THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

ELY - Q1 2013 Callaway Golf Earnings Conference Call

EVENT DATE/TIME: APRIL 25, 2013 / 9:00PM GMT

OVERVIEW:

ELY reported 1Q13 consolidated net sales of $288m and EPS of $0.47. Expects full-year 2013 net sales to be $830m and non-GAAP loss per share to be $0.04. Expects 1H13 net sales to be $540m and earnings to be $0.44.

THOMSON REUTERS

CORPORATE PARTICIPANTS

Brad Holiday *Callaway Golf - CFO*

Chip Brewer *Callaway Golf - President,CEO*

CONFERENCE CALL PARTICIPANTS

Casey Alexander *Gilford Securities - Analyst*

Lee Giordano *Imperial Capital - Analyst*

Rommel Dionisio *Wedbush Securities - Analyst*

Craig Kennison *Robert W. Baird & Company, Inc. - Analyst*

Scott Hamann *KeyBanc Capital Markets - Analyst*

James Hardimann *Longbow Research - Analyst*

Brendan Smith *Cypress Capital - Analyst*

Devin Prater *D.A. Davidson - Analyst*

PRESENTATION

Operator

Good afternoon. My name is Ali and I will be your conference operator today.

At this time I would like to welcome everyone to the first 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. If you would like to ask a question during this time, simply press * then the number 1 on your telephone keypad. If you would like to withdraw your question, press the # key.

I would now like to turn the conference over to your host, Mr. Brad Holiday, chief financial officer. Sir, you may begin your conference.

Brad Holiday - *Callaway Golf - CFO*

Thanks, Ali, and welcome everyone to Callaway Golf, Company's first quarter 2013 earnings conference call. Joining me today is Chip Brewer, president and CEO of Callaway Golf.

During today's conference call I will provide some opening remarks and then Chip will -- excuse me -- Chip will provide some opening remarks and then I will provide an overview of the company's financial results, and then we will open the call for questions. We've also issued today a press release and schedules to the press release which provide additional detail concerning our results.

I would like to point out that any comments made about future performance, events, prospects, or circumstances including statements relating to estimated net sales, gross margins, operating expenses, operating income, net income, and earnings per share for 2013, future foreign currency rates, or the effectiveness of the company's hedging contracts; the company's turnaround, expectations for sell-through, market share, or inventory position in 2013; future improvements in operations, products, brand momentum, financial performance and shareholder value; as well as the company's estimated capital expenditures and depreciation and amortization expenses are forward-looking statements subject to Safe Harbor protection under the Federal Securities Laws.

Such statements reflect our best judgment today based on current market trends and conditions. Actual results could differ materially from those projected in the forward-looking statements. As a result of certain risks and uncertainties, applicable to the Company and its business. For details concerning these and other risks and uncertainties, you should consult our earnings release issued today as well as Part 1, Item 1A of our most recent Form 10-K for the year ended December 31, 2012, filed with the SEC, together with the company's other reports subsequently filed with the SEC from time to time.

In addition, during the call, in order to assist interested parties with period-over-period comparisons on a consistent and comparable basis, we will provide certain non-GAAP information as to the company's performance excluding the gain on the sale of the Top-Flite and Ben Hogan brands, charges related to the 2012 cost reduction initiative, and the impact of businesses that in 2012 were sold or transitioned to a third-party model.

We provide certain of the company sales 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.

With that, I'd 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.

For the first time in my tenure, and hopefully the start of a trend, I'm happy to start by saying we're pleased with our results. For Q1 on a constant currently continuing business basis, our team delivered a revenue increase of 12% year over year, and our pro forma operating income more than doubled. Our sell-through, brand momentum, margins, operating efficiency, and cost management were all improved.

I'll cover the sell-through and brand momentum portion later in my comments, but I do want to also highlight the strong progress our operations team has made in improving our supply chain and manufacturing base.

When I came to Callaway last March, we had just moved our assembly operation to Mexico and we were experiencing significant cost and service issues, particularly in our custom club business. One year later the situation looks completely different. In our Monterrey, Mexico assembly operation we have achieved a 45% labor cost per unit improvement and are now delivering 95% of our custom club orders to the consumer within 5 days of receiving that order. These are approaching world-class performance metrics, but fortunately we see further room for improvement and are taking steps to achieve that.

Similarly in our golf ball business, structural and process changes are delivering a 49% year over year productivity gain. Congrats and well done to the operations team for this progress and for their commitment to further gains. As we all know, these changes set up and support the gross margin and sell-through improvements we are seeing in the marketplace.

Looking at the regional performance for the quarter, our U.S. revenues were up 7% year over year based on improved sell-through and brand momentum. On a continuing business basis this was a 16% year over year increase, despite challenging year over year weather. Internationally, on a local currency basis, our European business was down 8% for the quarter, but our Japan business, historically one of our strongest and most profitable businesses, was up an impressive 22% year over year.

Unfortunately, as has well been documented, currency headwinds offset most of the gains in Japan and are anticipated to provide translation challenges going forward. Still, foreign exchange aside, I want to thank and congratulate the Japan team for a great operating performance and a strong start to the year.

On most of our previous calls I spent considerable time outlining our turnaround plan and talking about a new Callaway -- one that builds on our considerable strength and tradition but is also significantly more dynamic and contemporary. We are fortunately now starting to see some of the early results from these change efforts.

Our marketing and our product appear to be resonating well with consumers both in the U.S. and abroad, especially our X Hot product line -- in particular, the X Hot fairway wood, which I believe is the best fairway wood in golf -- and has returned Callaway to a position of strength in this important category.

All reports show our sell-through market shares are trending up on a global basis. In the U.S. our February year-to-date hard goods share of 13.4% is up from 12.6% in the same period last year, and with improved momentum and improved inventory position. In Japan our hard goods market share is at 12% through the first week of April, up from approximately 10% in the same time period last year. In Europe we don't yet have market share information, but account-specific data is indicative of market share gains as well.

We are very pleased with our year-to-date hard goods sell-through and maintain strong expectations for the future. However, after further analysis I do want to update a statement I made on our last call. In that call I said I expected to regain hard goods market share in all of our major markets in 2013. That is certainly happening in Japan; Europe is to be determined but we remain optimistic. However, after more analysis we are less confident that this will happen in the U.S.-Israel relationship

Our new launches are selling through well and we expect to continue to gain share in this portion of our business. However, in 2012 a significant portion of our market share was from products or programs that were not profitable; and during the year of 2012 we lowered our field inventory position by selling through old or excess inventory that we believed was or would clog the channel or cannibalize new product sales.

If all goes as planned, we're going to sustain the lower field inventory position we are now enjoying. We are also not going to anniversary a lot of this less profitable business. And thus, our full year total market share may not be as up as we much had previously assumed. Fortunately I believe the quality of the share, our brand momentum, and profitability are certainly headed in the right direction. I'm very comfortable with where we are and where we're headed, but I also just wanted to clarify these expectations, since I know many analysts and investors also track Datatech sell-through information.

Lastly, for the first time in several years, independent brand research conducted this spring showed an uptick in consumer perceptions for the Callaway and purchase interest in our product. This research matches the anecdotal feedback we're receiving as well as the sell-through market share of our premium products. It's another strong indication that we're headed in the right direction.

Turning now to market conditions. As everyone already knows, the weather patterns in North America and Europe were not very conducive for golf this winter and early spring. As a result, these markets got off to a slow start this year, which is the exact opposite of what happened last year, when the golf industry had one of the best early-weather seasons in recent memory. This year, slow start to the season, along with the market share shifting among major brands, is leading to some earlier-than-normal promotional activity and creates a higher than normal level of uncertainty for the all-important peak season that runs from April through August.

Net net we are still hoping for a good peak season but at this point there is some added market risk. On the positive side we are in a relatively strong position thanks to our sell-through and our field inventory positions.

In addition to the market conditions, exchange rates, especially the yen and to a lesser extent, the pound, are continuing to provide significant headwind. The timing of the currency movements, along with our accounting for the foreign exchange hedge contract gains, will shift our earnings towards the first half and away from the back half of the year. Brad will outline this issue with more specificity during his comments. However, for purpose of emphasis, let me clarify that. To the best of our abilities, all of these comments and expectations for market conditions are fully baked into our forecast and the guidance we are providing.

With that said, let me turn to the guidance. For the first half we are decreasing our revenue forecast from $555 million to $540 million. This decrease is based on the previously discussed market conditions as well as the foreign exchange headwinds. For the first half, this guidance would deliver a 7% increase in continuing business constant currency revenue. On the strength of our improved operating result and the fact that our hedging gains occur in the first half, we are increasing our first half earnings guidance from $0.33 to $0.44 per share.

For the full year we are now expecting revenues of approximately $830 million, a reduction of $20 million, which is almost entirely due to exchange rates. However, we are holding our previous earning expectations for break-even net income based on the hedging efforts and our improved operating performance, which includes both sell-through cost management, and operational efficiencies. Results consistent with this guidance would show a pro forma constant currency continuing business revenue increase of 12% for the year and an approximate $70 million improvement in pro forma pretax income.

When I step back and I look at the total picture, I'm proud of the team's results and pleased with the pace of our transformation. This transformation, paired with the strength of our global brand and recovering market conditions, is our primary investment thesis.

In closing, I remain confident that the clear and specific actions we're taking will in fact turn this business around and that we have a promising long-term outlook. During the balance of the year we'll be working to further drive our change effort along the same playbook that I outlined to you for over the last year. We expect continued improvement in operating efficiencies, product excellence, and engaging messaging, and that this will lead to brand momentum. Over time we believe this in turn will lead to steadily improved financial performance and shareholder value.

We did not predict nor can we control this year's weather pattern or foreign exchange movements. However -- and this is the part I would like to emphasize -- the items that are in our control are performing consistent with, or in some cases better, than expectations. We are on track for our turnaround plan, which we previously told you and we continue to believe is a multi-year process.

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

Brad Holiday - *Callaway Golf - CFO*

Thanks, Chip. I will quickly cover some of the highlights of the first quarter and then we'll open the call for questions.

Consolidated net sales for the quarter were $288 million, compared to $285 million in 2012, or an increase of 1%. This year's sales were adversely impacted by approximately $20 million due to the sale of the Top-Flite and Ben Hogan brands and the transition to a third-party model for the other products including U.S. footwear, apparel, and GPS businesses as part of last year's streamlining efforts. Excluding these sales from 2012 results, our current business had sales growth of approximately 8%. Additionally, foreign currency translation had a negative impact of $8 million on our international result. So on constant currency our current business sales grew 12% compared to the same period last year.

The 12% increase in net sales this year was due to the early launch of our 2013 products, the strong performance of our X Hot line of products -- especially the new X Hot fairway wood -- and the first quarter launch of our new Odyssey Versa line of putters, which has seen great sell-through already compared to last year's Odyssey MetalX line that was launched during the second quarter.

Income from operations improved to $40 million, or an increase of 44% compared to $28 million last year. This year's results include charges of $4 million associated with last year's cost reduction initiatives and 2012 results include a gain of $7 million from the sale of the Top-Flite and Ben Hogan brands. Excluding these adjustments, pro forma income from operations for 2013 more than doubled to $44 million, compared to $21 million last year.

Earnings per share increased 27% to $0.47 compared to $0.37 in 2012. This year's results include a $0.02 charge associated with last year's cost reduction initiatives and 2012 results include a gain of $0.05 associated with the sale of Top-Flite and Ben Hogan businesses. Excluding these adjustments and assuming a pro forma tax rate of 38.5% in both years, pro forma earnings per share for 2013 would have been $0.33 compared to $0.18 last year.

In looking at our regional breakouts, U.S. sales increased 7% to $160 million compared $150 million last year, and represented 56% of total sales, a slight increase compared to last year. On a comparable basis, excluding the impact of the businesses sold or transitioned last year, U.S. sales increased 16% compared to 2012.

International sales for the quarter were $128 million, a decline of 5% compared to last year's sales of $135 million, and represented 44% of total sales. On a constant currency basis, international sales increased approximately 1%, driven by Japan and Korea, which grew 22% and 12% respectively due to the positive reception of our X Hot line of products as well as the Odyssey Versa putters. These increases were offset by declines in Europe and Canada due to late starts of the season due to weather.

For our product categories, and excluding from 2012 sales the businesses we sold or transitioned last year, wood sales increased 10% to $100 million compared to $91 million last year. As mentioned earlier, this increase was due to the earlier shipping of our new products this year as well as strong sales of our X Hot line of products.

Sales of irons and wedges were $58 million, flat compared to 2012. Sales of wedges declined this year due to no new product launches during the quarter compared to last year, but was offset by the successful launch of our new X Hot irons.

Putter sales increased 35% to $33 million compared to $24 million last year due to the earlier launch of our new Versa line of putters in January of this year, compared to the MetalX line of putters that were launched during the second quarter of last year.

Golf ball sales of $43 million increased 22% compared to last year due to an increase in the sale of mid- to lower-priced golf balls, more than offsetting a decrease in premium golf ball sales, as we anniversary the 2012 launch of our Hex Black Tour and Chrome models.

Accessories and other sales decreased 3% compared to last year due to lower sales of gloves, bags, and package sets this year.

First quarter gross margins improved to 45% of net sales compared to 44% last year. Included in 2013 gross margins are charges of $2 million associated with last year's cost reduction initiative. Excluding these charges, pro forma gross margins improved to 46% compared to 44% last year due to last year's cost reduction initiatives, improved manufacturing efficiencies, and the positive impact of eliminating from this year's mix Top-Flite, Ben Hogan, and the other businesses transitioned to third parties; all of which was partially offset by the adverse impact of FX.

Pro forma operating expenses improved to $89 million compared to $103 million last year as a result of our 2012 cost reduction initiatives and the positive impact of FX.

Looking at the balance sheet we ended the quarter with $28 million in cash, compared to $52 million last year; and the outstanding balance on our credit facility decreased to $79 million at the end of the first quarter compared to $86 million last year.

Consolidated net receivables were $256 million, flat compared to $255 million last year; and DSOs of 81 days improved one day compared to last year. The overall quality of our accounts receivable remain good.

Net inventories decreased 15% to $202 million compared to $236 million in 2012 due to the impact of the sale of Top-Flite and Ben Hogan brands and the transitioning to a third party of our apparel and footwear business. I would point out that that this represents better inventory efficiencies given that our current business on a constant currency basis had a 12% increase in sales on flat net inventories.

Capital expenditures for the quarter were $3 million compared to $9 million in 2012. We estimate full-year CapEx at 15 to $20 million, unchanged from our last estimate.

Depreciation and amortization expense was $7 million for the quarter, compared to $9 million last year. We estimate full-year depreciation of $30 million, also unchanged from our last estimate.

With regards to pro forma guidance, let me start with the first half. Net sales are estimated at $540 million compared to our last guidance of $555 million. This adjustment and guidance is due primarily to our expectations that FX headwinds will continue as well as the impact of the late start to the season in both the United States and Europe, as Chip mentioned.

We are increasing our earnings guidance, however, from $0.33 to $0.44 due to better operating performance as well as favorable timing of the gains on our FX hedging contracts during the first half. As you are aware, we are never more than 70% hedged on our international business due to forecast volatility. So on an annual basis our FX hedging contracts will never completely offset the translation impact on our international results.

However, for the first half of the year, because accounting rules require that we revalue all outstanding hedge contracts at current rates, we estimate the gains recognized on these contracts will be greater than the translation impact on the first half of our international operating results. Second half results should be adversely impacted because if rates remain the same, international operating results for the second half of the year will continue to be adversely impacted with no offsetting hedging gains.

For the full year, assuming that FX rates remain flat at current spot rates, we are lowering our net sales forecast from $850 million to $830 million, which in constant currency would represent growth of 12% for our current business compared to 2012. We estimate that pro forma gross margins as a percent of sales will remain at approximately 40% for the full year, consistent with our last guidance, due to improved operating performance offsetting the negative impact of unfavorable FX rates.

Even though we are maintaining our gross margin percent, the reduction in our sales estimate will result in lower gross margin dollars that we estimate will be offset by hedging gains and lower pro forma operating expenses, which are estimated to improve slightly to $335 million compared to our last guidance of $340 million.

For these reasons we are maintaining our estimate that non-GAAP net income will remain at break-even with a non-GAAP loss per share of $0.04 through the impact of dividends paid on the company's outstanding convertible preferred stock.

We would now like to open the call for questions.

QUESTIONS AND ANSWERS

Operator

Ladies and gentlemen, at this time if you would like to ask a question please press * then the number 1 on your telephone keypad. We'll pause for just a moment to compile the Q&A roster.

Your first question comes from James Hardimann with Longbow Research.

James Hardimann - *Longbow Research - Analyst*

Good afternoon, and congrats on what sounds like a pretty encouraging start to the year.

I guess my question is with regards to any visibility on the key selling season. Obviously over the years the first quarter doesn't really seem to have traditionally been the problem. You know, as we work our way through the year and we see some more sell-through trends that's really the rub here.

So I guess my question -- and I appreciate some of the market share data that you gave through February -- but as we're almost already in March -- I'm sorry, almost already in the month of May, is there anything you can tell us about the last couple of months, and I guess generally have you gained more visibility into the day-by-day trends of what's going on there at retail?

Chip Brewer - *Callaway Golf - President,CEO*

Sure, James. Thanks for the positive comments to start with. We appreciate that. We're pleased with the start.

And you're absolutely right. Historically the first quarter has not told the full story for Callaway or really any other golf brand. But I would say it's better to have a good start than not have one. You're exactly right. We only have Datatech's market share data through February, and that is premature. We have some information from individual retailers that we look at on a regular basis on sell-through, but we don't have full market data beyond that February at this point.

And it is encouraging at this point. Our products are selling through well and we're pleased with the brand momentum and progress on sell-through. The only relevant offset to that I see is the comments that I made this season, certainly in Europe and the U.S., got off to a slower start than normal. We've anticipated that the season would have normal weather -- whatever the heck that means -- versus last year's great weather, and what we think we got was worse than normal.

So market conditions, as you would expect there, have been affected and that creates a little bit of uncertainty in the quarter. But the net is we do think things are different than they were previously -- certainly in my tenure, which is only a year now -- we're selling through better. There are certain levels of risk, but like the position we're in. And to keep my legal team happy, everything I just said is fully baked into the guidance we gave you.

James Hardimann - *Longbow Research - Analyst*

Very helpful. And then just moving a little bit to the timing of the new product introductions. You made a couple comments in the prepared remarks about the like-for-like sales in the first quarter benefitting from not only earlier introductions but also pretty successful sell-through of those products. Is there any way to sort of tease out how much came from one versus the other? Obviously timing -- well, I guess that's the question in and of itself. Is that timing going to reverse itself in the second quarter, and is there any way to tease out how much came from solid sell-through trends versus just earlier timing?

Chip Brewer - *Callaway Golf - President,CEO*

Let me try on that. So there certainly was some shift from Q2 to Q1 relative to the timing of launches on a year over year basis, so that creates a positive impact. And obviously when you break down our guidance, we're saying we're going to grow faster in Q1 than we will in Q2 for various reasons, but part of it is that timing shift.

I think that first half is still a very good indication when you look at the half in total as opposed to by quarter. And I'll just reiterate that we are selling through well. There's always room for improvement and we're going to work hard to realize that. But significant improvement has been made and we are seeing that in the marketplace and customers are reporting that to us.

James Hardimann - *Longbow Research - Analyst*

Very helpful. Thanks, guys.

Chip Brewer - *Callaway Golf - President,CEO*

Thanks, James.

Operator

Your next question comes from Lee Giordano with Imperial Capital.

Lee Giordano - *Imperial Capital - Analyst*

Thanks. Good afternoon, guys.

Excluding the currency impact -- looks like Japan was up nicely in the quarter -- can you talk about what you're seeing in Japan trendwise and what's driving those gains over there?

Brad Holiday - *Callaway Golf - CFO*

Sure. The Japan team has just done a wonderful job. As you know, that's been one of the blessings of the position here. We've got a great brand position over there, a strong management team who's done well over a long period of time. And the market in Japan was up for the first -- actually they report data a little differently. So we have data for the first week of April over there, and market conditions are also cooperating in that market. It was almost 8% up, if I remember correctly, during that period. But our business was up 22% for the first quarter on a local currency basis. So just a wonderful job.

And you may recall we signed Ryo Ishikawa to the Callaway staff. That was a big move in support of the strong team we have there in brand position that has resonated well in that marketplace. And then on top of that, the team's just executing very well and the product's being received very well; in particular, the fairway wood. But really more across-the-board strength there that matches what we're seeing elsewhere but is even stronger than anywhere else. So great job to that team and off to a strong start but also have good market conditions in that market.

Lee Giordano - *Imperial Capital - Analyst*

Great. And then just secondly, can you talk a little more about the marketing strategy for the rest of the year? It seems that you're being more aggressive in social media, including a partnership with LinkedIn that we saw recently. Can you talk about that strategy and how you think it's working? Thanks.

Chip Brewer - *Callaway Golf - President,CEO*

Yeah. The marketing strategy, which I tried to outline for you with very little to actually show you for the last year, it's nice now to have at least a few months where you see the actual results of the change efforts and what the team's done. And again, from all measurable outside feedback it's working. Our marketing is more authentic; it's more engaging to the consumer. It's more benefit-oriented. We are working the social media side very hard. All of those things are combining, we think, in a positive manner.

You're going to see that same game plan for the balance of the year, candidly. The LinkedIn think you mentioned was just one element of the team's strategy there, which does include a much more robust digital marketing effort. But even in the traditional space our marketing is significantly different than it was a year ago; thus far seems good.

They're mixing in some real clever things, too. You've seen those bomb patches that we talked about and hopefully you've seen a little bit of that. In the month of May it's Odyssey month and you're going to see drain patches. So if they make a putt of a certain length, you'll get a patch for making the putt. Brad and I are pretty excited because we actually might get one of those. We've never actually got a bomb patch yet. Our marketing guy did but we're suspect on that.

Any further questions on the marketing?

Lee Giordano - *Imperial Capital - Analyst*

No. That's great. Thank you very much.

Chip Brewer - *Callaway Golf - President,CEO*

Sure. Pleasure.

Operator

Your next question comes from Scott Hamann with KeyBanc Capital Markets.

Scott Hamann - *KeyBanc Capital Markets - Analyst*

Hey, good afternoon, guys.

Brad Holiday - *Callaway Golf - CFO*

Hey, Scott.

Scott Hamann - *KeyBanc Capital Markets - Analyst*

Just want to understand some of the guidance revisions a little bit. I mean, you kind of alluded to a few things, but is it fair to say that the majority, or if not all of it, is currency translation and there's really no change to your underlying assumptions for the business, or is there something else in there?

Brad Holiday - *Callaway Golf - CFO*

For the full year the revenue revision is, for all intents and purposes, all currency. And we would have otherwise had it and we made up the balance in operating performance.

Scott Hamann - *KeyBanc Capital Markets - Analyst*

Okay.

Brad Holiday - *Callaway Golf - CFO*

So in the half it's a little more complicated, but for the full year it's all currency.

Scott Hamann - *KeyBanc Capital Markets - Analyst*

Okay. So Chip, just in terms of what you're seeing in channel inventory levels -- I know you really drew things down pretty aggressively at the end of last year. It seems like things are selling through this year, so maybe for Callaway versus the industry, where do you think you fit at retail? Because your implied second quarter is not a tremendous amount of sales growth, even constant currency. So just trying to understand, is that just a timing issue or are you just being conservative?

Chip Brewer - *Callaway Golf - President,CEO*

Very true. If you look at the first half, which I do think is the way you should look at it, we're seeing a 7% growth constant currency continuing business. But there was more in the first half than the second half.

We are in, we believe, a good position in terms of field inventory levels overall. We believe we are in better position than many of our competitors, and better positioned in the industry in total at this point. But we want to sustain that position going forward.

And Scott, I'm not sure if I can add much more to it other than that if you have further questions on it. But 7% growth for the half I think is the right way to look at it. You know, we were up on -- well, our U.S. business. Just look at the U.S. business -- 16% up on a continuing business basis. In the first half, the market was, we think, soft, so that would mean that we'd have to give some of that back during the second half but still be in a very good position.

Scott Hamann - *KeyBanc Capital Markets - Analyst*

Okay. And then Brad, just on the currency side, you've kind of given us some sensitivities I think in past years around what some of the flow-through would be and kind of how to think about moves and the basket of currencies. Any update you can provide on that?

Brad Holiday - *Callaway Golf - CFO*

You know, Scott, it's about the same as the last time we talked. About 65% of the translation would flow through. And the way you look at it is you have a negative hit on the sales side you get a positive hit or positive benefit for all of the local spending. So about 65 to 70% flows through to operating income on a local basis. So that hasn't changed. It's about the same that it's been for the last several years.

And I think just to clarify, I think I mentioned in my comments that our policy says that we can really hedge up to about 70% of our forecast, if you will. And the reason it's at 70% is just because of forecast volatility. We never want to be over-hedged. And I would tell you that we were pretty close to that 60, 65% hedge for the year in terms of currency.

So we really only kind of focused on the major currencies, and as Chip pointed out in his comments, the biggest changes that we've seen have really been in the yen and to a lesser extent the pound and a little bit on the Korean won. But I think the hedging program, for all practical purposes, is playing out the way we would expect.

I think also, to Chip's point of view, we'll get all of the gains on those hedging contracts in the first half and, assuming that spot rates stay flat, there'll be no additional gains or losses against those contracts -- we know there will be because the spot rates will change a little bit. But the translation against our business happens every quarter where the rates are. So that sort of gets spread out over the entire year. But as Chip said, the benefit of the hedges are really front-end-loaded.

Scott Hamann - *KeyBanc Capital Markets - Analyst*

Okay. Thanks.

Brad Holiday - *Callaway Golf - CFO*

You bet.

Operator

Your next question comes Rommel Dionisio with Wedbush Securities.

Rommel Dionisio - *Wedbush Securities - Analyst*

Yeah, thanks. Good afternoon.

Just a golf product/marketplace-related question. You know, during the economic downturn I think some of the higher price points, especially in the woods category, the driver category, saw some consumer shift to more value price points. And I wonder now that the economy's picking up a little if you're seeing that sort of revert back to normal type of product mix, not just for yourself but for the industry also.

Brad Holiday - *Callaway Golf - CFO*

Hi, Rommel. Yes, we are. Over the last two years there's been a greater acceptance and interest in the more premium product, and you are seeing both in irons and in woods, so that is happening.

Rommel Dionisio - *Wedbush Securities - Analyst*

And in light of that, Chip, does that sort of make you rethink your new product launches for future years? Not to ask you to front us in terms of what you're going to be launching, but does that change your strategy going forward?

Brad Holiday - *Callaway Golf - CFO*

It's not new news to me recently, since I saw last year. But it's certainly a relief. Yeah, it does create degrees of freedom. But that 2009-2010 time period there was a pullback in buying patterns, and that appears to be relaxing, thank goodness.

We're always going to be, at Callaway, trying to drive innovation and product performance that allows us to excite consumers and we're not ashamed to be paid for that. So to the best of our ability that strategy will continue and I think consumers will accept it.

Rommel Dionisio - *Wedbush Securities - Analyst*

Great. Thanks very much.

Brad Holiday - *Callaway Golf - CFO*

Thank you.

Operator

Your next question comes from Casey Alexander with Gilford Securities.

Casey Alexander - *Gilford Securities - Analyst*

Yeah. Hi. Good afternoon.

Brad Holiday - *Callaway Golf - CFO*

Hi, Casey.

Casey Alexander - *Gilford Securities - Analyst*

I'm trying to sort of parse out how the golf ball business is working. You have a $400,000 improvement in sales and a $4.5 million improvement in profitability, which is tremendous because this business has been an albatross for several years. Is this due to the absence of Top-Flite?

Now, you talked about some efficiencies. Can you kind of parse this out for me so I can understand how that happened?

Chip Brewer - *Callaway Golf - President,CEO*

Okay. First of all, it is a pretty good result, so that's for noticing it. It is partly due to the absence of Top-Flite and the streamlining of that business. And the operations team's done just a wonderful job of streamlining that operation. We recommitted to Chicopee but rescaled and greatly improved the productivity of our operation up there and you're seeing some of the positive impact from that in that P&L.

The golf ball business, it's still a hard category. Obviously consumables didn't have a great start to the year for multiple reasons, but partly because nobody was playing golf in major markets. But we're in a much stronger position going forward in our golf ball business and starting to show up in the financial statements.

Casey Alexander - *Gilford Securities - Analyst*

Is that an apples-to-apples, or how much Top-Flite runoff sales is in that 2012 number?

Chip Brewer - *Callaway Golf - President,CEO*

There is some; let's put it that way. Apples-to-apples we grew. Where it shows flat in the report, that does include Top-Flite business from -- $7 million? It includes $7 million in total.

Casey Alexander - *Gilford Securities - Analyst*

Okay. So you grew the business pretty impressively, then?

Brad Holiday - *Callaway Golf - CFO*

Yeah. And that was really (inaudible) balls that provided the growth in Q1.

Golf balls, as you said, is still going to be -- what do you call it -- the cage match, the grudge match for market share? Your quote is something like -- I butchered something similar to that. But we got ourselves in shape for the battle.

Casey Alexander - *Gilford Securities - Analyst*

All right. Good. Now, on the accessories business, down $14 million year to year, how much of that decline is pulling the apparel business out and turning it into a royalty business?

Chip Brewer - *Callaway Golf - President,CEO*

More than half is that, but we were also a little softer in some of the other businesses that go in there. But we improved the margins of those businesses. So when we took a look at that business we needed to get -- improve some profitability aspects of that. We're still a work in progress there like we are elsewhere, but most of the miss there -- not all of it, but more than half -- was the apparel and footwear.

Casey Alexander - *Gilford Securities - Analyst*

Okay. And lastly, can you give me a little color on, I think it was yesterday's announcement about the association with LinkedIn. Is this an attempt to penetrate the corporate golf universe? How do you expect an agreement like that sort of monetize itself? It seems to me that everything that we do in this world ought to relate to top and bottom line. How does that assist the company in its corporate goals?

Brad Holiday - *Callaway Golf - CFO*

Well, that's just a clever offshoot of our digital marketing effort. You know, LinkedIn obviously has a rich target demographic for us and good brand position and running a cooperative program with them we think will help us both get the word out on Callaway and sell some product to them. So it's just a clever little flanking strategy that the digital marketing team and marketing team in general came up with; just one of many clever little paths that we're using to restore the growth and profitability of the brand.

Casey Alexander - *Gilford Securities - Analyst*

It's a nice job here. Congratulations.

Chip Brewer - *Callaway Golf - President,CEO*

Thanks, Casey. Appreciate it.

Operator

Ladies and gentlemen, once again, if you would like to ask a question, please press *1 on your telephone keypad.

Your next question comes from Craig Kennison with Robert W. Baird.

Craig Kennison - *Robert W. Baird & Company, Inc. - Analyst*

Good afternoon. Thanks for taking my question as well.

Chip, I wanted to ask you a question just to get some historical context on how weather can play out in various product categories. Are you able to quantify sort of which categories are more consumable and therefore demand is destroyed, versus the categories where, look, it's just a deferral from Q1 to Q2?

I'd imagine, for example, if you're going to buy a driver this year it doesn't matter whether it happens in March or April, but golf balls are different?

Chip Brewer - *Callaway Golf - President,CEO*

Craig, I think you just nailed it. So golf balls is certainly a consumable, and lost rounds -- lost balls and lost rounds is lost revenue. So we have to move on on that basis. Gloves would certainly be in there, and then you get kind of noisy in bags and such. But clubs is generally not, but what the retailers and the old sages of the industry say, as long as it doesn't last too long, that the club business will just mostly shift.

And then what is too long? I can't tell you that but I know we're right up against the edge of it right now. This year, the weather was a little -- it was worse than average. So we will -- it will be better if it got good and stayed good and these courses opened up across the Midwest and northern climate. I think we're seeing that, but it's close this year to see where that'll end up.

Craig Kennison - *Robert W. Baird & Company, Inc. - Analyst*

Yeah. We're not seeing it where I live, unfortunately. But just to follow up on the guidance, then --

---

Chip Brewer - *Callaway Golf - President,CEO*

Yeah. That's the risk right now, Craig. And the other risk is that it makes people nervous out in the field.

Craig Kennison - *Robert W. Baird & Company, Inc. - Analyst*

Yeah. No doubt.

If I could just follow up on the guidance, then. Really, you're citing primarily currency as a risk factor, but there has to be some impact from the loss of consumable demand related to the weather.

Chip Brewer - *Callaway Golf - President,CEO*

Yep. And we factor that into our guidance and we were able to cover that.

Craig Kennison - *Robert W. Baird & Company, Inc. - Analyst*

Okay.

Brad Holiday - *Callaway Golf - CFO*

Our business, as you can tell, is performing well. Within the areas that we are able to control, we're meeting or exceeding expectations. And there have been some weather impacts this year which -- we're citing those for the reason to roll back revenue guidance in the first half, but we're not citing those for the full year, and that's intentional. We believe we can more than offset those issues; currency speaks for itself.

Craig Kennison - *Robert W. Baird & Company, Inc. - Analyst*

Makes sense. Thank you, guys.

Brad Holiday - *Callaway Golf - CFO*

Sure. Thanks, Craig.

Operator

Your next question comes from Devin Prater with D.A. Davidson.

Devin Prater - *D.A. Davidson - Analyst*

Hey, guys. This is Devin Prater on for Andrew Burns.

Brad Holiday - *Callaway Golf - CFO*

Hey, Devin.

Devin Prater - *D.A. Davidson - Analyst*

Just a quick question for you, and I apologize if I missed this earlier. But promotional activities in the quarter seemed pretty clean with the exception of some small discounts in TaylorMade woods. How do you guys view the promotional cadence in the channel now and what's the outlook for the rest of the season?

Brad Holiday - *Callaway Golf - CFO*

I think, Devin, that there was some more promotional activity in the market earlier in the season than normal, and we're waiting to see whether it stabilizes now or gets worse. So that is one of our risk factors in the Q2.

In addition to the slow weather start that just takes away the consumable portion earlier in the year, it has a tendency to make people nervous because their inventories aren't turning; there's natural reaction to that from whomever. And sometimes that stabilizes and the market behaves you want it to and sometimes it doesn't right now. So I don't really have a good prediction for you.

You know, we're prepared to deal with whatever comes our way but there's a slight risk that Q2 would be more promotional than "normal." But it's not a certainty at this point. It's a jump ball.

Devin Prater - *D.A. Davidson - Analyst*

Okay. Thank you very much.

Brad Holiday - *Callaway Golf - CFO*

You're welcome.

Operator

Your next question comes from Brendan Smith from Cypress Capital.

Brendan Smith - *Cypress Capital - Analyst*

Hi, guys. How're you doing?

Chip Brewer - *Callaway Golf - President,CEO*

Hi, Brendan.

Brendan Smith - *Cypress Capital - Analyst*

All right. Just a couple of clarifications and then a question. I guess first, I know that we're a little bit apples-and-oranges here given the discontinued operations. But 16% year over year growth in the U.S., when's the last time that happened?

Chip Brewer - *Callaway Golf - President,CEO*

Never happened before in my tenure, Brendan.

Brendan Smith - *Cypress Capital - Analyst*

Brad, what do you think?

Chip Brewer - *Callaway Golf - President,CEO*

I'm not sure it's happened even in my tenure since I've been here. That's a big growth for the first quarter. Been a while.

Brendan Smith - *Cypress Capital - Analyst*

Okay. Good. And then secondly, just to make sure that we have all the currency impact sorted out. So the guidance before last quarter was 7% for the first half; now with constant currency it's also 7%; correct.

Brad Holiday - *Callaway Golf - CFO*

Yeah.

Chip Brewer - *Callaway Golf - President,CEO*

Yep.

Brendan Smith - *Cypress Capital - Analyst*

And then the full year guide previously was 10%, and then now with constant currency it's actually 12%?

Chip Brewer - *Callaway Golf - President,CEO*

That's correct.

Brendan Smith - *Cypress Capital - Analyst*

Okay. And then, finally on the op margin side, I mean, 15% op margin in a Q1, obviously pretty impressive. And Chip, I know we talked about this in the past -- and I know Adams is not exactly the same business mix as Callaway, but given how long you operated that business at 10 to 12% op margins, why can't Callaway approach at least a 10% op margin over the longer term?

Chip Brewer - *Callaway Golf - President,CEO*

You know, Brendan, at this point I'm not in a position to give you where I expect it to be long-term, but I think we are headed in the right direction and we're going to be able to return this business to a viable, profitable, successful business.

We've outlined a turnaround path for you, a plan. It's a multi-year process and we're on that plan right now.

Brad Holiday - *Callaway Golf - CFO*

Brendan, I would just add also, comparing a full year operating margin target to a first quarter or first half, which is typically the peak season for golf, probably not a good comparison. You've got to look at it on an annual basis.

Brendan Smith - *Cypress Capital - Analyst*

Yep. No, completely. When you look back over history, 15% in the Q1 stands out as well.

Brad Holiday - *Callaway Golf - CFO*

Good.

Brendan Smith - *Cypress Capital - Analyst*

All right. Thanks a lot, guys.

Chip Brewer - *Callaway Golf - President,CEO*

Thank you, Brendan.

Operator

And ladies and gentlemen, we have now reached the end of our allotted time for questions and answers. I would now like to turn the call back over to Mr. Brewer. Do you have any closing remarks, sir?

Chip Brewer - *Callaway Golf - President,CEO*

No. I just want to quickly thank everybody for tuning in. Where the weather permits, go out and play some golf; we need you. And we look forward to updating you at the end of Q2. Thanks for your time.

Operator

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