FINAL TRANSCRIPT

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ELY - Q2 2011 Callaway Golf Co Earnings Conference Call

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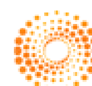

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CORPORATE PARTICIPANTS

Brad Holiday
Callaway Golf Co - Chief Financial Officer

Tony Thornley
Callaway Golf Co - Interim President & CEO

CONFERENCE CALL PARTICIPANTS

Phil Anderson
Longbow Research - Analyst

Dan Wewer
Raymond James - Analyst

Casey Alexander
Gilford Securities - Analyst

Craig Kennison
Robert W. Baird & Co. - Analyst

Jeff Blaeser
Morgan Joseph - Analyst

PRESENTATION

Operator

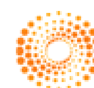
Good afternoon. My name is Marcello and I will be your conference operator today. At this time, I would like to welcome everyone to the Callaway Golf second-quarter earnings conference call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks there will be a Question-and-Answer session. (Operator Instructions) I will now turn the call over to Brad Holiday, Chief Financial Officer. Mr. Holiday, you may begin your conference.

Brad Holiday - *Callaway Golf Co - Chief Financial Officer*

Thank you, Marcello. I would like to welcome everyone to today's call. Joining me today is Tony Thornley, our Interim President and CEO. During today's conference call, Tony will provide some opening remarks and I will provide an overview of the Company's financial results for the quarter and we will then open the call for questions.

I would like to point out that any comments made about future performance, events, prospects, or circumstances including statements related to the reversal of the deferred tax valuation allowance in future periods, the estimated amount or timing of the charges or savings related to the Company's restructuring plan, the reinvestment of the savings, future estimates of operating expenses, the anticipated recovery in Japan and future growth or operating improvement, as well as the Company's estimated 2011 capital expenditures and depreciation amortization expenses, are forward-looking statements subject to Safe Harbor protection under the federal securities laws. Such statements reflect our best judgments today, based on current markets, market trends, and conditions.

Actual results could differ materially from those projected in the forward-looking statements as a result of certain risks and uncertainties applicable to the Company and its business. For details concerning these and other risks and uncertainties, you should consult our earnings release issued today, as well as Part 1, Item 1A of our most recent Form 10-K for the year ended December 31, 2010, filed with the SEC together with the Company's other reports subsequently filed with the SEC from time to time.



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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 pro forma information as to the Company's performance excluding charges associated with the Company's global operations strategy, a non-cash, TopFlite intangible asset impairment charge, non cash tax adjustments, including a deferred tax valuation allowance charge, restructuring charges, and the gain on the sale of 3 buildings. We will also provide information as to the Company's operating results on a currency neutral basis and information on the Company's earnings, excluding interest, taxes, depreciation, amortization expenses, and the TopFlite intangible asset charge. 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 like to now turn the call over to Tony for a few opening remarks.

Tony Thornley - *Callaway Golf Co - Interim President & CEO*

Thanks, Brad. And good afternoon, everybody. As we discussed last month, Callaway's financial performance has been a disappointment for too long. Our recovery from the global recession is clearly out of sync with the recovery of the golf industry as a whole. And the Company is weathering the effects of insufficient investments made on behalf of trend marketing and demand creation over the past few years. Aggressive and immediate action was needed and I'm pleased to report that the implementation of the broad organizational restructuring plans are progressing well.

Before getting into details, I think it's important to note several positives that Callaway holds as we enter this significant period of transition for the company. First, Callaway is an iconic brand that continues to be valued by golfers around the world. Second, the Company has recently made significant improvements in its operations and now operates at a lower cost than it has in many years. Third, and perhaps most important, Callaway's research and development team continues to introduce high-quality products with outstanding performance. As many of you know, Callaway has earned more gold medals than any other manufacturer over the last 5 years from Golf Digest's annual hot list equipment review. And our commitment to developing best-in-class products will remain steadfast moving forward.

These policies provide a strong foundation, however, we are obviously facing challenges and the figures we released today illustrate where several of them reside. Our mission is to return the Company's profitability in 2012. It begins with an extensive restructuring of the organization. This restructuring will produce an estimated $50 million in annual savings that better aligns our cost structure with our sales levels. It's clear to us that we need to connect more effectively with the golf consumer. As such, we plan to reinvest up to half of the $50 million in annualized savings behind marketing initiatives specifically aimed at strengthening our brands and promoting our products around the world.

It's also our position that investment alone does not create effective marketing. It's a calculated art form that must be treated with great care. We will be working diligently over the next stretch with several strategic partners to create impactful campaigns that energize the introduction of our products and reinvigorate the brand. The objective is to grow our sales profitably.

In addition to the significant savings, the Company's restructuring plan will streamline the organization, simplify our business processes, and increase the attention paid to our relationships with consumers and retail partners. We have created a central brand and product organization that will drive a coordinated message for our brand in all markets and be responsible for the commercial success of our products. We've also created 4 geographic regions that will implement the global brand plan with local character and be the primary owners of sales and earnings performance. Our intention is to utilize the power of our brand and our people to the fullest extent.

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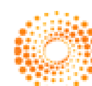

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Our restructuring resulted in a significant reduction in personnel that affected all levels of the Company and many people who had long service with Callaway. We are very sorry for the impacts on those individuals, though we felt these actions were necessary and right for the future of the business.

In regards to the Company's leadership, I'll repeat what I said on June 30. As Interim CEO, I am taking a long-term view of the business and will work full-time with the Board and senior management until we find a better leader for the Company. Our primary focus at present is on full implementation of our restructuring plan, our reinvestment in brand and consumer initiatives, and building our business around the world.

Working here in Carlsbad this past month had bolstered my belief that Callaway is a company with strong potential. Undoubtedly, there is a lot of work to be done but I have witnessed an incredible amount of passion amongst Callaway employees and our partners in all aspects of the golf business who are now prepared to play their part in restoring Callaway to its full leadership position in the golf industry. I view it is my role to convert all this passion and energy into business results of which we can all be proud. I strongly believe we can achieve growth in overall revenues, which combined with the benefits of restructuring and increased brand investment, can return our business to satisfactory levels of profitability. I'll now turn it back to Brad to give you some details on the financials and then I'll look forward to your questions.

Brad Holiday - *Callaway Golf Co - Chief Financial Officer*

Thanks, Tony. There is obviously a lot to cover in today's call. I want to start by addressing some key items that occurred in the second quarter. The first is the deferred tax valuation allowance.

While a very complicated calculation, let me try to simplify the facts as much as I can. There is an accounting practice that suggests that when you have sustained losses on your US business, it raises questions about your ability to utilize deferred US tax assets that reside on the balance sheet against future taxable income. And when taken into consideration with several other factors, may require a non-cash valuation allowance to be established against these deferred tax assets. The accounting practice doesn't necessarily take into consideration any unique and perhaps one-time factors and/or decisions that might have contributed to these sustained losses. It also doesn't specifically take into consideration the fact that these assets may have long-term expiration dates, which lessens the risk of not being able to use them in the future.

In the case of Callaway Golf, we have certainly encountered some one-time factors. But the accounting rules require that we establish a valuation allowance against our US deferred tax assets on our balance sheet. We have preliminarily estimated the amount of this non-cash valuation allowance in our June 29 communication to be approximately $46 million. But after further analysis, the valuation allowance actually recorded for the quarter was $57 million, which in addition to the allowance for December 31 balances, also includes an allowance against deferred tax assets generated for the first half of 2011. The balance in this allowance account will continue to increase as we establish allowances against future generated deferred tax benefits, until we reach a point of sustained profitability. At which point in time, these valuation allowances will be reversed as a non-cash benefit in the period when we reach that conclusion.

Now turning to the next topic, let me briefly review the $5.4 million impairment charge taken during the quarter against our TopFlite intangible assets. Throughout the year we review our intangible assets to assure that based on several factors the valuations are appropriate. In the case of our TopFlite intangibles, as you know in December, we took an impairment charge based on several factors, including our forecast of that business. That forecast, at the time, was based on the assumption that we would see general improvement in the golf industry this year and that some of the premium brands that have been competing in the same retail channels as the TopFlite brand would begin to depart those channels. Our actual results have been negatively impacted by a decline in rounds played in the US, which were down 6% through May, which has directly impacted overall golf ball sales, as well as the fact that these premium brands have remained in these channels as direct competitors to the TopFlite brand. For these reasons, we felt we needed to adjust our assumptions used in our impairment analysis, resulting in a $5.4 million non-cash pretax charge for the quarter.

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As mentioned by Tony, we have completed a major part of our restructuring plan that is estimated to generate approximately $50 million in gross annual savings. These actions will result in charges estimated to be approximately $15 million to $20 million, $5 million of which impacted the second quarter, with a majority of the balance occurring over the second half of 2011. A majority of these savings are the result of a reduction of about 7% of personnel globally, and consists primarily of savings in salaries, benefits, and lower FAS 123 expense for long term stock base compensation. The remaining savings will come from modifications of sales programs and reductions of other general expenses.

These savings will fall into various areas of the P&L with approximately $40 million coming from a reduction in operating expenses and the balance falling into cost of goods sold and sales discounts. Approximately $7 million of these savings will occur in the second half of 2011, with the balance positively affecting 2012.

So to be clear, our annual forecast for operating expenses for 2011 prior to this restructuring, and excluding the gain on the sale of the buildings that occurred in the first quarter, was approximately $380 million. Including the OpEx savings I just mentioned of $40 million, our new annualized run rate would be reduced to about $340 million before any reinvestment against the demand creation initiatives to drive sales and strengthen the brands that Tony mentioned. If you assume that we may spend up to half of the total savings, or $25 million, then our annualized OpEx run rate should be approximately $365 million in 2012. Hopefully, this provides some additional clarity around this action and the impact on next year.

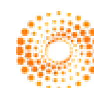
We are pleased to announce that we have recently closed on a new credit facility for $210 million, replacing our previous facility of $250 million that was to expire in February of 2012. This credit line is an asset-based facility secured by US and Canadian accounts receivable and inventory. Unlike our other facility, the available under this line flexes with our working capital needs throughout the year. It is a pretty simple facility with very few financial covenants and carries an interest rate of approximately LIBOR plus 250 basis points. The details of this facility will be included in our 8-K in case you want to review them in more detail. We appreciate the support of Bank of America, our lead bank and long-term partner, and the other banks who are participating in the facility.

Now let me turn to the pro forma operating results for the quarter and the first half of the year. All of the detailed financials are attached to our press release, but let me add some color on the operating results. These results will be on a pro forma basis and exclude charges for our global operations strategy, the deferred tax asset allowance, the TopFlite impairment, and the restructuring actions just taken. And also excludes the gain on the sales of the building that took place in the first quarter. A schedule was included with our press release to bridge GAAP results to the pro forma results.

For the second quarter, sales totaled $274 million, a decline of 10% compared to last year, with 51% of sales coming from the US and 49% from our international markets. Foreign currency rates were favorable for the quarter and positively impacted sales by $11 million. On a constant currency basis, sales would have declined by 14%. Sales in the US declined 15% to $139 million in the quarter and international sales declined 4% to $135 million. Excluding the $11 million positive impact of currency rates, international sales would have declined 12%.

On a year-to-date basis, consolidated sales declined 8% to $559 million, with the same split of 51% coming from the US and 49% from our international markets. Foreign currency rates have been favorable over the first 6 months, and have impacted sales by $19 million. On a constant currency basis, sales would have declined by 11%. Sales in the US were $284 million, down 9% compared to the first half of last year, and international sales were $276 million, down 6% versus a year ago. Excluding the $19 million positive impact of currency rates, international sales would have declined 11%.

Excluding Japan results for a moment, the balance of international sales were flat through the first 6 months compared to last year. And if you exclude favorable currency rates, they would have declined 6% compared to last year. Our Japan revenues in local currency through the first half of the year declined about 30% compared to last year, due primarily to the natural disasters that occurred in March. We are seeing continued improvement and recovery in Japan and believe that we will continue to see solid recovery over the balance of the year and into 2012.



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On a product category basis, through the first 6 months, wood sales were $146 million, a decline of 7% compared to last year. This decline was primarily due to the timing of the Octane launch in December of 2010, versus the first quarter of this year, as well as the sharp decline of sales in Japan for the reasons already mentioned. But was partially offset by a range of wood line that has significantly out-performed our expectations.

Iron sales were $131 million through June, an increase of 2% compared to last year. This increase is due to the strong sales through of the RAZR line, offset partially by the fact that we didn't have another model launched this year to anniversary last year's X-24 hot launch. Putter sales were $53 million, a decline of 27% compared to last year due to the fact that last year we launched a new platform of putters in the White Ice line, compared to few new model updates this year, along with the fact that the putter category was down 3% in the US this year.

Golf-ball sales were $99 million, a decrease of 9% compared to last year. Impacting sales is the fact that rounds played in the US are down 6% through May and we have not launched a new premium model this year and have not invested heavily in the promotion of our existing tour models. Accessory sales were $130 million, a decrease of 7% compared to last year, due to lower sales of package sets and GPS devices, offset partially by increases in apparel and footwear sales.

Pro forma gross margins for the quarter declined 150 basis points compared to last year, and were unfavorably impacted by higher raw material costs associated with increased oil prices as well as lower volumes and the related negative impact on manufacturing absorption, particularly in the ball business. This was partially offset by savings from our global operations strategy, favorable foreign currency rates, and product mix. On a year-to-date basis, pro forma gross margins were 43%, flat compared to last year, and were positively impacted by savings from our global operations strategy, offset by loss absorption on lower production volumes and a negative price mix variance due to the loss of high margin sales in Japan.

Pro forma operating expenses were $103 million for the quarter, compared to $98 million last year, due to an unfavorable foreign exchange impact and a slight increase in marketing expenses as we shifted spending more to the second quarter compared to last year. Year-to-date operating expenses totaled $209 million, compared to $207 million last year, again negatively affected by foreign currency rates. Other expenses improved by about a $1 million for the quarter, due to a net gain on FX transactions and through the first 6 months with approximately $2 million worse than last year due to higher interest expense and losses on hedge contracts.

Turning to our balance sheet, we ended the quarter with cash of $67 million, compared to $54 million last year, and consolidated net receivables were $253 million, flat with last year. DSOs were 84 days, a slight decrease from last quarter, and an increase compared to 76 days last year. The overall quality of our accounts receivables remain good. Net inventories were $215 million, flat with last year, and as a percent of trailing 12 months, sales was 23.2% compared to 21.8% last year, which represents a significant improvement compared to 27.1% last quarter.

We ended the quarter with $37 million outstanding on our credit facility, compared to no balance outstanding last year, and continue to have no long-term debt. Capital expenditures for the quarter were $7 million, and we estimate full-year CAPEX to be $25 million to $30 million. Depreciation and amortization expense was $9 million for the quarter and we estimate full-year of approximately $40 million. We would now like to open the call to questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Bill Anderson; Longbow Research. Please go ahead with your question.

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Phil Anderson - *Longbow Research - Analyst*

Yes. Thanks for taking my call. With Japan only down 5%, has demand returned to that great of an extent? Or were your expectations for Japan significantly higher than that prior to the tsunami? Or then, the second part of that question, what's the quality of those sales in terms of pricing and so forth? And if you have any expectations for the rest of the year in terms of Japan, that would be helpful. Thank you.

Brad Holiday - *Callaway Golf Co - Chief Financial Officer*

A lot of the (inaudible) reported in local currency is down about 30% so a lot of it is the foreign currency gain. So, we are still seeing the impact through the first six months of the disaster that happened in March. I think the way we would look at it is, Japan is slowly improving, continues to improve as the year progresses. We have seen heavier discounting by some of the competition over there in terms of trying to get consumers to come in and start buying again. We haven't participated at the same level as some of our competition. So we would expect it to continue to improve through the balance of the year and into next year. Phil, does that answer your question?

Phil Anderson - *Longbow Research - Analyst*

Yes. That's great. Thank you.

Operator

Dan Weaver; Raymond James. Please go ahead with your question.

Dan Wewer - *Raymond James - Analyst*

Thanks. Tony, on increasing the marketing budget, is it your perspective that the company was under investing, or is it your perspective that it was just the wrong message that was being conveyed in the marketing program? Perhaps an example, is the tie-in with Lamborghini may not have resonated with your true golf customer.

Tony Thornley - *Callaway Golf Co - Interim President & CEO*

Hi Dan. I think, indeed, my assessment is, it is a question of both, quantity and quality. Not picking on specific programs, I'm sure some would argue that the Lamborghini program is actually good in some respects. But overall, I think we would certainly all agree here that consistency in our message and having a strong message with impact on the consumer is very important. And then the share of voice which does involve the quantity of advertising and other ways to get our message out is very important, too. So, relative to the competition, we certainly are lagging in terms of our investment there. So we intend to correct that.

Dan Wewer - *Raymond James - Analyst*

Can you remind us on an annual basis what you invest in marketing so we can get a gauge of what this $25 million of incremental marketing would represent?

Tony Thornley - *Callaway Golf Co - Interim President & CEO*

We don't disclose specifically the marketing expenses, Dan. The SG&A expenses, you'll see.

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Dan Wewer - *Raymond James - Analyst*

Okay. A different question. I was looking at the golf ball performance here to date, and obviously, it's not very good. Actually, I'm looking at the golf ball performance going back in 2002, and it looks like there's only a couple of years that product ever generated a profit during the last decade. What is your commitment to the golf ball category?

Tony Thornley - *Callaway Golf Co - Interim President & CEO*

I believe that our golf ball has been really suffering from a very core issue that the company has had. But it's particularly true of the golf ball.

Dan Wewer - *Raymond James - Analyst*

What makes it unique?

Tony Thornley - *Callaway Golf Co - Interim President & CEO*

We have the very best golf ball consistently over the last several years. But the consumer just hasn't recognized that fully. And we've not, as you said, our segment results for the golf ball segment have shown marginal profits and marginal losses over the past few years and sales have been declining. Certainly the sales of TopFlite balls have been a significant contribution to the decline in sales overall. However, the bottom line is I think there's a lot of opportunity in our golf ball. And so we're looking at the ways to leverage our spending and promotion of our golf ball more effectively. And, we're going to continue to invest in developing the best golf ball on the market.

Dan Wewer - *Raymond James - Analyst*

I think the last question I have right now is on inventories. I'm looking at these correctly, they are relatively flat year-over-year despite the 10% drop in revenues. In effect, you had heavy inventories entering the quarter. How were you able to work off those? Was it through extra clearance or any other strategies that helped you reduce your inventories?

Brad Holiday - *Callaway Golf Co - Chief Financial Officer*

Well, Dan, a lot of the reason it was up again in the first quarter was timing. I think I mentioned in the first quarter we had brought things like bags in early because last year we kind of got caught with not having enough manufacturing capacity available to meet the demand. So part of it was just the timing of bringing some of the products forward. So it was just normal shipment of products through the quarter. We didn't do anything magical out there in terms of deep discounts to move products. So it's pretty much, sometimes you just get the timing of when inventory hits your books versus what you needed in the marketplace. And we talked last quarter about the fact that some of these products were brought in a little bit early in anticipation of shipping in the second quarter. So, it was just normal sales of products in the quarter.

Dan Wewer - *Raymond James - Analyst*

Great. Thank you.

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Tony Thornley - *Callaway Golf Co - Interim President & CEO*

I would just add that the quality of our inventory has always been good and from a financial reporting perspective remains that way. As Brad says, we're not doing anything particularly different in managing inventory. Obviously, later in the year, the natural course of the businesses that there are promotions and discounts and that will undoubtedly take place again.

Dan Wewer - *Raymond James - Analyst*

Okay.

Operator

Casey Alexander; Gilford Securities. Please go ahead with your question.

Casey Alexander - *Gilford Securities - Analyst*

Good afternoon. Has there been a new person named in charge of the international division now that Thomas Yang has left the company?

Tony Thornley - *Callaway Golf Co - Interim President & CEO*

Hi, Casey. No, we've actually as part of our new organization, we have flattened the organization. We have four regions now. Each of those is reporting directly to me.

Casey Alexander - *Gilford Securities - Analyst*

Okay. So there's not really an independent international silo anymore?

Tony Thornley - *Callaway Golf Co - Interim President & CEO*

There is no longer a corporate international organization.

Casey Alexander - *Gilford Securities - Analyst*

Okay. All right. Great. Brad, can you tell me, there's $10 million to $15 million of restructuring charges still to go in Q3 and Q4. Do you have an idea of how those are going to fall? Is it mostly going to fall in Q3? Or mostly in Q4? Or is it going to be evenly spread?

Brad Holiday - *Callaway Golf Co - Chief Financial Officer*

Let me take a look here. It's going to be more heavily in Q3 than Q4, Casey. Probably in the neighborhood of 80% of the remaining in Q3 and then a little bit, the other 20% in Q4.

Casey Alexander - *Gilford Securities - Analyst*

Okay, great. And how much is left in terms of potential charges for the global operations strategy? Or is that in that number?

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Brad Holiday - *Callaway Golf Co - Chief Financial Officer*

Well, that's separate from this number. And this is the last year of really the heavy investment in the global operations strategy. Once we get the manufacturing and distribution footprint changed this year, we will be pretty much done with the heavy lifting to get the global operations strategy as we defined it.

Casey Alexander - *Gilford Securities - Analyst*

Do you have an estimate for how much is left in terms of charges?

Brad Holiday - *Callaway Golf Co - Chief Financial Officer*

We're about halfway through, probably, for the year. I think roughly. I want to say we were in the neighborhood of probably around low 20s for the year, about halfway through it for the year.

Casey Alexander - *Gilford Securities - Analyst*

Okay. And why an asset-based line? Your line before was an unsecured line. How come its asset-based line now?

Brad Holiday - *Callaway Golf Co - Chief Financial Officer*

Because as I said, it flexes with our need for working capital. So as our receivables and inventory balances as an asset goes up, so does the need for credit if we were to need it to fund that working capital. This is very flexible. It has limited covenants associated with it. It just seems to make the most sense for our business.

Casey Alexander - *Gilford Securities - Analyst*

But that has always been the nature of your business. So if that's the correct line, why wasn't it an asset-based line before?

Brad Holiday - *Callaway Golf Co - Chief Financial Officer*

Well, this line goes back probably about seven years. We renewed it and expanded the terms. So it goes way back to seven years ago and our business has changed in size. And we just felt that this was the best facility to put in place right now given the needs of the business. It just needs to be more aligned with our working capital needs.

Casey Alexander - *Gilford Securities - Analyst*

Okay.

Tony Thornley - *Callaway Golf Co - Interim President & CEO*

And I would add, Casey, just repeating what Brad said, and it's a combination of flexibility and cost.

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Casey Alexander - *Gilford Securities - Analyst*

Right. Now the golf ball business, there were some questions about that before. Is there still any profitability penalty being paid for the relocation and realignment of the golf ball business that might improve at some point in time next year?

Brad Holiday - *Callaway Golf Co - Chief Financial Officer*

We have incurred some expenses in the GOS to move some of our operations to Mexico, some of the logoing. Aside from that, we've over the past couple of years have been sourcing more of our lower technology golf balls from overseas. So really, what remains in our facilities here in the United States are more of the higher technology premium golf balls, where trying to protect intellectual property is of more importance. But I will tell you that the guys in the facilities that we have right now have done a terrific job of really scaling the cost down the existing facility. But we've been doing a lot of that around the line, a lot of that around sourcing. But as part of the global operations strategy, we did move the logoing operation down to the Mexico facility.

Tony Thornley - *Callaway Golf Co - Interim President & CEO*

And Casey, I think, to me, we have had absorption issues so the fixed costs of ball manufacture is still a relatively high portion of the manufacturing costs. And so a key element of improving profitability is actually to get the volume up.

Casey Alexander - *Gilford Securities - Analyst*

Right. Well that would certainly help. You must be getting caught long supplies on the TopFlite side as that business keeps scaling back. So that would certainly help to get the volume up there. Tony, Can I ask you a question? Do you have a game plan for what you need to see in order to begin a new CEO search? What are kind of the dominoes that you need to see fall before you're going to engage in that process?

Tony Thornley - *Callaway Golf Co - Interim President & CEO*

We haven't come up with a firm program around that at this point, Casey. What I'm doing is I'm focusing on getting the team here to realize their full potential. And we would look for a CEO to carry on that program. We'll let you know when we are actually going to actively look for someone.

Casey Alexander - *Gilford Securities - Analyst*

Okay, great. Thanks very much.

Tony Thornley - *Callaway Golf Co - Interim President & CEO*

You're welcome.

Operator

Craig Kennison; Robert W. Baird. Please go ahead with your question.

Craig Kennison - *Robert W. Baird & Co. - Analyst*

Good afternoon. Thanks for taking my questions. Brad, could you repeat the operating expense run rate numbers you expect?

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Brad Holiday - *Callaway Golf Co - Chief Financial Officer*

Right. If you take a look at our current forecast this year, Craig, excluding the gain on the sale of buildings, our forecast was about $380 million for operating expense. So about $40 million of the savings is coming out of OpEx so that puts at a run rate of about $340 million. And if you assume up to $25 million would be sent back against the marketing and branding initiatives, that we'll put you at a run rate of approximately $365 million next year. And the reason I wanted to share that with you is because of the timing, you're going to see some of the benefits this year, and I wanted to talk more about an annual run rate. We have taken the costs out and run rate will drop, but we will spend some back into next year. But when you do the year-over-year comparison, it won't necessarily sync up with those numbers because some of, up to $7 million will be realized this year. Does that help?

Craig Kennison - *Robert W. Baird & Co. - Analyst*

It does help. Thank you. And if you look at the portfolio, you've talked about the golf ball business, but you do have additional brands beyond Callaway. You've got the GPS business as well. Do you see the portfolio remaining intact or are there changes to that portfolio as you consider this restructuring?

Tony Thornley - *Callaway Golf Co - Interim President & CEO*

Well, we're certainly going to look at every element of the business on a continuing basis with a view to achieving a return on investment on each of the segments of the business. And in addition, a positive impact on the brand. So every element of our business is going to have to pass those tests. We're not announcing any specific things at this point. But those are the measures we're going to use to assess our portfolio going forward.

Craig Kennison - *Robert W. Baird & Co. - Analyst*

And lastly, as you try to measure your reinvestment of let's say $25 million in marketing, how do you know whether that's effective? Do you mentioned that in market share points, in revenue dollars? What should we look at as a bogey to reach?

Tony Thornley - *Callaway Golf Co - Interim President & CEO*

I definitely look at that in terms of revenue dollars. I'm looking for that investment pay off relatively quickly in terms of growth in sales.

Craig Kennison - *Robert W. Baird & Co. - Analyst*

Okay. Thank you.

Operator

Jeff Blaeser; Morgan Joseph. Does go ahead with your question.

Jeff Blaeser - *Morgan Joseph - Analyst*

Thank you. Good evening. You mentioned $7 million in savings this year. Any offsets from marketing initiatives or is that run rate going to be consistent?

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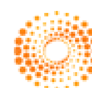

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Brad Holiday - *Callaway Golf Co - Chief Financial Officer*

Okay. We're going to have about $7 million of savings this year and our run rate next year will be about the 365. There will be maybe a little bit of incremental spending the balance this year against marketing initiatives to be determined. But, for example, in Japan, they typically have their big second season starting September, October. And if they launch a new product there will be some incremental market spend over their. I think a lot of the increases that Tony talked about is under development right now. I think to his point, if we believe there's a good return on it, we would probably go ahead and spend some of that. But a lot of those plans are in the process of being developed now. So we have to wait to see if we think there's a good impact. Typically, that's not the season you start to increase advertising. In the case of Japan, it is.

Jeff Blaeser - *Morgan Joseph - Analyst*

Yes. I was just thinking this year. What should we look for in terms of some of the market initiatives? Increased professional endorsements? More TV? More direct collaborations? Is there any particular areas we should look at to start seeing some of these things come through?

Tony Thornley - *Callaway Golf Co - Interim President & CEO*

Well, you'll probably see all of the above. But, you know, we're still working on just how we're going to invest that money. And we're certainly looking at the broad spectrum. I certainly think that you will see more advertising in general.

Jeff Blaeser - *Morgan Joseph - Analyst*

Okay. And any expectations for Japan rebounding or is it going to be next year? You should start to see some good jumps with easy comparisons? Or is it going to take a little while for that area to get back to where it was in the past?

Tony Thornley - *Callaway Golf Co - Interim President & CEO*

Well, I think we're certainly optimistic that as Brad mentioned, Japan is indeed recovering already. That we are hopeful that 2012 will be a year when revenues get back more towards, call it normalized, before the disaster levels. It remains to be seen how the market develops. There are a lot of repercussions of the disaster on how the market is working this year, and how that affects 2012. We are certainly optimistic that things are going to pick up in Japan next year.

Jeff Blaeser - *Morgan Joseph - Analyst*

Great. Thank you very much.

Operator

At this time, we have no other questions in queue. Mr. Thornley, do you have any final comments before closing the call?

Tony Thornley - *Callaway Golf Co - Interim President & CEO*

Yes. Thanks everyone for your questions. As stated earlier, there are challenges facing the Company and a lot of hard work ahead. However, I truly believe that the foundation we have in place is solid. The restructuring plan and investments and demand creation that we have designed, or are in the process of designing, is right for the business. And the talents and passion of our

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team will combine for a healthy turnaround in the business. I look very much forward to forward to working with you as Callaway moves ahead.

Operator

Ladies and gentlemen, this does conclude today's conference call. You may now disconnect. [end of transcript]

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