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EDITED TRANSCRIPT

ELY - Q3 2013 Callaway Golf Earnings Conference Call

EVENT DATE/TIME: OCTOBER 24, 2013 / 9:00PM GMT

OVERVIEW:

ELY reported YTD consolidated sales of $716m and pro forma EPS of $0.33. 3Q13 consolidated sales were $178m and pro forma EPS was $0.33. Expects 2013 net sales to be approx. $836m and EPS to be negative $0.03 to positive $0.01. Expects 4Q13 revenue to grow 11% YoverY on constant currency continuing business basis.

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PRESENTATION

Operator

Good afternoon. My name is Rachel, and I will be your conference operator today. At this time, I would like to welcome everyone to the Callaway Golf Q3 Earnings Conference Call. (Operator Instructions)

I would now like to turn the call over to Mr. Brad Holiday, Chief Financial Officer. Sir, you may begin your conference.

Brad Holiday - *Callaway Golf - CFO*

Thank you, Rachel, and welcome, everyone, to Callaway Golf Company's Third Quarter 2013 Earnings Conference Call. Joining me today is Chip Brewer, our President and Chief Executive Officer.

During today's conference call, Chip will provide some opening remarks, 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 estimated full-year 2013 net sales, sales growth, gross margins, operating expenses, net income or loss and earnings or loss per share, future market conditions, the success of the Company's future products or the Company's turnaround plan, future improvements in operations, market share, brand momentum, financial performance, and shareholder value, as well as the --

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Operator

Excuse me, this is the Operator. Excuse me, this is the Operator. Excuse me, this is the Operator.

Brad Holiday - *Callaway Golf - CFO*

-- (inaudible). 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, which we also refer to as pro forma information. This information as applicable excludes the gain on the sale of the Top-Flite and the Ben Hogan brands, charges related to the 2012 cost reduction initiatives, and the impact of the 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, and 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 thank you for joining us on today's call.

I'm happy to say we had a strong quarter and I believe our results confirm our turnaround plan is on track and probably building momentum. I'd like to start the call by thanking the Callaway Golf team and employees for their hard work and commitment to turning this business around.

In Q3, we delivered impressive revenue growth. On a constant currency continuing business basis, our year-over-year revenues increased 38% for Q3 and are up 13% for the first nine months. We are confident this growth significantly outpaced our industry, which has experienced soft market conditions for the year in whole, especially in North America and Europe.

This growth, combined with our improved operating efficiency, led to improved financial performance, with our year-to-date pro forma income before taxes up $62 million year over year.

During Q3, our growth was aided by several factors, including improved market conditions in both the US and Europe, where better weather led (to) some more golf being played. It's worth mentioning that these conditions were more favorable than our expectations going into the quarter, which were conservative given the industry's performance through the time of our last call.

The growth was aided by new product launches, including the launch of the Mack Daddy wedges and Optiforce drivers, as well as the Legacy Black family of products and the Damascus IX putters in Japan.

There were no comparable launches to the Mac Daddy and Optiforce products in Q3 of 2012, and thus, these were incremental year over year. The legacy and Damascus IX products' anniversary launches that were split between Q3 and Q4 of last year and, thus, are not incremental for the year as a whole.

These new launches are consistent with our communicated plan of being more effective utilizing our R&D assets, be introducing more aggressive products more frequently, and thereby, delivering excitement throughout the year.

It is important to note that in the planning and execution of these launches, we are also managing inventory appropriately so it all fits together without overloading the [tray] or cannibalizing future sales.

Last, and most importantly, our Q3 growth was driven by better brand momentum and sell-through of the premium products we launched earlier this year. In our opinion, this is the primary cause of the improved results.

In support of this position, Datatech market share numbers show we continue to gain share in the US, finishing August with a 15.1% year-to-date hard good dollar share, up 110 basis points year over year and with a considerably better field inventory position than last year.

On a continuing business basis, our Q3 US revenues were up 33% for the quarter and are up 13% for the first nine months. I would like to take this chance to congratulate the US team on these excellent results.

Looking at major markets outside the US, we see the same pattern of market share growth in a strengthening brand.

In Japan, our year-to-date through September sell-through market share was at 14%, up 350 basis points year over year. This is the highest share gain of any major brand in that market, and our X Hot fairway woods are the number-one selling model of fairway woods in that market.

These share gains led to an impressive increase in local currency revenues of 47% for the quarter and 31% year to date. 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.

Turning to Europe, after a slow start to the year, this team delivered an exceptional quarter with constant currency continuing business revenues up a very strong 52% year over year and our hard goods market share continuing to show a positive trend.

In the UK, Europe's largest market, our year-to-date share through August was 14.8%, up 140 basis points year over year, and the most recent market share data shows that our X Hot driver has taken over the number-one selling position year to date in that market.

During the quarter, we also continued to make excellent progress in our Operations Group, where we are transforming our structure in support of improved cost, service, and capabilities going forward.

One example of this is our golf ball business, where our first nine-month operating income swung from a year-to-date loss of $8 million to a year-to-date profit of $3.5 million despite lower sales volume in this category. Excluding this year's cost-reduction initiatives, our year-to-date golf ball operating income would be a positive $8.2 million.

Turning to the financial side of our business, we again had a busy and productive quarter. We made an incremental investment of $5.7 million in TopGolf, a business that is gaining momentum and which we are increasingly bullish on.

We also converted an additional $23.4 million of our preferred equity to common, thereby improving our cost structure by eliminating the 7.5% after-tax dividend associated with this tranche of equity.

Last but not least on the product side, our recently announced Apex irons will hit the stores in December. Not a high-volume product on launch but an exciting product due to its performance and appeal. If you have not seen these, please check them out online, and if you're in the market for a set of irons, I can't recommend them highly enough.

We are also in the process of showing and selling in much of our spring 2014 product line. Reviews and feedback are positive. If you look at our 2013 success, it has been driven largely by clubs, especially woods. For 2014, we are anticipating continuing our momentum in clubs but also supporting it with a significantly improved position in both golf balls and accessories, two important categories where our revenues were down this year but where we have high expectations for 2014.

Moving to guidance --

We're pleased to be able to increase our full-year guidance, which is fully covered in our press release and Brad will go into more detail on during his section. However, I have to add that after several years of significant losses and negative momentum, the prospect of positive pro forma net income this early in our turnaround process is very gratifying.

Looking at Q4, our revised guidance shows constant currency continuing business revenue growth of 11% year over year. This estimate reflects Callaway continuing its positive momentum but also takes into account a conservative outlook for Q4 market conditions due to more competitive launches than normal for this time of year, moderate recent readings in overall consumer confidence, and our Company's specific plan to manage our inventory in a way which we believe will best position us for long-term success.

In closing, I remain pleased with our results year to date and remain confident that we are on track with our turnaround plan. With significant headwinds from both foreign exchange movements and weather conditions highlighting the first half of the year, 2013 has turned out to be a challenging year for the industry as a whole. Our results in face of these challenging conditions gives us even greater conviction in our path and our potential.

During the balance of the year, we will 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.

We believe we are demonstrating that our business planning, 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.

Consolidated sales for the third quarter were $178 million, an increase of 38% on a constant currency continuing business basis, which excludes the brands 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 $14 million due to changes in foreign currency rate and by approximately $9 million for the sold or transitioned businesses, increased 21%.

Sales in the US for the quarter were $67 million, an increase of 33% on a continuing business basis and an increase of 17% compared to last year on a GAAP basis.

International sales for the quarter were $111 million, an increase of 40% on a constant currency continuing business basis compared to last year.

On a GAAP basis, international sales increased 23% compared to last year and with 62% of consolidated sales due to the launch of legacy product in Asia during the quarter.

On a year-to-date basis, consolidated sales were $716 million, an increase of 13% on a constant currency continuing business basis.

Sales on a GAAP basis, which were adversely impacted by approximately $32 million due to changes in foreign currency rates and approximately $53 million for the sold or transitioned businesses, grew less than 1% compared to 2012.

Year-to-date sales in the US were $351 million, an increase of 13% on a continuing business basis, with sales on a GAAP basis increasing 1% compared to the same period last year.

International sales year to date were $365 million, an increase of 13% on a constant currency continuing business basis compared to last year.

Sales on a GAAP basis were flat compared to last year and represented 51% of consolidated sales.

Looking at year-to-date sales on a constant currency continuing business basis for our two largest international regions show that sales in Japan increased 31% year over year but on a GAAP basis in US dollars increased 7% due to the effect of a weaker Japanese yen.

Sales in our Europe region increased 7% but on a GAAP basis in US dollars were flat compared to last year due to weaker currencies and adverse economic and weather conditions this year.

On a product category basis, through the first nine months, our wood sales were $228 million, an increase of 26% compared to last year, due primarily to the success of our X Hot line of woods, as well as a successful third quarter launch of our new Optiforce products.

Iron sales were $152 million, an increase of 4% compared to last year, on a more streamlined and profitable product offering and driven by the success of our X Hot irons this year, along with our new Mack Daddy line of wedges launched into the market this past quarter.

Putter sales, which increased 30% for the quarter due to the timing of new product launch in Japan, have declined 4% on a year-to-date basis to $76 million due to a decline in the overall category this year, but despite this drop in sales, Odyssey has increased its year-to-date US market share by nearly 200 basis points to 30.3%.

Golf ball sales were $112 million, a decrease of 6% compared to last year, due to the sale of the Top-Flite brand last year, but sales of the Callaway branded balls have increased 12% compared to 2012.

Pro forma profitability for golf balls has increased significantly this year despite lower sales due to the actions we've taken this year to consolidate and better leverage our manufacturing footprint.

Accessory sales were $147 million, a decrease of 22% compared to last year, due primarily a reduction of approximately $26 million in sales associated with the businesses that were sold or licensed in 2012.

Pro forma gross margins for the third quarter improved significantly to 34% compared to 21% last year due to less promotional expense this year, the positive impact of the new full-priced product launched during the quarter, and continued strong demand for our higher-margin X Hot products this year.

On a year-to-date basis, pro forma gross margins have increased 350 basis points to 41% compared to last year, also due to less promotional expense and the success of the X Hot products, as well as improved manufacturing efficiencies.

Pro forma operating expenses for the third quarter declined 4% to $76 million compared to $79 million in 2012 as we begin to anniversary last year's cost-reduction initiatives.

Year-to-date pro forma operating expenses totaled $248 million, a reduction of 11% compared to $279 million last year, due primarily to these cost-reduction initiatives.

We had a pro forma operating loss for the third quarter of $15 million, which was an improvement of $32 million compared to a loss of $48 million last year.

Year to date, we have generated $45 million of operating income, an improvement of $57 million, compared to a loss of $12 million last year.

We had a pro forma loss per share for the third quarter of $0.18 compared to a loss per share last year of $0.50 and on a year-to-date basis have generated pro forma earnings per share of $0.33, an improvement of $0.60, compared to a loss per share last year of $0.27.

Turning to our balance sheet --

We ended this past quarter with cash of $38 million compared to $59 million last year.

Cash from operations through the first nine months improved significantly to a positive $8 million compared to a minus $29 million in 2012.

Please keep in mind that last year's ending cash balance of $59 million was positively impacted by the sale of the Top-Flite and Ben Hogan brands, as well as the net cash raise from last August's convertible debt issuance.

Additionally, we have no outstanding borrowings on our credit facility at this time.

Our consolidated net receivables were $157 million, a 10% increase compared to last year due to higher sales during the quarter.

DSOs improved to 81 days compared to 90 days last year, and we remain comfortable with the overall quality of our accounts receivables.

Net inventories were $191 million, a very slight increase compared to $189 million last year. We had increases in new product inventory during the quarter as we prepare for the launch of our new 2014 products, which were offset by a decline in inventory associated with the businesses sold or licensed last year.

Capital expenditures for the first nine months were $9 million, and at this time, we estimate approximately $15 million for the full year, which is at the low end of our previous guidance.

Depreciation and amortization expense for the first nine months was $20 million, and we estimate full year at approximately $26 million, consistent with our previous guidance.

As Chip mentioned in his earlier comments, the annual guidance we provided last quarter was based on the assumption that industry trends would continue to be challenged in the US and Europe during the second half of the year.

Weather and industry trends actually improved in the third quarter compared to the first half of this year, which, along with gains in our hard goods market share, driven by improved brand momentum, resulted in our third quarter sales exceeding our internal estimate. For these reasons, we are increasing our annual forecast to the following --

On a full-year basis, we are increasing our net sales forecast from our previous guidance range of $810 million to $820 million to our current estimate of approximately $836 million, which on a constant currency continuing business basis would represent 13% growth compared to last year.

Estimated pro forma gross margins as a percent of sales are now estimated to be approximately 39% plus or minus 20 to 30 basis points, which is at the high end of our previous guidance and would represent an increase of approximately 500 basis points compared to last year. This improvement is due to less promotional expense this year, the continued success of our X Hot products, along with improved manufacturing efficiencies.

Pro forma operating expenses are still estimated at approximately $320 million, consistent with our previous guidance.

As you may recall, our original guidance for 2013 OpEx was estimated at $340 million, which was a significant reduction from our $380 million annual run rate prior to last year's cost-reduction initiatives. However, given the challenging market conditions this year and in an attempt to offset the potential impact to earnings, we took actions early in the year to reduce spending in certain areas that we felt would have the least amount of impact on our turnaround plan.

These actions, along with the favorable impact of FX rates this year, have resulted in lower operating expenses -- lowering our operating expenses from the original estimate of $340 million to our current estimate of $320 million.

While we haven't completed our 2014 planning yet, we are assuming a return to a more normal market condition next year, and as a result, we expect to see an increase in our annual operating expenses as we restore the temporary cuts we made this year, assume some level of inflation, and look to make additional investments in tour and other areas to continue to fuel our turnaround. We will provide more details on 2014 in our January earnings call.

On a full-year basis, we now estimate pro forma net income of $2 million to $4 million, with earnings per share estimated to range between a minus $0.03 to a plus $0.01, which includes the impact of the dividends paid on the Company's outstanding convertible preferred stock. This estimate compares to our previous net income guidance ranging from breakeven to a loss of $6 million and a loss per share ranging from $0.04 to $0.12.

We will now open the call for questions. Rachel?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Scott Hamann, KeyBanc Capital.

Scott Hamann - *KeyBanc Capital Markets - Analyst*

I know, Brad, you kind of touched on a few line items as we kind of start to think about 2014. Can you kind of give us maybe some puts and takes that we should think about as we start to focus a little bit more on 2014? You know, just kind of general observations, gross margin kind of puts, takes, and kind of where you see this business shaking out next year?

Brad Holiday - *Callaway Golf - CFO*

We're not really prepared to do that, Scott. What I was trying to at least point out in the OpEx is that where we started the year at $340 million, down $20 million, about half of it's due to foreign currency and about half of it is due to cuts that we've made in areas that we felt would not have a significant impact on our turnaround.

As we think about next year and think about returning to kind of more normal conditions, you would assume that we will -- well, we're assuming that we will try to recapture the spending that we delayed this year, if you will, and if you add some inflationary effect in there, as well as some additional investment, as we've talked about, on tour, that the number certainly is not going to be in that 320 range. There will be some growth there. While we're not prepared to tell you specifics on that because we're still kind of working through our 2014 planning, if you will, just thought it was important to let you know that that base is going to go up from this year. It's just not reasonable to stay at this same base.

Scott Hamann - *KeyBanc Capital Markets - Analyst*

Okay. So on the ball business, you kind of identified that there were some opportunities there. I know you lay the groundwork with some of the back office stuff and on the manufacturing side. I mean what are some of the things that need to get done to get that business kind of ramping up? Is it distribution or how should we think about that?

Chip Brewer - *Callaway Golf - President, CEO*

Sure, Scott, Chip. You were correct. Some of the heavy lifting we did this year was on the operations side, and the operations team should be commended for what they've been able to accomplish or are in process of accomplishing on that front.

For next year, we're going to have a premium ball launch, which we didn't have in a meaningful way this year. The HEX Black Tour ball launched in 2012, and we did not have as significant a premium ball entry in 2013, and then it was a difficult year in the market given the market conditions this year, with [grounds] down through the first half of the year almost double digit. This was a tough year for golf balls.

So a lot of it is cycles in terms of weather, our launch cycles, and I also believe the brand is strengthening, and we're bullish on the product offering that we're going to be bringing out for 2014.

The last thing is on the distribution side, and one of the opportunities that we will -- we believe we can continue to improve on is distribution and particularly at the [Green Grass] channel, where as our brand strengthens, we have high expectations.

Scott Hamann - *KeyBanc Capital Markets - Analyst*

And just -- I mean the final question on that, on that brand momentum stuff that you guys are talking about, I mean how are you kind of -- outside the retail sell-throughs kind of collecting information and gaining anecdotal evidence that it really is the brand? Is it a penetration of a certain caliber player, or how are you kind of measuring that?

Chip Brewer - *Callaway Golf - President, CEO*

Well, you can measure it lots of ways, and we do. You can measure your -- on an anecdotal basis or a relatively wide swap look at the people talking about the brand, the social chatter, the amount of good players that are starting to put Callaway back in the bag, and such. You can look at the market share.

But you also better look at outside metrics, such as Golf Datatech research and the Attitude and Usage survey. The most recent survey showed that the brand strength increased both in the spring survey and the summer survey, and it was the first increases in brand strength in many years after some erosion for several years going into the year.

So from outside metrics to anecdotal to market share, we believe the data's clear we're moving in the right direction.

Scott Hamann - *KeyBanc Capital Markets - Analyst*

All right, great. Thank you.

Chip Brewer - *Callaway Golf - President, CEO*

Thank you.

Operator

Dan Wewer, Raymond James.

Dan Wewer - *Raymond James - Analyst*

Chip, when you sold Adams Golf to Adidas, I believe your operating margins were 8% to 9%, and looking back at Callaway's peak operating margins back in '07 and '08, they were in the mid-8% range, as well.

When you start to think about the art of the possible for the Company two, three, four years down the road, do you think that you have upside to that 8% or 9% operating margin, thinking the Company is a lot leaner than it used to be? You've discontinued some of these unprofitable business lines a year ago? Or on the other hand, do you look at this, this is a more complex industry, competitive challenges are intensifying, maybe that is kind of the lifetime peak or potential on operating margin rate?

Chip Brewer - *Callaway Golf - President, CEO*

Dan, good question. I don't remember the specifics of the Adams Golf margins, so I'll rely on your recollection on that front. The direct answer is we're not sure yet. We're working through a turnaround that's dynamic, and we're comfortable that we're going to get this business back to profitability.

Now, we're showing good path towards that. We've talked about on previous calls that what we've seen from well-run golf companies is operating margins in the 7% to 8% range, and we believe we can be and will be a well-run golf company, but again, the markets are dynamic enough at this point that we're not sure where and when all of this is going to occur and don't have that long-term conclusiveness at this point in time.

Dan Wewer - *Raymond James - Analyst*

Second question. You'd noted that Callaway is more successfully leveraging the R&D budget, newer products at a more frequent rate.

Chip Brewer - *Callaway Golf - President, CEO*

Yes.

Dan Wewer - *Raymond James - Analyst*

Of course, your competitor on the street is doing the same. It appears that product cycles are no longer one year; they're down to about six or eight months. Is there a risk that you could have the law of unintended consequences for the industry, that maybe that avid golfer is not going to spend $900 for a set of clubs knowing that six months later, he'll be able to find that same set for $600 or $700?

Chip Brewer - *Callaway Golf - President, CEO*

You're correct. One of our strategic initiatives here is leveraging the R&D assets, which is one of our crown jewels here at Callaway, and I love the opportunity to do that, and they're showing off some of their capabilities with some of these late experience products, including those Apex irons that will be out shortly.

And there's no doubt that over the last years, product lifecycles have shortened. I would say they're one-year cycles in most cases, not less than that, but I understand that you could argue on all sides of it.

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The outside research at this point doesn't indicate that it's an issue to the consumer to have the lifecycles shortened. In fact, they show excitement. There was just a report out by the NGF that researched some of that, and it showed that consumers are buying these products more frequently and have high satisfaction levels.

Could it click over a tipping point someday theoretically? I guess so, but I don't see any evidence that has me concerned about that at this point, and I think it's a strategic path that plays to Callaway's strength, and we're enjoying it as part of our strategy right now. I don't see the negative of it, although we do try to also manage our inventory levels, and it's how you do it sometimes, not just whether you're launching the new products, but how you're handling the old inventory positions and how you're phasing out between models. All of that fits together to deliver the effectiveness of the strategy.

Dan Wewer - *Raymond James - Analyst*

And just the last question I had. You had noted that you wanted to put a bigger focus on accessories in 2014. Does that imply you're reconsidering the changes that you made in the footwear and apparel model?

Chip Brewer - *Callaway Golf - President, CEO*

No, Dan --

Dan Wewer - *Raymond James - Analyst*

Otherwise, I'm --

Chip Brewer - *Callaway Golf - President, CEO*

Good question again. We have -- we've licensed out footwear and apparel, and we're happy with those positions. Those partners are doing well with those product lines. But what specifically -- we have a very large business in golf bags, gloves and towels, hats, etcetera. This is over a $100 million business for us, and as we came in and really changed everything last year, in the time that was permitted to us, we had to focus, and we did arguably a very good job, as judged by the market reaction, on the golf club side, particularly the woods.

We didn't do as much as we're in the process of doing on the accessory and golf ball line, and I've got high expectations for those going into next year, thanks to the team's work over the last 12 months in those particular categories.

Dan Wewer - *Raymond James - Analyst*

Great, thanks. I'm going to look forward to hitting those Apex clubs, right? Thanks.

Chip Brewer - *Callaway Golf - President, CEO*

I think you'll love them.

Operator

James Hardiman, Longbow Research.

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James Hardiman - *Longbow Research - Analyst*

Congrats on a pretty quick turnaround here given a tough start to the year.

So a couple questions here. I think, obviously, it's way too early to really quantify the opportunity for 2014, but I guess two things.

Weather stunk early in the year. That's picked up in the back half. Presumably any lost ball sales or you're not going to recoup that. I don't know. To the extent that you can look at prior years in which you had rough spring weather, is that an incremental opportunity as we look to next year? Do you think there's some pent-up sales on the club side?

And then I guess as I think about other potential opportunities, you guys scaled back, as you put it, on the OpEx early in the year given the weakness. Do you think that had any sort of negative impact on your top line that again might be able to be recouped next year?

Chip Brewer - *Callaway Golf - President, CEO*

Good questions, and James, I'm not really sure. What the people tell me around the industry even longer than myself is that as you get slow through Q1, you can pick it up in Q2 if the weather turns in Q2. It did not turn in Q2 this year. And so some of those had to be lost sales. I would think it's logical that there would be some potential to pick up a small portion of that into next year, but we're not going to be forecasting based on that.

We do expect better weather next year than this year through the first half, which is just running law of averages, so we would anticipate better market conditions from that basis going into next year.

Brad Holiday - *Callaway Golf - CFO*

What was the rest of the question?

James Hardiman - *Longbow Research - Analyst*

The OpEx spend that you scaled back on. I know you said that you tried to focus on opportunities that weren't going to really hamper your long-term ability to grow, but do you think that had any sort of negative impact on the top line this year?

Brad Holiday - *Callaway Golf - CFO*

I don't really think so, James, because overall, I'm pleased with our top line, and I know there are things that we can do better. We're working and debriefing on those, and we expect to be a stronger company and competitor going into next year. But I don't think there were meaningful items that impacted us in the short term, and so again, I'm not going to be forecasting growth for next year based on that individual change.

James Hardiman - *Longbow Research - Analyst*

Got it. And then, secondly, sort of another question on the new product cadence, I guess, a more consistent release of new products.

Chip Brewer - *Callaway Golf - President, CEO*

Yes.

James Hardiman - *Longbow Research - Analyst*

That's worked extremely well for you guys this year, and I guess in retrospect, it seems like the most obvious strategy change in the world. Obviously, it's easier said than done, and I'm sure at some point in the past, you guys have attempted to sort of mix up the cadence or expand the calendar.

What are sort of the puts and takes there? What allows your company to be able to do that today that you weren't able to do a year ago, two years ago, three years ago?

And, I guess, ultimately, is it a different customer that buys a club in the middle of the summertime? And are you designing towards that customer if it is -- if there is a distinction versus the guy that's first in line in January to buy their clubs?

Chip Brewer - *Callaway Golf - President, CEO*

I don't think it's a different customer, so let's take that one. It's often the same customer. I don't know what prevented Callaway from doing it in the past. They had -- one of the great assets here is the quality of the people and the R&D resources, and that's one of our assets that we're going to be leveraging now. We spend a great deal on R&D, and we're very proud of the resources there. And so using that as a weapon in this way makes perfect sense to me, and I'm not in a position to speak to strategies prior to me.

It's not just R&D, of course, though, because, again, this is perhaps one of the economies of scale that exists in the industry because you have to have an operations team, you have to have an inventory and planning team that have the ability to effectively maneuver through that.

It's one thing to design the product, and it's probably arguably among the most important things is the product is impressive, but if you can't market it effectively, if you can't deliver it effectively, if the operations team isn't managing the inventory cycles effectively, then the whole thing collides on itself, and that's one of the things that we're priding ourselves on right now is our ability to make that all fit together, and I think golfers enjoy it.

James Hardiman - *Longbow Research - Analyst*

Excellent. Thanks for the color, guys.

Chip Brewer - *Callaway Golf - President, CEO*

Thank you.

Brad Holiday - *Callaway Golf - CFO*

Thanks, James.

Operator

Andrew Burns, D.A. Davidson.

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

Congratulations on the quarter.

Chip Brewer - *Callaway Golf - President, CEO*

Thank you.

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

You discussed a certain level of conservatism for 4Q and cited a few factors -- the consumer, competitive launches -- but I was wondering if you saw anything towards the end of 3Q that also gave you pause, any changing consumer trends that rolled into that?

Chip Brewer - *Callaway Golf - President, CEO*

You know, I [said] what I saw, and it was clearly market conditions were better in Q3 than they were in the first half of the year, so that was positive, and we have continued some nice brand momentum, so that's positive.

But the outlook for the quarter is still somewhat uncertain, although we're projecting 11% growth. So we're still expecting to have a good quarter. We're still expecting -- I believe that will be a gaining-market-share position, and there are some offsetting factors, though, that I went through and mentioned.

Consumer confidence is to be determined, and that's well publicized. There are going to be a lot of competitive launches during the quarter. That might be good for the industry in total, but that will attract attention, and it will take away some attention from Callaway product at the time, and we're also managing our inventory positions in a way that we think maximizes the long-term potential of the business.

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

Great. Great, thanks. And the growth in Japan in the quarter and even year to date just phenomenal. Was hoping you could comment on the sustainability of that kind of growth trajectory, and as look forward, is there the product launch and market share gain opportunities to keep that type of momentum going into '14?

Chip Brewer - *Callaway Golf - President, CEO*

The team there has done a great job, so let me first just reiterate how proud we are of that team, and our brand strength and the quality of our team in Japan is clearly one of our strengths.

They have had 30% growth, if I remember correctly, or 31% growth constant currency year to date. No, they probably won't continue to grow 30% in any long-term fashion. That would make them the market over there if they did that. But I do have high confidence in that team, and they've demonstrated over long periods of time their ability to perform, and we recognized that and made some big investments with them, even going into a year where we've had to cut a lot of costs in 2012.

But at the same time, we signed Ryo Ishikawa because we knew the potential of the Japan market and the quality of our team over there.

That, combined with the other changes that we've made as a global group, has paid off very handsomely for us, and I continue to expect strength from Japan.

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

Thanks, and last question more of a point of clarification. You talked about optimism for the accessories category, and it sounds like that, and just to clarify, is going to be new product launches, exciting product within existing categories that you're already in?

Chip Brewer - *Callaway Golf - President, CEO*

That's correct, Andrew. We're optimistic regarding the line that we have for 2014.

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

Okay, great. Thanks, and good luck.

Chip Brewer - *Callaway Golf - President, CEO*

Thank you. I appreciate it.

Brad Holiday - *Callaway Golf - CFO*

Thanks, Andrew.

Operator

Lee Giordano, Imperial Capital.

Lee Giordano - *Imperial Capital - Analyst*

Chip, the brand really seems to be gaining momentum here. Can you talk a little more about the marketing strategy heading into 2014? What's been working for you this year in how you might be adjusting that? And then, secondly, how you might be planning to split the spend between traditional media or print for social media and then also increasing your exposure on the tour. Thanks.

Chip Brewer - *Callaway Golf - President, CEO*

Okay, sure, Lee.

You're right. The marketing team has done a wonderful job, and they're to be commended. They've really energized the brand. They've taken some strengths that we have had historically and added a contemporary flair and feel to it while also keeping us authentic. And they've really leveraged the new age digital space to bring energy back. We expect to continue to do that going into next year.

For competitive reasons, I can't really talk too much about the split between traditional marketing and digital, although I would expect what we've done this year will in many ways continue. We were active on both and believe that both serve very healthy and helpful purposes.

On the tour side, I do have the expectation to continue to invest on tour. I believe that's very relevant for the brand, and so we are looking at opportunities on that front.

Lee Giordano - *Imperial Capital - Analyst*

Got it. And just, lastly, putters saw a very nice growth this quarter. Can you talk about what drove that gain and just give us an update on Odyssey and what's going on there? Thanks.

Chip Brewer - *Callaway Golf - President, CEO*

Sure. Yes, a great job by the putter team. The Odyssey brand strengthened during the quarter. It was up something like 30%, which, again, impressive.

We had a product launch in Japan, but some of that was also -- there was a comparable launch last year in that market that was split between quarters, so -- the real strength is coming from the overall Odyssey brand, and I've talked in previous calls about the fact that we won all the accounts at all the majors, all the world championships for the first time in the history of the brand. We won the account on the Web.com tour this year.

On top of that, we've brought out some great new products with Versa and then the Tank product lines. The Tank product lines are particularly interesting with the counterbalance, and that, we are finding, is replacing anchored putters, long or mid-belly putters, with a alternative that will be conforming under the USGA rules going forward and takes away some of those issues for guys like me who have an occasional little wiggle problem on that last effort.

So great innovative product, strong brand success, tour success resonating well in the marketplace.

Lee Giordano - *Imperial Capital - Analyst*

Great. Thanks a lot.

Operator

Casey Alexander, Gilford Securities.

Casey Alexander - *Gilford Securities - Analyst*

Given the way that Callaway and also some of your competitors are as to you admittedly sort of tweaked up the new product cycle --

Chip Brewer - *Callaway Golf - President, CEO*

Yes.

Casey Alexander - *Gilford Securities - Analyst*

-- is it -- I mean I know (inaudible) can't eliminate it completely, but do you think it's changing the seasonality, and are we seeing some of that in this quarter's numbers?

Chip Brewer - *Callaway Golf - President, CEO*

Yes, I think it does, Casey, because part of the strategy, which I stated from the beginning, is we're going to bring energy and excitement all year long, and we're trying to do it in a way that doesn't cannibalize or create inventory issues. But it clearly does smooth some of the revenues that would have been -- if you'd only launch in Q1 and then you just hold on for dear life the rest of the year, that is no longer the way the game is played in the marketplace, the way -- and this new strategy will smooth it out a little.

Casey Alexander - *Gilford Securities - Analyst*

Okay. As sort of the [stalking horse] for the Company, there's been clearly some conversation that Mickelson is planning on playing less in the coming year. When does his deal come up? Does that cause some possibility for a negotiation against that? And does it concern you that he's going to play less during the course of the year?

Chip Brewer - *Callaway Golf - President, CEO*

No, it doesn't concern me, Casey. He's been a great ambassador. We stand by him. And if he's -- he's very hungry right now for continued success, and to the degree that he chooses to play less going forward, it will be because he believes that will best prepare him for the biggest events, or at least that's how I understand that thought process. I do not think this is a conclusion or definitive position from him or his camp at this point, and I would defer the rest of that to his camp on it. But if he chose to do that, it would not concern me.

Casey Alexander - *Gilford Securities - Analyst*

Yes, okay. Well, I did notice that even though he says he's playing less, he's in Malaysia this week, so--.

Chip Brewer - *Callaway Golf - President, CEO*

Yes, he's -- what's he going to do if he plays less? He plays golf when he's here, so he's going to be -- it will be interesting to see how that plays out, but he's motivated.

Casey Alexander - *Gilford Securities - Analyst*

Well, I'm going to ask you a different question. A considerable number of your touring pros, including Mickelson, have been playing the Chrome ball instead of the Tour Black, and yet I haven't really seen the Company sort of market to that, and price-wise, it's actually priced somewhere underneath the premium ball. Are there some plans to make a push on that and take advantage of that fact?

Chip Brewer - *Callaway Golf - President, CEO*

We tried to do that this year, Casey, and to a degree, we had some success with it. The Chrome+ ball was introduced in January of this year as an extension to the Chrome family. It was priced more moderately relatively to HEX Black Tour, and a phenomenal ball that we did convert some of our players, including Phil Mickelson, into, which obviously helps with sales.

So that has, we think, been successful for us this year. Although we didn't grow our golf ball revenue year over year, we did grow our Callaway-specific golf ball revenue because you've got to take into account that we sold Top-Flite.

Casey Alexander - *Gilford Securities - Analyst*

Right.

Chip Brewer - *Callaway Golf - President, CEO*

But we have other plans and some exciting plans for 2014 that we'll share with you at a later date.

Casey Alexander - *Gilford Securities - Analyst*

Okay. Can I ask, how many employees does the Company have now versus what they had one and two years ago?

And knowing that you were taking a really hard line on costs when you first got there, at what point in time do you start turning the employee count back up in order to really start to push growth of the Company, as opposed to turnaround?

Chip Brewer - *Callaway Golf - President, CEO*

You know, Casey, the employee count went down last year, unfortunately, because of the cost savings that we had to go through at this point in time, and it went down, and I don't have the specific numbers for you right now in terms of what our employee count is. I know we eliminated, unfortunately, over 200 positions last year.

As we ramped up Monterrey and as we take some distribution centers from third party to Company owned, you see some changes in employee count, but that is not necessarily an increase in cost structure. We're doing it believing that it is more efficient and effective.

And from time to time, there may be an incremental headcount added in a productive area or an area where we believe that will be needed to support the revenue growth and desires that we have going forward, but I don't have interest and desire to grow the employee count in a meaningful way. I don't think that the business will need that. A few here and there on some key positions, yes, but overall, we're going to have to stay attentive on costs, and that's a new reality for us.

Casey Alexander - *Gilford Securities - Analyst*

All right.

Brad, a question for you. In the exchange of the convertible preferred that took place during the third quarter, did the dividends that were promised to be paid through the December dividend payment date, was the cost of those accelerated into the third quarter?

Brad Holiday - *Callaway Golf - CFO*

Yes, they were, Casey.

Casey Alexander - *Gilford Securities - Analyst*

Okay. That's what I thought.

And, lastly, Chip, you said the Company made an incremental investment of $5 million plus into TopGolf. What's the sort of -- what's sort of the strategy there? Where do you see that investment going? The Company's got a considerable amount of money invested in TopGolf at this point in time, and I don't believe you control TopGolf, so where do you go with it? What's sort of the long-term strategy, and how do shareholders benefit by the investments that you've made in that?

Chip Brewer - *Callaway Golf - President, CEO*

Sure, good question. TopGolf is a phenomenal consumer experience, and it's developed into a very high-potential business, in our opinion. It's high growth, it's building momentum, and we think long-term it's high-potential return. It also has brand synergy with us and category synergy.

Now, you're correct; we have a minority position, so we don't have control, and it is a private business. So where we could liquidate those investment position is not something I can articulate for you right now. I can tell you as this business strengthens, we think it's a great asset and we think that there will be a positive return to the shareholders as a result. So not answering your question, unfortunately, because I can't.

Casey Alexander - *Gilford Securities - Analyst*

Well, let me ask you (inaudible). Was this investment sort of a prearranged capital call, or was this a voluntary investment?

Chip Brewer - *Callaway Golf - President, CEO*

I'm not sure I can answer the specifics because it's private company at this point, but we still have -- definitely voluntary, to start with, whether the -- but that business's situation is still private. They're not in need of excess outside capital, and they are funding growth with the existing ownership. Highly motivated to support them on that.

I can tell you the business is building momentum, Casey. It's a phenomenal consumer experience and developing into a very high-growth, strong business.

Casey Alexander - *Gilford Securities - Analyst*

All right. Well, I appreciate your taking my questions. I think this is the first time since about 2008 that people have been legitimately congratulating Callaway for a quarter, so I'll congratulate you, also. Good job.

Chip Brewer - *Callaway Golf - President, CEO*

Thanks, Casey. Appreciate it.

Operator

Scott Hamann, KeyBanc Capital.

Scott Hamann - *KeyBanc Capital Markets - Analyst*

Just had a follow-up here. As you kind of think about your position in the markets globally, I mean I think that the share numbers, at least domestically, are still below where they were. Can you remind us of, first of all, where hard goods share peaked and kind of how you think about that opportunity going forward as you continue to launch products?

Chip Brewer - *Callaway Golf - President, CEO*

Sure. Domestically, I believe we peaked at 19.6 approximately, I'm being told, and we're now at 15.1 year to date. So we think we can continue to gain share, Scott. We know that we're building momentum, but I'm sure there will be some challenges that will hit us at some point, and I think we'll work through those and continue to do well.

I don't know where the top is. There are strong competitors out there now. They obviously covet that share, but I think we can continue to improve on where we are right now.

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Scott Hamann - *KeyBanc Capital Markets - Analyst*

All right. Thanks, Chip.

Chip Brewer - *Callaway Golf - President, CEO*

Sure.

Operator

And you have no further questions at this time. I would like to turn the call back over to Mr. Brewer for closing comments.

Chip Brewer - *Callaway Golf - President, CEO*

Well, thank you, everybody, for your participation today, and we very much value your time and attention.

And to the Callaway Golf team, great job on this step in our journey to turning around this business and getting back to where we want to be.

Thanks for your time today, and appreciate everybody calling in.

Operator

And, ladies and gentlemen, this does conclude today's conference call. You may now disconnect.
