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EDITED TRANSCRIPT

ELY - Q2 2013 Callaway Golf Earnings Conference Call

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OVERVIEW:

ELY reported 1H13 revenues of $537m and pro forma EPS of $0.45. 2Q13 revenues was $250m and pro forma EPS was $0.12. Expects full-year 2013 revenues to be $810-820m and 2H13 revenues to be $273-283m.

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PRESENTATION

Operator

Good afternoon. My name is Ginger and I will be your conference operator today. At this time I would like to welcome everyone to the second quarter 2013 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) Mr. Brad Holiday, you may begin your conference.

Brad Holiday - *Callaway Golf - CFO*

Thank you and welcome everyone to Callaway Golf Company's second quarter 2013 earnings conference call. Joining me today is Chip Brewer, our President and CEO. During today's conference Chip will provide some opening remarks, I will provide an overview of the company's financial results for the quarter and will then open the call for questions.

I would like to point out that any comments made about future performance, events, prospects, or circumstances including statements relating to estimated 2013 net sales, sales growth, gross margins, operating expenses, pretax income or loss, net income or loss, and earnings or loss per share, future market conditions or foreign currency rates, the success of the company's products or the company's turnaround plan, future improvements in operations, market share, brand momentum, financial performance and shareholder value as well as the collectability of accounts receivable and the company's estimated 2013 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 filed for the year ended December 31, 2012, 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, which we also refer to as pro forma information. This information as applicable, excludes the gain on the sale of the Top-Flite and Ben Hogan brands, charges related to the 2012 cost reduction initiatives, and the impact of businesses that in 2012 were sold or transitioned to a third-party model.

We provide certain of the company's results on a constant currency basis which essentially applies the prior period exchange rates to the current period results. For comparative purposes, the pro forma income and earnings information assumes a 38.5% tax rate.

We also provide information on the company's earnings excluding interest, taxes, depreciation, amortization expenses and impairment charges. This pro forma 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 relations section of the Company's website at www.CallawayGolf.com.

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

Chip Brewer - *Callaway Golf - President, CEO*

Thanks Brad. Good afternoon everybody and thanks for joining us today for this call. I'm happy to be able to say that we're pleased with our year to date operating results and that we believe we're on track with our turnaround plan. As a result, I'd like to start the call by thanking the Callaway Golf team for their hard work and commitment to turning this business around. I believe our results show we've made significant progress.

In Q2, our team delivered $250 million in revenues and $0.12 pro forma earnings per share. For the first half we delivered $537 million in revenues and $0.45 in pro forma earnings per share. Our year to date pro forma earnings were up $18 million or 86% year-over-year. Our sell-through, our brand momentum, our operating efficiency and cost management were all improved versus a year ago.

Datatech numbers show we continue to gain share in the US market, finishing May with a 14.9% year to date hard goods share of 130 basis points year-over-year and with considerably better momentum and inventory positions. As a result, our continuing US business is up 9% year to date despite a market that was flat to slightly down, thus we grew considerably faster than the market.

This growth was driven primarily by success in clubs, especially the X Hot line and especially the X Hot fairway wood, where our May year to date dollar share was 17.9%, up a strong 750 basis points year-over-year.

Looking at major markets outside the US, we see the same pattern of market share growth and a strengthening brand. In Japan, our year to date sell-through market share was at 13.9% for the first week of July, up 350 basis points year-over-year. This is the highest share gain of any brand in that market and our X Hot fairways have been the number one model for 20 consecutive weeks. These share gains led to an impressive 23% increase in local currency revenues both for the quarter and year to date. Unfortunately it's been well documented that foreign exchange headwinds have offset most of these gains. That being said, we continue to be very pleased with our performance in Japan and I'd like to once again congratulate that team on the outstanding results year to date.

Turning to Europe, after somewhat slower start, we are now seeing a similar pattern market share gains emerging there as well. In the UK, Europe's largest market, our team has delivered a year to date golf club market share of 14.7%, which is up just slightly year to date but it's trending very well with the latest report being 18% share for the month of May. Market conditions have been challenging there though and as a result, despite our improved momentum, our constant currency continuing business revenues were down 1% for the quarter and 2% year to date in Europe.

In support of our global growth, our operations team has had a busy but productive first half of the year. They greatly improved custom club fulfillment rates, bringing us to world class levels of speed and reliability. They continue to drive productivity improvements in our Mexico assembly operations with labor and productivity more than double that of last year. They've lowered our cost structure and improved the efficiency in our streamlined Chicopee golf ball operation. As a result, our golf ball business was more profitable than a year ago, despite lower revenues.

More recently they began the process of setting up an in house club assembly operation in Japan. This operation is currently in the startup mode and will be fully up and running in Q4. It will provide both service and cost advantages for Korea and Japan going forward. They also began the process of exiting Suntech, our China golf ball joint venture, which we expect will lead to great utilization of our Chicopee ball operation for further savings for us in the future.

During Q2 we also announced several exciting new products which will ship in the second half of the year. These include the Mack Daddy 2 line of wedges designed by Roger Cleveland, the Legacy Black lines of golf clubs for Japan and parts of Asia. And the FT Optiforce wood line for regions outside of Asia, including the US. This midseason launch of products has been in our business plan all along and reflects our new commitment to being more aggressive and contemporary in our introduction of new technology. The reaction from tour, consumers and the trade has been very positive.

Also from a business point of view, it's great to have some new full-price technology to talk about during a period of the year that's normally very promotional.

Last but not least, it's been a good year for Callaway Golf on the tour front and an amazing last two weeks. On behalf of everyone at Callaway Golf, we want to congratulate Phil on his fifth major, a well-deserved and popular victory which was also good for golf. We feel honored to have been a small part of it.

Turning back to the more mundane stuff. Market conditions were worse than expected during Q2, due to both continued adverse weather conditions in the North American market and a higher than normal promotional activity both here and in Europe. Market conditions in Japan with that market showing improvement versus last year. For the second half of the year we are expecting more normal weather conditions, but since we have not seen any solid evidence of improved consumer activity for the industry as a whole, we are becoming more conservative in our estimation of market conditions and also expect a continuation of this year's enhanced promotional activity through the balance of the year.

Moving to guidance. For the second half, due to the aforementioned market conditions, we are lowering our revenue expectations to a range of $273 million to $283 million, a reduction of approximately $12 million. In constant currency and continuing business basis this would deliver second half revenue growth of approximately 18%, very strong growth although down from previous expectations.

For the full year we are now expecting revenues in the range of $810 million to $820 million, a reduction of approximately $15 million from previous guidance and pretax earnings in the range of a $9 million loss to breakeven, or a pro forma earnings per share loss in the range of $0.12 to $0.04. Results consistent with this guidance would show a full year constant currency continuing business revenue increase of approximately 10%. These results would also deliver a year-over-year improvement in pro forma pretax income of approximately $66 million for the full year.

In closing, I remain very pleased with our results year to date and confident that we're on track with our turnaround plan. The significant headwinds from both foreign exchange movement and weather conditions, 2013 is proving to be a most unusual year for the golf industry. Fortunately, history shows these factors are not likely to repeat themselves with any regularity. The fact that they occur during the first year of our turnaround effort certainly creates some added challenges but it also shows that our business plan will work, even in difficult market conditions.

In the first year, it's hard to both completely turnaround market place momentum and make all the operational improvements we are achieving. To do so in these conditions is like playing golf into the wind. It's tougher but it's a sure test. Good scores in these conditions are especially encouraging.

During the balance of the year we'll be working to further drive our change effort along the same playbook we've outlined for you over the last year and we expect continued positive progress. Over time, weather and market conditions will settle out, foreign exchange changes will work themselves through the value chain. Throughout these cycles, we believe we are demonstrating that our business plan combined with the strength of our brand and the quality of our people will lead to steadily improved financial performance and long-term shareholder value.

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

Brad Holiday - *Callaway Golf - CFO*

Thanks Chip. Sales for the second quarter were $250 million, an increase of 1% on a constant currency continuing business basis, which excludes the brand and businesses that were sold or transitioned to a third party model in 2012. Sales on a GAAP basis, which were adversely impacted by approximately $10 million due to changes in foreign currency rates and by approximately $26 million for the sold or transitioned businesses declined 11%.

Sales for the quarter were evenly split between the US and international markets. Sales in the US for the quarter were $124 million, an increase of 1% on a continuing business basis but decreased 12% compared to last year on a GAAP basis.

International sales were $125 million, an increase of 2% on a constant currency continuing business basis compared to last year, but on a GAAP basis declined 10% compared to last year. On a year to date basis, consolidated sales increased 6% on a constant currency continuing business basis. Sales on a GAAP basis which were adversely impacted by approximately $18 million due to changes in foreign currency rates, and approximately $47 million for the sold or transitioned businesses, declined 5%. US sales represented 53% of total through the first six months of the year.

First half sales in the United States were $284 million, an increase of 9% on a continuing business basis, but decreased 3% compared to the first half of last year on a GAAP basis. As a side note, Datatech reported a 3% decline in retail sales through May in the US hard goods category.

International sales for the first half were $253 million, an increase of 4% on a constant currency continuing business basis but declined 8% on a GAAP basis. Looking at sales for our two largest international regions showed that sales in Japan increased 23% in local currency but in US dollars increased only 2% due to the weakness in the Japanese yen this year.

Europe sales decreased 2% on a constant currency continuing business basis due to adverse weather and economics conditions experienced this year. On a GAAP basis sales in Europe declined 9% compared to last year.

On a product category basis through the first six months, our wood sales were $171 million, an increase of 15% compared to last year due primarily to the successful launch of the X Hot line of drivers and fairway woods. Iron sales were $113 million through the first six months, a decrease of 3% compared to last year, due primarily to a decline in the sales of wedges, partially offset by an increase in iron sales driven by the success of our X Hot irons. The decline in sales of wedges was due to product launch timing, as we just launched our new Mack Daddy line of wedges in the third quarter rather than in the first half of the year.

Other sales were $55 million through the first six months, a decrease of 12% due to fewer model introductions this year compared to the Metal X and Mid and Long putters that were introduced last year. Golf ball sales were $86 million, a decrease of 6% compared to last year but adjusting for the sale of the sale of the Top-Flite brand last year, sales of Callaway branded balls for the first half of 2013 increased 13% compared to 2012, with significantly improved pro forma profitability on lower sales compared to last year.

Accessory sales were $111 million; a decrease of 24% compared to last year, due primarily to a reduction of approximately $20 million associated with the businesses sold or licensed in 2012 as well as declines in package sets, bags and gloves.

Pro forma gross margin for the second quarter were 40% and were flat compared to last year due to higher promotional expense, which was offset by a favorable mix of our higher margin X Hot products. On a year to date basis, pro forma gross margins increased 160 basis points to 43% compared to last year, due to improved manufacturing efficiencies and favorable product mix.

Pro forma operating expenses for the second quarter were $83 million compared to $97 million, 14% lower than 2012, due to our cost reduction initiatives taken mid last year. Year to date operating expenses totaled $172 million, also a 14% reduction compared to $201 million last year for the same reason.

Turning to our balance sheet, we ended the quarter with cash at $30 million compared to $28 million last year. Consolidated net receivables were $229 million, a 10% decrease compared to last year due to lower sales during the quarter. DSOs were 84 days compared to 83 days last year. And the overall quality of our accounts receivable remain good.

Net inventories were $187 million, a decrease of $29 million or 13% compared to last year, the majority of which was due to the impact of the businesses sold or licensed last year, as well as improved inventory management and as a percent of trailing 12-month sales, improved to 23% compared to 24% last year. We ended the quarter with $87 million available on our credit facility of which $39 was outstanding compared to $70 million last year.

Capital expenditures for the quarter were $3 million and our full year estimate remains the same at $15 million to $20 million. Depreciation and amortization expense was $6 million for the quarter and we estimate full year at approximately $26 million, a slight decrease compared to our previous estimate of $30 million.

As Chip mentioned in his comments, we are lowering our sales and earnings guidance for the year due to our expectations that the challenging market conditions experienced during the first half of the year will continue, resulting in a higher level of promotional activity for the balance of the year. On a full year basis, we now estimate revenues to range from $810 million to $820 million or a reduction using the midpoint of this range of approximately $15 million from last our guidance of $830 million. This revised sales estimate would represent sales growth on a constant currency continuing business basis of approximately 10% compared to last year.

Estimated pro forma gross margins as a percent of sales are now estimated at 38% to 39% compared to previous guidance of 40%, due to the adverse impact of the expected higher level of promotional activity, as well as lower sales. Pro forma operating expenses are estimated to be approximately $320 million compared to previous guidance of $335 million. This includes a reduction in discretionary spending which will not impact our turnaround plans, as well as tight cost controls and the effects of lower sales volume.

On a full year basis, we now estimate pro forma net income will range from breakeven to a loss of $6 million or a loss per share of $0.04 to $0.12. This compares to our previous guidance of breakeven net income and a loss per share of $0.04.

We will now open the call for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Lee Giordano, Imperial Capital.

Lee Giordano - *Imperial Capital - Analyst*

My question is on the potential impact from Phil Mickelson's win at the British Open; historically when you've seen a big win from one of your [PJ stats] professionals, have you seen a pickup in demand? His winning in Europe, is that going to help your European business?

Chip Brewer - *Callaway Golf - President, CEO*

Typically when a player wins, you don't see a specific impact, but Phil's different. We have seen pickup in demand around Phil's wins. In fact, when he won this year in Phoenix there was a slight in sell-through of Callaway products immediately following that. That may well be true for this win as well. It's certainly getting a lot of excitement and attention. Phil is special in that regard and it does have some positive implications we think. But we can't be sure at this point. I think that would apply overseas as well as here. He's very popular internationally as he is in the US and obviously the Open championship is so impassionable in that part of the world that yes, it would have the potential outside globally but no great way to get a full read on that at this stage.

Lee Giordano - *Imperial Capital - Analyst*

Secondly on this promotional environment, have you seen any improvements in recent months or are you expecting it to continue at this pace for the remainder of the season? And then how do you feel about inventory in the field at this point in time?

Brad Holiday - *Callaway Golf - CFO*

Good questions Lee. This has been a more highly promotional year than normal. The promotional activity kicked in earlier in the year. We believe partially because of the slow market conditions which were driven by weather and we have not seen that abate and at this point we really are not expecting it to do so through the balance of the year.

Now the second half of the year is always more promotional than the first half and this year because the promotional activity started earlier, it's not going to be able to move up to the same magnitude but I do anticipate it being more promotional during the second half of the year than a normal year, as it was in the first half of the year.

And then on the inventory in the field, inventory is a little higher for the industry in total. It's not awful, but in a couple of categories it's a little bit higher than we would like to see it, but the Callaway inventory we believe is in good shape because of the positive sell-through of the inventory in general out there, again due to the market conditions. The retailers have done a good job but they've had a lot of work to do, given the slow conditions and so there are pockets where there's a little bit more inventory than you'd like to see.

Operator

James Hardiman, Longbow Research.

James Hardiman - *Longbow Research - Analyst*

Let's start with Chip. One of my frustrations with this industry over the years has just been once things start to go wrong, the wheels typically fall off pretty quickly and I want to commend you guys with a slight reduction in guidance for the year despite the fact that it seems like between weather and the promotional environment things are materially worse than you'd anticipated. And so Chip, sort of walk us through the first half of the year, what you saw and when that made you think that the industry wasn't quite shaping up the way you wanted and what specifically your response has been?

It sounds like from Brad's comments, you scaled back on some discretionary spending. Are there other things that can be done to respond to a weaker environment? And Brad, I guess I don't really want to put you on the spot, but I will. Have you seen a change in the way that the company has identified and responded to weakness early in the season?

Chip Brewer - *Callaway Golf - President, CEO*

Thank you James, first of all, for the positive comments. It's a broad question but one I'm looking forward to at least trying to answer. The weather and the March conditions this year are atypical. I've been in the industry for 14 years now and rounds played are down roughly 12% in the US, more than that in Europe. Last year was a wonderful weather year and the industry was up and this year's been the exact opposite. And so just got off to a very slow start to the year in the North American and the European markets. That created some pressures on the business, negative momentum, higher promotional environment, etc.

We don't see this as a structural issue; we just see it as a weather pattern. But in a seasonal business it's a relevant issue. What we believe is the most important item is that we're performing very well against the key turnaround metrics and that's growing market share, improving brand momentum, improving the operating efficiencies of this business. And as I tried to call out, doing so in these conditions we think is a strong result. It's never easy turning a business around, but it's particularly hard when you have negative momentum which any turnaround starts with and then you've got to fix that and do the operational improvement and combat it. We think it's a testament to our plan, our potential, our brand and our people that we're able to do that.

So through the first half of this year has been stick to the plan. Our plan has been to bring the energy back to the Callaway Golf brand, differentiate within the product and put in the R&D researches that I bragged about and start to resonate again in the marketplace. And we've done that. And we've done that on a global stage. We've done it in Japan. We've done it in Europe. We've done it in America.

And on a macro scale, there has not been any change to that game plan as a result of tougher conditions. Now, when the condition did we increase promotional activity a little bit? Yes, we moved some promotional activity earlier in the year, in response to market conditions. And we'll be a little bit more promotional in response to some market conditions in the second half. We have not accelerated a single product launch. Every product launch that we've done has been part of the plan that was mapped out at the end of last year. We're not anticipating changing a single stitch of that plan through the balance of the year.

We will obviously control discretionary spending. But what we're doing is working; it's just some stiff headwinds. Again, we don't' believe the structural and we believe that the bigger picture issues are shaping up well relative to the business plan. We take solace in that.

What did I miss?

James Hardiman - *Longbow Research - Analyst*

That's very helpful. Maybe Brad or whoever wants to comment on how that plan may have been different from what you historically came to the market with at the beginning of a year and how you were able to respond. Do you feel like the company is more nimble than it was one, two, five years ago?

Chip Brewer - *Callaway Golf - President, CEO*

Well you know James, I will have been here 13 years next month and so I've seen a lot of different changes in the company and I think to echo a few things that Chip mentioned, we started with the turnaround plan a little over a year ago, starting with reducing costs, doing more with less, reengineering products, turning the market share around and starting to see gains.

Brad Holiday - *Callaway Golf - CFO*

And I think to Chip's point, the plan in and of itself is working well despite the conditions we're seeing in the marketplace. So I am personally very pleased at the fact that this plan is working despite some of the headwinds. I would tell you that one difference that I would see is that we, I think, are more aware of and responsive to what's going on in the marketplace. So we see when we knew when the promotional events were hitting out there. We addressed them at the appropriate level, not too quickly, because earlier in the year our products were selling through well on their own. But when we started to see the promotional activity picked up, we had plans in place ready to execute.

So I've seen that and I've also seen I think a change in the culture where despite the heavy cuts that we took here in staffing and just expenses, and you can see those flowing through in the P&L, we're doing more with less and we have a much more cost conscious environment and culture here now that allow us to keep really tight controls on our spending. So yes, I think in a very positive way I see a Company that acts differently and more responsive than in years past.

Chip Brewer - *Callaway Golf - President, CEO*

And James, the unique thing about it is the market is responding well to it.

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James Hardiman - *Longbow Research - Analyst*

That's exactly what I was looking for. Thank you both.

Operator

Your next question comes from the line of Dan Wewer from Raymond James.

Dan Wewer - *Raymond James - Analyst*

Thanks. I don't think that you guys discussed gross margin drivers during the second quarter, other than the fact that promotional activity is increasing. But can you walk us through the change in gross margin rate, how much of that was in promotional activity and how much was due to other products, acquisition costs?

Brad Holiday - *Callaway Golf - CFO*

Dan, this is Brad. Really, the biggest headwind was the higher promotional expense that we had during the quarter, and that was actually offset by better mix and higher margins on the products that are selling through at full price throughout the quarter, because we did manage to sell an awful lot of products through at full price during the quarter. So we're flat to last year. Some of it is tiny and the other thing that impacted the quarter was last year, compared to last year, was that last year we lost the [Metelec] line of cutters and the putter lines, and the mid-longs last year have pretty good margins on them and we didn't have that same effect this year.

So the headwinds were the promotional activity. FX certainly had a negative impact on us and then we really offset it because of the good mix of X Hot, the performance of X Hot this year.

Chip Brewer - *Callaway Golf - President, CEO*

Dan, on a constant currency basis the margins would have been 42 points for the quarter. So again, our most profitable market is Japan and the Yen rates there had an impact as well.

Dan Wewer - *Raymond James - Analyst*

That's helpful because I thought that the business should be getting back to 42%, 44% historic gross margin given you entered the period with lean inventory. You had a $50 higher price on X Hot than the equivalent level a year ago. So I was thinking that it should be back up to that 42%, 44% rate.

Second question, this represents, what, the fifth consecutive year of losses for Callaway. What's the patience level or anxiety level among the Board? Clearly, there are other alternatives than a turnaround strategy that the Company can look at.

Chip Brewer - *Callaway Golf - President, CEO*

Dan, this is Chip. A, this year is not over yet. B, this is my first year at the helm. They hired us to come in and turn it around and put a new, fresh game plan into place. If there was not clear evidence that that game plan was working, I would expect there would be frustration on everybody's part, mine first and foremost. But the vast majority, if not overwhelming majority of evidence is what we're doing is in fact turning this business around.

We would like to have it at a faster pace. It's disappointing that when you have headwinds, but I don't feel capable of speaking for the Board. I do have communication with them. I'll speak for myself and I think the big story here is indeed the progress that's being made, and yes, that does require you to look past the foreign exchange and some market conditions, which we believe are atypical. But it is not time to be frustrated with this turnaround plan. It's time to be looking at the metrics that are within our control and how we are delivering against those.

Dan Wewer - *Raymond James - Analyst*

And just one other question regarding the midseason product watches. We were certainly expecting a new wedge line. I guess it's been a couple of years since that was introduced. But a bit surprised with the Optiforce given X Hot sales are still strong and then Tailor Made is putting out the slider. Are the product cycles shortening even faster than the one-year cycle that we've been looking at the last couple years?

Chip Brewer - *Callaway Golf - President, CEO*

No, they're not. There's still that one-year cycle, but as I stated, I'm going to be more aggressive using the R&D engine that Callaway has. We're going to bring product out in exciting and unique times when we have the technologies. We're not going to be slave to how it was done in the past or specific times. And it's a lot of fun and it's good for the business. And in a one-year product life cycle, by the second half of the year that product is on promotion. In fact, everything on the brand would be on sale in the store. If you have an exciting new technology and you can spread those launches through the year, it gives more energy and excitement to the business and the brand and gives the consumer the opportunity to not only just by a cheap driver, but buy some great new technologies. And that is one of the earlier questions is what's different, right. This is different. And that is going to drive results. That energy is part of the new Callaway, but it also drives business and other competitors have used it well. Callaway can do that exceptionally well in addition.

Dan Wewer - *Raymond James - Analyst*

Does Harry believe that he has the same marketing support behind Optiforce that he had behind X Hot at the beginning of the year?

Chip Brewer - *Callaway Golf - President, CEO*

The same as -- we have appropriate marketing support. And if you look at the ways that Harry and his zoo crew, as they call themselves, I had to fit that in there because they're probably listening, are bringing energy to these products varies. And they're using a lot of digital social. They're using as well TV, et cetera. So they've got a very energetic and we believe effective plan. That product is doing extremely well on tour. It's doing extremely well in the field and it's flat out great product, and you should try it. And they're getting the word out on it.

Dan Wewer - *Raymond James - Analyst*

Great, thank you.

Operator

Your next question comes from the line of Scott Hamann from Keybanc Capital Markets.

Scott Hamann - *Keybanc Capital Markets - Analyst*

Just a couple of questions on the guidance. Chip, you said some stuff earlier that there was some economic -- potentially consumers not showing up as well as the weather. And I'm curious on the guidance reduction on the top line, how much of that is a function simply of just the weather versus I guess seeing maybe some consumer pushback?

Chip Brewer - *Callaway Golf - President, CEO*

The weather conditions really were the story to start the year, Scott, and my sense is that they hut the momentum of the industry at large. Even though Callaway has positive momentum and is gaining share, there has not been as much consumer activity at the industry at large, and interest both from around play to just traffic at retail. And that is the reason why we're -- we were hoping for a pickup. We talked about it on the last call, the poor start to the year for the industry as a total. It was very clear and evident to everybody that it was weather related that originally got that ball rolling. We were hoping to see improvement during the quarter and although the weather now is not an item that I'm calling out for Q3, the industry conditions are -- we're expecting -- they appear to be continuing.

Scott Hamann - *Keybanc Capital Markets - Analyst*

Okay, and just in terms of the promotional activity, I mean it seems to us that you've been able to gain share throughout the vast majority of the year without really promoting much. And obviously, that's good for the long-term, and Brad indicated last quarter that I think you had some allowances baked into your guidance for some promotional activity. And I'm curious if something has changed here very recently, if it was just a compounding of promotions, or how much was really contemplated prior to this quarter?

Chip Brewer - *Callaway Golf - President, CEO*

We were able to hold off on some of the early promotions that some of our competitors did, but we're not immune from them either. So eventually, we did feel compelled to match many of those promotions. So we have demonstrated to ourselves that we have brand strength so that we don't have to immediately follow and we can stand at times alone. But we're also very attentive and responsive. And so that is not an absolute and forever scenario. That's also one of the reasons we love the fact that we have some new product out there because that is not going to be affected by promotional activity, but X Hot has already been put on promotion.

So we think we're in a good spot there, but not completely immune on the promotion. We've had a certain level of promotional activity in the game plan for this year. We understand how the industry works on that front. The amount that we're going to do is probably more than what we originally accepted because the market conditions have been softer and therefore those that have not been shared this year will have to be more promotional to get rid of their inventory. That will have some impact on us.

Scott Hamann - *Keybanc Capital Markets - Analyst*

Okay, and has your outlook changed with respect to the US market in that you still aren't sure you're going to be able to gain share for the course of the year?

Chip Brewer - *Callaway Golf - President, CEO*

I'm not really sure on that share question right now, Scott, but let me tell you I'm really pleased with how we're doing in the US market. There have been no real change in our feeling on the US. So we're gaining momentum. We're strengthening. I'm really pleased with our progress in the US market. Europe is especially tough for us as it is for others right now. There are a lot of very well documented issues associated with the economies over there. On top of that, the golf industry has had a rough start, which is with rounds played down even worse than they are in the US. But the US market, which is probably the most strategic thing that we need to do in this business is strengthen the US market and turn that around. And we are on track for that. So very pleased with the progress there.

Scott Hamann - *Keybanc Capital Markets - Analyst*

Okay, and then I guess my last question is on Japan and given some of the strength there around X Hot and Rio, Legacy launched this Fall, is there the appetite to be able to take some price there to help offset some of the compression you've seen with the currency issues?

Chip Brewer - *Callaway Golf - President, CEO*

Yes.

Scott Hamann - *Keybanc Capital Markets - Analyst*

We should see that in the Legacy line?

Chip Brewer - *Callaway Golf - President, CEO*

Yes, you'll see some in the legacy line.

Scott Hamann - *Keybanc Capital Markets - Analyst*

Great. Thanks.

Operator

Your next question comes from Andrew Burns from DA Davidson.

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

Good afternoon. It was good to see the reduction in SG&A guidance by $15 million in context of only a $10 million to $20 million decline in revenue forecasted. Given the reductions you've been making in quarters in years past, it begs the question is there more that you can cut out? This didn't impact the turnaround, as you said. Just trying to get a sense for as we roll into '14 and presumably we've got revenue growth, is [320] a baseline that would return to sort of a normal spend trajectory? Or is there still some buckets of opportunity out there to cut costs?

Brad Holiday - *Callaway Golf - CFO*

Andrew, this is Brad. As I mentioned to you, I mean there's a culture here of being very conscious. So we're always looking at ways to continue to leverage our expenses. And I think in this particular case we had some money in our forecast that we thought we might be able to use for certain things and determined that just given the drop in guidance that it was best not spent this year. So I think we would weigh all spending to give the opportunity. We certainly will have some level of inflation going in the next year. And as Chip has mentioned, in times past that he does believe that there's a certain level of investment that he wants to make to strengthen the PGA tour.

So I'm not going to give guidance for next year, but I think we've done a nice job this year managing it very tightly, and as we get into next year, we'll give you a little more clarity around that. It's just too early to tell right now what next year requires. But I think that the savings and the actions we took last year are at least flowing through and I think that's a real positive.

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

Okay, thanks. And the second question is just on product launch timing. Are you guys now satisfied with the pace of new product launches and the number of midseason launches, or will the pace continue to accelerate as we move into '14? And as part of that question, are the profit dynamics of the midseason launch similar to a preseason considering you're launching in the face of a heavier promotional environment come midseason?

Chip Brewer - *Callaway Golf - President, CEO*

Andrew, the scale of a midseason launch is sometimes smaller than a launch that might occur in a January time period. The profitability, the relative profitability is the same and there are successful product launches in this industry that occur at all different seasons. Callaway has not had a history of launching product around this time. I have in my past and many of the other big brands have. So this is not a strange item for the industry in general. And I wouldn't say we're going to quicken or slow down the pace of product. We're going to be a little bit unpredictable on that front and we're going to be responsive to opportunities as they present themselves either based on the markets or technologies that come forward.

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

So no clear pattern will be coming forward there other than a strong desire and commitment to bring energy to the marketplace, grow brand momentum, and profitably grow market share.

Thanks and good luck.

Chip Brewer - *Callaway Golf - President, CEO*

Thank you.

Operator

Your next question comes from Rommel Dionisio from Wedbush Securities.

Rommel Dionisio - *Wedbush Securities - Analyst*

Yes, thank you. Good afternoon. I wonder if I could just ask for a little more color on the strength of the Callaway branded ball business. This didn't seem like this was a big launch year for new products and yet you guys, I think Brad you mentioned us doing extremely well this year. Could you just provide more color? Is it better merchandising, or distribution, or what's kind of the driver behind that strength?

Brad Holiday - *Callaway Golf - CFO*

The ball business in general, Rommel, is slow, really certainly in the US and North America industry wide, and it's all the reasons that we previously talked about. When people are not playing golf, they don't tend to buy and use as many golf balls. When the Company made the strategic decision to sell Top Flight brand, one of our goals was to replace that volume with Callaway branded product, but not in the low end side of the business so much as the mid-price. And we've been successful in doing that. We did have a launch this year of a ball called Hex Chrome Plus that has been successful for us. And there is more brand momentum around Callaway Golf in general now, and we think that has some nice halo effect.

So a lot of good things going on in that direction and the item that I love the most about this is the cost structure of the golf ball operation now, with overall lower volume but higher profitability, and that's been a challenging year. It feels like something we can work with effectively going forward. And then on top of that, we announced that we're doing some further operational changes with exiting the [Sun-Tech] operation, which we think is going to create additional upside opportunity for us. So lots going on in the golf ball business. Some positive trends despite the market conditions and we've had some nice plans coming forward for us.

Rommel Dionisio - *Wedbush Securities - Analyst*

That's great. Thanks very much.

Operator

Your next question comes from Casey Alexander from Gilford Securities.

Casey Alexander - *Gilford Securities - Analyst*

In -- as we look at the new product launches, all of the Optiforce, Mack Daddy, and Legacy, is that all in third quarter or did any of that fall in second quarter?

Chip Brewer - *Callaway Golf - President, CEO*

None of it happened in second quarter, Casey. I believe all of it is in third quarter, but a little might spill into fourth quarter in Asia, but primarily third quarter.

Casey Alexander - *Gilford Securities - Analyst*

So as we look at our models rather than being kind of balanced between third quarter and fourth quarter, should we now skew the second half a little more towards the third quarter?

Chip Brewer - *Callaway Golf - President, CEO*

Yes.

Casey Alexander - *Gilford Securities - Analyst*

And because these are new product launches that at least are initially being out there at full price, I mean last year's third quarter had a 21% gross margin rate. Would it be --

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Chip Brewer - *Callaway Golf - President, CEO*

I think we can reach that.

Casey Alexander - *Gilford Securities - Analyst*

I'm trying to get to modeling (inaudible).

Chip Brewer - *Callaway Golf - President, CEO*

Even the lawyer didn't mind me saying that.

Unidentified Participant

Chip's going out on a limb there, Casey.

Casey Alexander - *Gilford Securities - Analyst*

Okay, we'll take a swing and try to beat that. That's great. On Legacy introductions, what's sort of been the revenue history for Legacy intros in the past in Japan and in Asia? Is there a real bulge or is that more of keeping a steady state to that market?

Chip Brewer - *Callaway Golf - President, CEO*

Well, it's a significant piece of business, Casey, but I don't know whether you will see in that particular launch. That is the only product family where we did do a Q3-Q4 launch last year. So they had moved to midseason launches, well at least they did last year. I don't really remember if they did it before that or not. But they moved to that last year, so you would have seen some comparable revenue there. But it is a significant launch and the reaction to it so far is very positive.

Casey Alexander - *Gilford Securities - Analyst*

When we look at the sort of knock on effect of currencies and we know that the Japanese currency year-to-year is down a lot, is that the way we should be looking at the FX comparisons on a year-to-year basis? Or should we be looking at it on a sequential quarterly basis? Or a little of both?

Brad Holiday - *Callaway Golf - CFO*

Year-to-year if you're compare it to the prior year obviously.

Chip Brewer - *Callaway Golf - President, CEO*

Yes, I think we've -- we baked the current currency expectations into our guidance. But for year-over-year, use year-over-year. And we've already factored in where the currency is roughly (inaudible) last week.

Brad Holiday - *Callaway Golf - CFO*

And why they took some pricing on this new line relative to last year. So.

Casey Alexander - *Gilford Securities - Analyst*

Okay, great. Congratulations on the British Open win. Last year, when Ernie Els won the British Open. You guys did what can be characterized as very aggressive promotion surrounding that. This year, the promotion I'm glad to see you feel strong enough that this year's promotion is more modest.

Chip Brewer - *Callaway Golf - President, CEO*

Yes, this one was just to create attention.

Casey Alexander - *Gilford Securities - Analyst*

But at the same point in time, one part of last year's promotion was surprisingly successful and that was the golf ball aspect of the promotion, which does not appear to be repeated this year, which creates not only significant volume, but a great deal of new users, which may have become new Callaway ball adherents. So what was the thinking around not including the balls in the promotion this year?

Chip Brewer - *Callaway Golf - President, CEO*

Well, we did a little bit include them, but it's not the same magnitude of a price discount, unless the grass is (inaudible). So we don't have -- our inventories are in a good position, and we wanted to create some energy and attention around it, but also --

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Casey Alexander - *Gilford Securities - Analyst*

I didn't see how the balls were included in this promotion.

Chip Brewer - *Callaway Golf - President, CEO*

There is a golf ball 28 [pen] on the Hex Chrome Plus, which Phil used to win the Open Championship. So it was included, but last year it was such a significant saving story that it got more attention.

Casey Alexander - *Gilford Securities - Analyst*

As I recall, you mentioned it -- not only did it create a lot of volume, but it actually improved your efficiencies because of the volume that was created at the plant.

Chip Brewer - *Callaway Golf - President, CEO*

That's correct. We've also changed our golf ball operation. So we went from 800,000 square feet in Chicopee to 200,000 square feet. We're in the process of shutting down the Sun-Tech operation. We're a much more efficient operation. We don't need that same move at this point. And we just made an adjustment that this was the smarter play for this year. For last year, they made a much more aggressive play to cut through and we had some excess inventory move last year and we moved it.

Casey Alexander - *Gilford Securities - Analyst*

The next question is more sort of have you thought about this. Back when you were at Adams and you successfully took -- grinded away at market share over several years, you were really -- Adams was really the flea on the back of the dog. You could take market share and nobody would -- rarely was somebody going to come directly back at you. At Callaway, if you start taking market share you have significant competitors who are going to react to that and react to that, and from time to time with significant promotional activity because they have much higher inventories at risk. Have you considered how you have to run the business differently as a result of the fact that the reaction to you taking market share could be different now than it was in your past history?

Chip Brewer - *Callaway Golf - President, CEO*

Absolutely, Casey. Everything that you said is true. I'm not sure I love the flea analogy, but other than that I'm with you 100%. And it's already been occurred. So we gained significant market share during the first half of the year and there were strong competitor reactions, which we stood up to very well. We had responses and some of those include having the Optiforce line available and ready to launch. So what you're seeing in our playbook does anticipate the reaction that is completely logical. And what I love about it is we're showing we can perform in that environment. It's not speculative. It's happening and it's happening not only when the market conditions are good, because it would be one thing if we're all doing pretty well and we started gaining a little share. But as you know, this is a very atypical challenging year in the golf business. So that's happening and all of the other implications of the market share shifts. But we're holding our own and still gaining positive momentum.

So you're right. We did see that and we expect it to continue and we expect we'll be able to deal with it.

Casey Alexander - *Gilford Securities - Analyst*

I would have to say in light of what's been horrendous weather here and clearly promotional activity that started up in March, a guidance change of 2% on the top line is certainly acceptable under those conditions. So congratulations, keep it up.

Chip Brewer - *Callaway Golf - President, CEO*

Thank you. We will do our best and I appreciate it.

Operator

Mr. Brewer, there are no further questions. Do you have any closing remarks?

Chip Brewer - *Callaway Golf - President, CEO*

I just want to thank everybody for calling in today and we appreciate your support. We're committed to continuing the turnaround plan that we have in place. So thanks for dialing in and we look forward to keeping you updated.

Operator

Ladies and gentlemen, this does conclude today's conference call. Thank you for participating. At this time, you may now disconnect.
