includes product and marketing, et cetera. More and more Green Grass professionals are choosing to support Callaway and that's allowed us to grow our business. If you look at the specialty retailing, Green Grass business in the quarter, according to Data Tech, they are moving almost in concert. It's not like one is gaining a lot of share vis-a-vis the others at this point. When Data tech reports the market up, they're both up. When Data tech reports the market down, they're both down. So what you're seeing is a good performance by Callaway in growing our distribution at Green Grass and we were already very strong at that specialty retail channel. So, it gives you a little bit of color on it anyway.

Randy Konik - *Jefferies LLC - Analyst*

Perfect, can you speak on the commentary around ASP? By categories, was it up across the board, just curious there?

Robert Julian - *Callaway Golf Company - CFO*

Yes Randy, this is Robert. The selling products have increased across the board in pretty much every category and just about every region. It has been pretty much universal.

Randy Konik - *Jefferies LLC - Analyst*

Okay. My last question, back in the golf ball business, it continues to track very well for you. Can we get some sort of perspective on how much Green Grass penetration you have now with the golf ball business? I'm just trying to get a sense of where we're at and where we're going towards over the next couple of years.

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

This is Chip again, Randy. I'm not going to be able to give you specific data for competitive reasons. We had double-digit growths on distribution, both Q1-- we continue to operate right now at double-digit growth in distribution. We think we still have room to grow there, but other than that, I can't give you specific numbers at this point.

Randy Konik - *Jefferies LLC - Analyst*

Okay, fair enough, thank you. Thanks guys.

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

Thank you.

Operator

Your next question comes from Mike Swartz of SunTrust.

Mike Swartz - *SunTrust Robinson Humphrey - Analyst*

Hey guys, maybe following the topic of the Green Grass channel and given the growth that you've cited and some of the distribution gains that you mentioned in prior calls, have you seen any competitive reaction out of the ordinary?

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

Mike, no, we have some very formidable competitors out there that have strong positions; we have got a lot of respect for them and certainly they're reacting and we counter and that is the daily dance that goes on in the marketplace. You see a consolidation of the bigger brands throughout the entire market right now. I've seen data which suggests the top four brands have nearly 80% of the sell-through at specialty retail and Green Grass. I am hearing similar stories of that consolidation on a global basis. So I think that supports some of our growth at Green Grass. But the overall environment is improved, from a promotional perspective, over the last several years and there is no change to that macro trend right now.

Mike Swartz - *SunTrust Robinson Humphrey - Analyst*

Okay thanks, just on the guidance, it seems currency got a little better throughout the quarter versus April and then you are maintaining your full-year outlook. I guess the question is, do you feel like you are embedding enough of the risk in the back half of the year from what you are seeing in retail; what is your comfort level with that?

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

The answer has to be yes there, Mike, or my lawyer is going to reach over and correct me on that. We think we have appropriately taken into consideration all the risk factors that exist out there. I know that we have demonstrated now an ability to operate very successfully in what are occasionally turbulent waters. We're comfortable at this point; we're very pleased with our results through the first half. Your comments are well taken and we're comfortable with the guidance that we are suggesting for the second half.

Robert Julian - *Callaway Golf Company - CFO*

Mike, this is Robert. You are correct that given what currencies have done since the last time we gave guidance, there would normally be some favorability in revenue and flowing through to EPS. But as you correctly stated, we view that as the hedge or the offset to some additional risk. It's sort of netted out in the grander scheme of things and led us to maintaining guidance.

Mike Swartz - *SunTrust Robinson Humphrey - Analyst*

And just my final question, I'm not sure if I missed it, but did you mention what the custom business is doing for the first half of the year? I think you've said in the past it was 20% plus the last couple of years; is that still the trend line that you are seeing in the first half?

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

It's certainly double-digit Mike; we are not seeing any significant change in that growth trajectory.

Mike Swartz - *SunTrust Robinson Humphrey - Analyst*

Okay great, thank you.

Operator

Your next question comes from Dan Wewer with Raymond James.

Dan Wewer - *Raymond James & Associates, Inc. - Analyst*

Chip, with your comments about softer domestic demand. Do you think it will make the industry reluctant to push another round of price increases in 2017 as it did in 2016?

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

Now, I don't think so Dan, I think that it has got our attention enough for us to call it out. Clearly, we're still performing well; we will evaluate those movements just as we did this year. So, I don't think there is any fundamental new news here. So my gut is, there is no change in long-term issues to think about from this perspective. The positives have been consistent and we will look at the business with the same rigor as we have in the past.

Dan Wewer - *Raymond James & Associates, Inc. - Analyst*

Do you think that the huge drops we saw in the Data Tech numbers, could that reflect TaylorMade and Callaway moving away from the one-year product launch to the two-year cycle? Is that just simply the big drop that we saw in May is just rolling in fewer product launches?

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

I think fewer product launches will definitely contribute to more managed inventories. So certainly that is a factor in that.

Dan Wewer - *Raymond James & Associates, Inc. - Analyst*

Also, I wanted to ask about the second-half revenue guidance; it's a very broad range from 22% growth and 10% growth. What would be the scenario that would lead to that high-end and the low-end?

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

Dan we talked about internally and, given the choppy waters, even though we're very comfortable with our business, we decided not to change the range; we recognize the range is very broad, but we thought that the right message was confirming guidance at this point and not moving that as opposed to trying to micromanage a smaller range. So that was the stylistic thing more than anything else.

Dan Wewer - *Raymond James & Associates, Inc. - Analyst*

One question for Robert, when you look at the change in the loss in the third and fourth quarter compared to historic results is that the shift in the marketing dollars that you were talking about from Q4 to Q3? Is that the bulk of the earnings?

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

Yes, it absolutely is. It's the timing of marketing dollars, it's compensation, but it's strictly timing yes during the shift.

Robert Julian - *Callaway Golf Company - CFO*

Net-net, we're favorable second-half of 2016 versus 2015, but the split has changed. But it's just timing.

Dan Wewer - *Raymond James & Associates, Inc. - Analyst*

Right, the seasonality looks considerably different than history, but that is all that is. That's the shift in there. Great, thank you.

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

Thank you.

Operator

Your next question comes from Dave King with Roth Capital.

Dave King - *Roth Capital Partners - Analyst*

Good afternoon guys. First off, on the softer market trends, to be clear, have you seen your sell-through slow at all at specialty or is the guidance more a function of what you are seeing for the overall markets?

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

We're very pleased with our performance year to date; so, I don't know how to add any more color to that. Some of the indicators out there, such as Data Tech suggested a significant decline in specialty retail and Green Grass during the quarter, we didn't see our results in fact impacted that much. We've also had numerous conversations with lots of customers who wouldn't necessarily support the same magnitude, but there was a little softness in the market we would agree with. And going forward, we're comfortable with our guidance at this point. We've continued to perform well in good markets last year. Data Tech showed the market is up this year. Year to date Data Tech shows the market a little bit down and we've been able to perform well in each of those. The plan is to continue that trend.

Dave King - *Roth Capital Partners - Analyst*

Okay, that helps, and that is both from a sell-in and a sell-through perspective then?

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

Correct.

Dave King - *Roth Capital Partners - Analyst*

Then on the guidance, how much do you expect TSI to contribute to the top-line in the back half? I want to say to you guys have shared a $30 million to $40 million or something annually, but I think there's product-launch timing around that, so?

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

We're working that out Dave and, as a policy, we're going to not call that one out separately.

Dave King - *Roth Capital Partners - Analyst*

Last for me, gross margin potential for further improvement, there going forward between manufacturing efficiencies, mix improvements, extended product cycles, et cetera, how should we think about that going forward? And what are the drivers that are likely to continue?

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

We've really done a nice job of growing the gross margins and we've been able to continue that trend of improvement. We have given you the guidance for the balance of the year; we're not in a position now to provide guidance or any forward-looking metrics on that. But, the team is going to be focused on continuing to deliver at this level or better; and we will update you further on that when we give you 2017 guidance.

Dave King - *Roth Capital Partners - Analyst*

All right. Thanks a bunch and good luck with the rest of the year.

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

Thank you.

Operator

Your next question comes from Casey Alexander with Compass Point Research.

Casey Alexander - *Compass Point Research - Analyst*

Good afternoon, late last year your golf ball share was running around 11% and now you're reporting in June a 14.9% number. As your share has been moving up, it's very consistently been coming from competitors below you. Is that starting to change? Is any starting to come from the competitor above you?

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

Casey, this is Chip. We're not sure. We have had nice steady progress in the golf ball business. It hasn't been a tidal wave, but it has been the tortoise, slow and steady. Where that share is coming from is speculation at this point. What we're really focused on is trying to continue the trend and make sure that we sustain this and hopefully build on it, little by little, as we have done year to date.

Casey Alexander - *Compass Point Research - Analyst*

Well, I ask that simply because the competitor above is so strong at Green Grass. And, given your move into Green Grass, it would make some sense that you are starting to bite into that at least a little bit.

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

We would be speculating on that at this point, Casey, so I try to avoid that at this point.

Casey Alexander - *Compass Point Research - Analyst*

All right. Secondly what is CapEx running at and, given the growth of the business, is there anywhere in the business that you are starting to feel a little capacity constrained to where some capital projects might make some sense?

Robert Julian - *Callaway Golf Company - CFO*

Casey, this is Robert. Our estimate for full-year CapEx this year is $15 million; it has been fairly constant for some time at that level. We don't feel constrained and I would say that our process by which people request capital is what people present and justify, we approve. And if it doesn't feel like we're constraining ourselves or that there are areas where we are starved for capital that it feels like we should be spending more.

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

Casey, we don't see any capacity constraints at this point.

Casey Alexander - *Compass Point Research - Analyst*

Good. Robert can you put a pin in the $2.4 million other loss? Is that Q4 Brexit-related or how would you pin that?

Patrick Burke - *Callaway Golf Company - Head of IR*

Casey, this Patrick. When you strip out the Top Golf gain, there actually was a benefit which is all related to not being in the convert. So, currency quarter to quarter was pretty neutral.

Robert Julian - *Callaway Golf Company - CFO*

In the other income and other loss category, there is $2.5 million of other expense which is just the interest expense, which is actually lower than it was in prior year. It was $4 million prior years, $2.5 million this year. It's offset in that line by a $17.7 million gain due to Top Golf, but other expenses it's just the $2.5 million.

Casey Alexander - *Compass Point Research - Analyst*

So that is off the asset backline.

Robert Julian - *Callaway Golf Company - CFO*

Casey, remember, there's also hedge losses in Q2, now they are just very similar to the hedge losses in Q2 of 2015. So we're explaining the benefit. It really is related to the convert being gone. The EBL expense is actually a little lower than the $2 million that is in there for the quarter.

Casey Alexander - *Compass Point Research - Analyst*

Good, thank you. Lastly, it would seem to me that if your custom business is growing double digits, and also, it would seem to me that the bigger competitors would have better customization capabilities, that that would be having an impact on the inventory and the inventory improvement in the channel. Because, if I was a retailer, I would be carrying less if I was doing more fitting and custom sales. But is there also any disruption happening in the distribution channel? And I'm thinking the Sports Authority has gone away and clearly, retailers, the retailing business overall just isn't what it used to be. So is there any disruption in the distribution channel that is also forcing them to carry lower inventories?

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

This is Chip. Yes, I think that they are managing their business differently. And, as the golf industry has resized, they've had to resize to stay profitable. I think that custom is part of that. As in everything, the strong will survive and flourish. But there's been some choppiness with Sports Authority and Sport Chalet and Lumpy's. They've all failed over the last six months or so. And they are changing their business model a little bit. There is significantly less retail inventory out there now than there was a year ago.

Casey Alexander - *Compass Point Research - Analyst*

All right, great. Thank you for answering my questions. I appreciate it.

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

Sure, Casey.

Operator

Your next question comes from Rommel Dionisio with Wunderlich Securities

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

Good afternoon. I just want to chat about Japan for a second. I obviously heard your comments earlier, but maybe a little more granularity on the strength that you saw in that market. Your market share is still down, but not nearly as much as first quarter. Was there something unusual with maybe the domestic competition there or maybe new product launches that you had maybe really resonated in that market relative to some of the other markets you had? Just a little more color on what drove some of the strength in Japan in the second quarter?

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

Yes. Obviously a lot of that, it helped to have the yen exchange-rate movement that we've seen for that market. But even on a constant-currency basis, you saw wonderful results in that market. And part of it was market-specific information; we probably launched a little more product there in Q2 than we did a year ago. And also, we had the number-one wood company in that market had a launch towards the end of last year that caused a significant market share shift in their favor at that time. And that effect is kind of waning as we've moved through the year. We have a really strong operating team in Japan; and what I see is they are making the right moves to regain that share and put that business back in a strong position. And on top of that, we have the favorable foreign-currency movement.

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

Great, thanks very much. That is very helpful.

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

Thank you.

Operator

George Kelly, Imperial Capital.

George Kelly - *Imperial Capital - Analyst*

A couple questions for you. First, I'm wondering if the super-hub distribution facility was opened in the quarter. And if so, could you talk at all, I'm trying to quantify what kind of savings that will drive?

Robert Julian - *Callaway Golf Company - CFO*

So, George this is Robert. The super-hub facility is open and I did have the privilege of going over there and visiting and seeing firsthand. It's a very excellent facility, a world-class facility; it's operating very, very efficiently. It was justified on the financial benefit; we have not specifically called out what the impact margins or costs have been for that facility, but we're very, very pleased with the facility. It's up and running; it went online on time and is doing very well.

George Kelly - *Imperial Capital - Analyst*

Okay. And when did it open?

Robert Julian - *Callaway Golf Company - CFO*

It was really January, the beginning of the year.

George Kelly - *Imperial Capital - Analyst*

Second question on marketing. You mentioned that the timing of certain marketing spending is shifting around into the second and third quarters. Has the channel mix changed a lot as well?

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

By channel mix, our revenue mix between channels?

George Kelly - *Imperial Capital - Analyst*

No, I mean where you're allocating your marketing budget.

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

It's changing; it is evolving as we move gradually to digital and social. But we are still very committed to the traditional media space, et cetera. There has been a gradual movement in the allocation across channels that I think is consistent with many businesses. What we've done, I think, uniquely well in the golf space, is leverage that and I believe we are a leader in that digital and new-age marketing.

George Kelly - *Imperial Capital - Analyst*

Thank you.

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

Thank you.

Operator

Our final question comes from Andrew Burns with D.A. Davidson.

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

Thanks, good afternoon. I had a quick follow-on as it relates to marketing. In the script there, you used a reference marketing excellence. And I know you don't want to give too much disclosure on what is to come, but if you could spend a little time on what is really working in terms of marketing year to date versus seasons past?

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

You know again, I will give the marketing team some kudos. They've clearly done a good job as have many areas of the business. Instance here has been our steady growth in golf balls in the campaign that we've had around chrome soft the, ball that changed the ball. The consistency of that marketing throughout the year, that is something Callaway did not used to do, you're going to see us continue to advertise that product throughout the entire calendar year. And we think that is very important for that.

Another key initiative for us on the marketing front this year was in the iron category. Last year we regained the number-one position in irons, a position Callaway had enjoyed for many years, but had reluctantly surrendered for a few years. We regained that position and one of the things that we wanted to do this year was recommunicate our leadership position. And you see, in our marketing, that message, I believe, loud and clear and created in many different matters.

And then in June, without any market changes of significance in the US. No product launches per se that were meaningful from a revenue perspective. We had 29.5% share, dollar share, in the iron category. So as the head of marketing jokes, it obviously didn't hurt.

We're really pleased with what they are doing along with the product excellence and winning on tour, operational improvements. It's a symphony that makes this work. It's not any one element, but the marketing has certainly held up its side and done a nice job.

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

Thanks and, as you referenced meeting on tour, I thought we might see a couple more lines in the prepared remarks about your major success this year. When you have a series of high-profile wins, a great Callaway-led duo at the British Open, how do you capitalize on that buzz and do you really see any lift in new business?

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

Andrew, we've had an exceptional year on tour, winning two majors on the men's side and one on the women's side already. We are continuing to grow our position across the world tours. Four first-team All-Americans joined team Callaway this year as the college season ended. It's all part of the mosaic of what makes us successful.

We do see some positive short-term sell-through when there is a big event such as a major won, but it's not material from a public-company perspective. But you can see a slight improvement and you know it is extremely positive for the brand over the long-term and that is perhaps the most important issue.

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

Great, thanks.

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

Thanks, Andrew.

Operator

We have no further questions in queue at this time. I would like to turn the conference back over to Mr. Brewer.

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

Thanks everybody for dialing in. We appreciate your support and interest in Callaway. We'll look forward to talking to you again at the end of Q3.

Operator

Thank you for your participation. This does conclude today's conference call. You may now disconnect.
