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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

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**Form 10-Q**

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☒ **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

**For the quarterly period ended June 30, 2019**

**OR**

☐ **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

**For the transition period \_\_\_\_\_ to \_\_\_\_\_**

**Commission file number 001-10962**

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**Callaway Golf Company**

**(Exact name of registrant as specified in its charter)**

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**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**95-3797580**  
(I.R.S. Employer  
Identification No.)

**2180 Rutherford Road, Carlsbad, CA 92008  
(760) 931-1771**

**(Address, including zip code, and telephone number, including area code, of principal executive offices)**

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Securities registered pursuant to Section 12(b) of the Act:

| Title of Each Class                      | Trading Symbol(s) | Name of Each Exchange on which Registered |
|--|-------------------|---|
| Common Stock, \$0.01 par value per share | ELY               | The New York Stock Exchange               |

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

|                         |                                     |                           |                          |
|-------------------------|-------------------------------------|---------------------------|--------------------------|
| Large accelerated filer | <input checked="" type="checkbox"/> | Accelerated filer         | <input type="checkbox"/> |
| Non-accelerated filer   | <input type="checkbox"/>            | Smaller reporting company | <input type="checkbox"/> |
|                         |                                     | Emerging growth company   | <input type="checkbox"/> |

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

As of June 30, 2019, the number of shares outstanding of the Registrant's common stock was 94,094,269.

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**Important Notice to Investors Regarding Forward-Looking Statements:** This report contains "forward-looking statements" as defined under the Private Securities Litigation Reform Act of 1995. Forward-looking statements can be identified by words such as: "may," "should," "will," "could," "would," "anticipate," "plan," "believe," "project," "estimate," "expect," "strategy," "future," "likely," and similar references to future periods. Forward-looking statements include, among others, statements that relate to future plans, events, liquidity, financial results or performance including, but not limited to, statements relating to future stock repurchases, cash flows and liquidity, compliance with debt covenants, estimated unrecognized stock compensation expense, projected capital expenditures and depreciation and amortization expense, market conditions, future contractual obligations, the realization of deferred tax assets, including loss and credit carryforwards, future income tax expense, the future impact of new accounting standards, the integration of the JW Stargazer Holding GmbH ("Jack Wolfskin") acquisition, the related financial impact of the future business and prospects of the Company, TravisMathew, LLC ("TravisMathew"), OGIO International, Inc. ("OGIO") and Jack Wolfskin and the impact of the 2017 Tax Cuts and Jobs Act (the "Tax Act"), which includes a broad range of provisions that could have a material impact on the Company's tax provision in future periods. These statements are based upon current information and the Company's current beliefs, expectations and assumptions regarding the future of the Company's business, future plans and strategies, projections, anticipated events and trends, the economy and other future conditions. Because forward-looking statements relate to the future, they are subject to inherent uncertainties, risks and changes in circumstances that are difficult to predict and many of which are outside of the Company's control. As a result of these uncertainties and because the information on which these forward-looking statements is based may ultimately prove to be incorrect, actual results may differ materially from those anticipated. Important factors that could cause actual results to differ include, among others, the following:

- certain risks and uncertainties, including changes in capital market or economic conditions;
- a material impact on the Company's tax provision as a result of the Tax Act;
- consumer acceptance of and demand for the Company's products;
- future retailer purchasing activity, which can be significantly affected by adverse industry conditions and overall retail inventory levels;
- any unfavorable changes in U.S. trade, tax or other policies, including restrictions on imports or an increase in import tariffs;
- the level of promotional activity in the marketplace;
- future consumer discretionary purchasing activity, which can be significantly adversely affected by unfavorable economic or market conditions;
- significant fluctuations in foreign currency exchange rates and the degree of effectiveness of the Company's hedging programs;
- the ability of the Company to manage international business risks;
- the costs and disruption associated with activist investors;
- significant developments stemming from the U.K.'s decision to withdraw from the European Union, which could have a material adverse effect on the Company;
- adverse changes in the credit markets or continued compliance with the terms of the Company's credit facilities;
- delays, difficulties or increased costs in the supply of components needed to manufacture the Company's products or in manufacturing the Company's products, including the Company's dependence on a limited number of suppliers for some of its products;
- adverse weather conditions and seasonality;
- any rule changes or other actions taken by the USGA or other golf association that could have an adverse impact upon demand or supply of the Company's products;
- the ability of the Company to protect its intellectual property rights;
- a decrease in participation levels in golf;
- the effect of terrorist activity, armed conflict, natural disasters or pandemic diseases on the economy generally, on the level of demand for the Company's products or on the Company's ability to manage its supply and delivery logistics in such an environment; and
- the general risks and uncertainties applicable to the Company and its business.

Investors should not place undue reliance on these forward-looking statements, which are based on current information and speak only as of the date hereof. The Company undertakes no obligation to update any forward-looking statements to reflect new

information or events or circumstances after the date hereof or to reflect the occurrence of unanticipated events. Investors should also be aware that while the Company from time to time does communicate with securities analysts, it is against the Company's policy to disclose to them any material non-public information or other confidential commercial information. Furthermore, the Company has a policy against distributing or confirming financial forecasts or projections issued by analysts and any reports issued by such analysts are not the responsibility of the Company. Investors should not assume that the Company agrees with any report issued by any analyst or with any statements, projections, forecasts or opinions contained in any such report. For details concerning these and other risks and uncertainties, see Part I, Item 1A, "Risk Factors" contained in the Company's most recent Annual Report on Form 10-K, as well as the Company's quarterly reports on Form 10-Q and current reports on Form 8-K subsequently filed with the Securities and Exchange Commission from time to time.

**Callaway Golf Company Trademarks:** *The following marks and phrases, among others, are trademarks of the Company: Apex, Apex Tour, APW, Aqua Dry, Arm Lock, Backstryke, Big Bertha, Big T, Black Series, Bounty Hunter, C Grind, Callaway, Callaway Capital, Callaway Golf, Callaway Media Productions, Chev, Chev 18, Chevron Device, Chrome Soft, Cirrus, Comfort Tech, CUATER, Cuater C logo, Cup 360, CXR, 360 Face Cup, D.A.R.T., Dawn Patrol, Demonstrably Superior And Pleasingly Different, Divine, Double Wide, Eagle, Engage, Epic, Epic Flash, ERC, ERC Soft, Exo, Cage, Fast Tech Mantle, Flash Face Technology, FT Optiforce, FT Performance, FT Tour, Fusion, Fusion Zero, GBB, GBB Epic, Gems, Gravity Core, Great Big Bertha, Great Big Bertha Epic, Griptac, Grom, Groove, In, Groove Technology, Heavenwood, Hex Aerodynamics, Hex Chrome, HX, Hyper Dry, Hyper-Lite, Hyper Speed Face, Innovate or Die, Ion-X, Jack Wolfskin, Jailbird, Jailbreak, Kings of Distance, Legacy, Life On Tour, Longer From Everywhere, Mack Daddy, Magna, Majestic, MarXman, MD3 Milled, MD4 Tactical, MD5, Metal-X, Microhinge Face Insert, Nanuk, NipIt, Number One Putter in Golf, O OGIO, O Works, Odyssey, Odyssey Works, Ogio, OGIO ALPHA, OGIO ARORA, OGIO CLUB, OGIO FORGE, OGIO ME, OGIO MY EXPRESSION, OGIO RENEGADE, OGIO SAVAGE, OGIO SHADOW, Opti Flex, Opti Grip, Opti Shield, Opti Therm, OptiFit, Opti Vent, ORG 14, ORG 15, Paw Print, PRESTIGE 7, ProType, ·R·, Red Ball, R-Moto, Renegade, Rig 9800, Rossie, RSX, S2H2, Sabertooth, Shredder, Silencer, SLED, SoftFast, Solaire, Speed Regime, Speed Step, Steelhead XR, Steelhead, Strata, Stroke Lab, Stronomic, Sub Zero, Superhot, Supersoft, SureOut, TM, Tank, Tank Cruiser, Tech Series, Teron, Texapore, TMCA, Toe Up, Toulon, Toulon Garage, Tour Authentic, Tour Tested, Trade In! Trade Up!, TRAVISMATHEW, TravisMathew TM logo, Trionomer Cover, Truvis, Truvis Pattern, Tyro, udesign, Uptown, Versa, VFT, W Grind, Warbird, Weather Series, Wedgeducation, White Hot, White Hot Tour, White Ice, World's Friendliest, X-12, X-14, X-16, X-18, X-20, X-22, X-24, X-ACT, X Face VFT, X Hot, X Hot Pro, X² Hot, X Series, XR, XR 16, XSPANN, Xtra Traction Technology, Xtra Width Technology, XTT, 2-Ball.*

**CALLAWAY GOLF COMPANY  
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# PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements (Unaudited)

### CALLAWAY GOLF COMPANY CONSOLIDATED CONDENSED BALANCE SHEETS (Unaudited) (In thousands, except share data)

|   | June 30,<br>2019 | December 31,<br>2018 |
|---|------------------|----------------------|
| <b>ASSETS</b>   |                  |                      |
| Current assets:   |                  |                      |
| Cash and cash equivalents   | \$ 81,490        | \$ 63,981            |
| Accounts receivable, net  | 263,652          | 71,374               |
| Inventories   | 360,467          | 338,057              |
| Income taxes receivable   | 15,417           | 713                  |
| Other current assets  | 64,954           | 50,781               |
| Total current assets  | 785,980          | 524,906              |
| Property, plant and equipment, net  | 121,511          | 88,472               |
| Operating lease right-of-use assets, net  | 167,585          | —                    |
| Intangible assets, net  | 499,727          | 224,692              |
| Goodwill  | 209,773          | 55,816               |
| Deferred taxes, net   | 68,752           | 75,079               |
| Investment in golf-related venture  | 72,238           | 72,238               |
| Other assets  | 11,655           | 11,741               |
| Total assets  | \$ 1,937,221     | \$ 1,052,944         |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>   |                  |                      |
| Current liabilities:  |                  |                      |
| Accounts payable and accrued expenses   | \$ 208,287       | \$ 208,653           |
| Accrued employee compensation and benefits  | 39,074           | 43,172               |
| Asset-based credit facilities   | 165,467          | 40,300               |
| Accrued warranty expense  | 10,976           | 7,610                |
| Operating lease liabilities, short-term   | 27,253           | —                    |
| Current portion of long-term debt   | 4,643            | 2,411                |
| Income taxes payable  | 6,091            | 1,091                |
| Total current liabilities   | 461,791          | 303,237              |
| Long-term liabilities:  |                  |                      |
| Operating lease liabilities, long-term  | 143,717          | —                    |
| Long-term debt (Note 5)   | 465,826          | 7,218                |
| Income tax liability  | 4,005            | 4,430                |
| Deferred taxes, net   | 85,829           | 1,796                |
| Other long-term liabilities   | 14,117           | 1,955                |
| Commitments and contingencies (Note 13)   |                  |                      |
| Shareholders' equity:   |                  |                      |
| Preferred stock, \$0.01 par value, 3,000,000 shares authorized, none issued and outstanding at June 30, 2019 and December 31, 2018                | —                | —                    |
| Common stock, \$0.01 par value, 240,000,000 shares authorized, 95,648,648 shares issued at both June 30, 2019 and December 31, 2018, respectively | 956              | 956                  |
| Additional paid-in capital  | 319,579          | 341,241              |
| Retained earnings   | 489,445          | 413,799              |
| Accumulated other comprehensive loss  | (22,271)         | (13,700)             |
| Less: Common stock held in treasury, at cost, 1,554,379 and 1,137,470 shares at June 30, 2019 and December 31, 2018, respectively                 | (25,773)         | (17,722)             |
| Total Callaway Golf Company shareholders' equity  | 761,936          | 724,574              |
| Non-controlling interest in consolidated entity (Note 9)  | —                | 9,734                |
| Total shareholders' equity  | 761,936          | 734,308              |
| Total liabilities and shareholders' equity  | \$ 1,937,221     | \$ 1,052,944         |

The accompanying notes are an integral part of these financial statements.

**CALLAWAY GOLF COMPANY**  
**CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS**  
(Unaudited)  
(In thousands, except per share data)

|  | Three Months Ended<br>June 30, |            | Six Months Ended<br>June 30, |            |
|--|--------------------------------|------------|------------------------------|------------|
|  | 2019                           | 2018       | 2019                         | 2018       |
| Net sales  | \$ 446,708                     | \$ 396,311 | \$ 962,905                   | \$ 799,502 |
| Cost of sales  | 239,891                        | 203,614    | 517,655                      | 406,343    |
| Gross profit   | 206,817                        | 192,697    | 445,250                      | 393,159    |
| Operating expenses:  |                                |            |                              |            |
| Selling expense  | 113,113                        | 83,261     | 232,434                      | 166,221    |
| General and administrative expense                               | 35,423                         | 24,408     | 72,361                       | 46,302     |
| Research and development expense                                 | 13,082                         | 10,708     | 25,620                       | 20,332     |
| Total operating expenses   | 161,618                        | 118,377    | 330,415                      | 232,855    |
| Income from operations   | 45,199                         | 74,320     | 114,835                      | 160,304    |
| Interest income  | 476                            | 363        | 665                          | 415        |
| Interest expense   | (10,736)                       | (2,024)    | (20,564)                     | (3,604)    |
| Other income (expense), net                                      | 1,167                          | 5,522      | (773)                        | 1,016      |
| Income before income taxes                                       | 36,106                         | 78,181     | 94,163                       | 158,131    |
| Income tax provision   | 7,208                          | 17,247     | 16,764                       | 34,466     |
| Net income   | 28,898                         | 60,934     | 77,399                       | 123,665    |
| Less: Net (loss) income attributable to non-controlling interest | (33)                           | 67         | (179)                        | (57)       |
| Net income attributable to Callaway Golf Company                 | \$ 28,931                      | \$ 60,867  | \$ 77,578                    | \$ 123,722 |
| Earnings per common share:                                       |                                |            |                              |            |
| Basic  | \$ 0.31                        | \$ 0.65    | \$ 0.82                      | \$ 1.31    |
| Diluted  | \$ 0.30                        | \$ 0.63    | \$ 0.81                      | \$ 1.28    |
| Weighted-average common shares outstanding:                      |                                |            |                              |            |
| Basic  | 94,074                         | 94,367     | 94,377                       | 94,670     |
| Diluted  | 95,891                         | 96,928     | 96,153                       | 96,981     |

The accompanying notes are an integral part of these financial statements.

**CALLAWAY GOLF COMPANY**  
**CONSOLIDATED CONDENSED STATEMENTS OF COMPREHENSIVE INCOME**  
(Unaudited)  
(In thousands)

|   | Three Months Ended<br>June 30, |           | Six Months Ended<br>June 30, |            |
|---|--------------------------------|-----------|------------------------------|------------|
|   | 2019                           | 2018      | 2019                         | 2018       |
| Net income  | \$ 28,898                      | \$ 60,934 | \$ 77,399                    | \$ 123,665 |
| Other comprehensive income:   |                                |           |                              |            |
| Change in derivative instruments  | (5,567)                        | 1,894     | (8,741)                      | 338        |
| Foreign currency translation adjustments                                    | 1,321                          | (9,711)   | (1,657)                      | (4,990)    |
| Comprehensive income, before income tax on other comprehensive income items | 24,652                         | 53,117    | 67,001                       | 119,013    |
| Income tax benefit (provision) on derivative instruments                    | 1,916                          | 79        | 1,488                        | (170)      |
| Comprehensive income  | 26,568                         | 53,196    | 68,489                       | 118,843    |
| Less: Comprehensive income (loss) attributable to non-controlling interests | (231)                          | (401)     | (339)                        | 188        |
| Comprehensive income attributable to Callaway Golf Company                  | \$ 26,799                      | \$ 53,597 | \$ 68,828                    | \$ 118,655 |

The accompanying notes are an integral part of these financial statements.

**CALLAWAY GOLF COMPANY**  
**CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS**  
**(Unaudited)**  
**(In thousands)**

|   | <b>Six Months Ended<br/>June 30,</b> |             |
|---|--------------------------------------|-------------|
|   | <b>2019</b>                          | <b>2018</b> |
| <b>Cash flows from operating activities:</b>  |                                      |             |
| Net income  | \$ 77,399                            | \$ 123,665  |
| Adjustments to reconcile net income to net cash (used in) provided by operating activities:         |                                      |             |
| Depreciation and amortization   | 16,999                               | 9,766       |
| Lease amortization expense  | 15,279                               | —           |
| Amortization of debt issuance costs   | 1,295                                | —           |
| Inventory step-up on acquisition  | 10,703                               | —           |
| Deferred taxes, net   | 10,514                               | 30,273      |
| Non-cash share-based compensation   | 6,964                                | 6,464       |
| Loss/(gain) on disposal of long-lived assets  | 657                                  | (3)         |
| Unrealized (gain)/loss on foreign currency hedges   | 2,677                                | (1,021)     |
| Change in assets and liabilities, net of effect from acquisitions:                                  |                                      |             |
| Accounts receivable, net  | (156,548)                            | (166,354)   |
| Inventories   | 57,509                               | 23,415      |
| Other assets  | (1,182)                              | 2,476       |
| Accounts payable and accrued expenses   | (51,924)                             | (13,761)    |
| Accrued employee compensation and benefits  | (10,331)                             | (9,323)     |
| Accrued warranty expense  | 1,159                                | 1,378       |
| Change in operating and financing leases, net   | (14,335)                             | —           |
| Income taxes receivable/payable, net  | (16,224)                             | (1,972)     |
| Other liabilities   | (1,370)                              | 84          |
| Net cash (used in) provided by operating activities   | (50,759)                             | 5,087       |
| <b>Cash flows from investing activities:</b>  |                                      |             |
| Capital expenditures  | (23,403)                             | (17,107)    |
| Investments in golf related ventures  | —                                    | (282)       |
| Acquisition, net of cash acquired   | (463,105)                            | —           |
| Proceeds from sales of property and equipment   | 15                                   | —           |
| Net cash used in investing activities   | (486,493)                            | (17,389)    |
| <b>Cash flows from financing activities:</b>  |                                      |             |
| Proceeds from credit facilities, net  | 125,167                              | 8,385       |
| Principal payments on finance leases  | (232)                                | —           |
| Borrowings on long-term debt  | 480,000                              | —           |
| Debt issuance cost  | (18,971)                             | —           |
| Exercise of stock options   | —                                    | 1,258       |
| Dividends paid, net   | (1,893)                              | (1,897)     |
| Repayments of long-term debt  | (2,325)                              | (1,083)     |
| Acquisition of treasury stock   | (27,394)                             | (22,301)    |
| Distributions to non-controlling interests  | —                                    | (821)       |
| Net cash provided by (used in) financing activities   | 554,352                              | (16,459)    |
| Effect of exchange rate changes on cash and cash equivalents  | 409                                  | 835         |
| Net increase (decrease) in cash and cash equivalents  | 17,509                               | (27,926)    |
| Cash and cash equivalents at beginning of period  | 63,981                               | 85,674      |
| Cash and cash equivalents at end of period  | \$ 81,490                            | \$ 57,748   |
| <b>Supplemental disclosures:</b>  |                                      |             |
| Cash paid for income taxes, net   | \$ 4,602                             | \$ 5,329    |
| Cash paid for interest and fees   | \$ 17,061                            | \$ 3,288    |
| <b>Non-cash investing and financing activities:</b>   |                                      |             |
| Acquisition of minority interest  | \$ 18,538                            | \$ —        |
| Issuance of treasury stock and common stock for compensatory stock awards released from restriction | \$ 19,304                            | \$ 5,461    |
| Accrued capital expenditures at period-end  | \$ 1,629                             | \$ 1,729    |





The accompanying notes are an integral part of these financial statements.

**CALLAWAY GOLF COMPANY**  
**CONSOLIDATED CONDENSED STATEMENTS OF SHAREHOLDERS' EQUITY**  
**(Unaudited)**  
**(In thousands)**

| Shareholders' Equity Callaway Golf Company                 |               |               |                                  |                      |   |                |                    |   |                                 |                   |
|--|---------------|---------------|----------------------------------|----------------------|---|----------------|--------------------|---|---------------------------------|-------------------|
|  | Common Stock  |               | Additional<br>Paid-in<br>Capital | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Loss | Treasury Stock |                    | Total Callaway<br>Golf Company<br>Shareholders'<br>Equity | Non-<br>Controlling<br>Interest | Total             |
|  | Shares        | Amount        |                                  |                      |   | Shares         | Amount             |   |                                 |                   |
| <b>Balance at March 31, 2019</b>                           | <b>95,649</b> | <b>\$ 956</b> | <b>\$ 326,209</b>                | <b>\$ 461,456</b>    | <b>\$ (20,172)</b>                            | <b>(1,604)</b> | <b>\$ (26,595)</b> | <b>\$ 741,854</b>   | <b>\$ 9,480</b>                 | <b>\$ 751,334</b> |
| Acquisition of treasury stock                              | —             | —             | —                                | —                    | —   | (1)            | (17)               | (17)  | —                               | (17)              |
| Compensatory awards released from restriction              | —             | —             | (837)                            | —                    | —   | 50             | 837                | —   | —                               | —                 |
| Share-based compensation                                   | —             | —             | 3,529                            | —                    | —   | —              | —                  | 3,529   | —                               | 3,529             |
| Stock dividends  | —             | —             | —                                | (2)                  | —   | —              | 2                  | —   | —                               | —                 |
| Cash dividends (\$0.01 per share)                          | —             | —             | —                                | (940)                | —   | —              | —                  | (940)   | —                               | (940)             |
| Equity adjustment from foreign currency translation        | —             | —             | —                                | —                    | 1,552   | —              | —                  | 1,552   | (231)                           | 1,321             |
| Change in fair value of derivative instruments, net of tax | —             | —             | —                                | —                    | (3,651)                                       | —              | —                  | (3,651)   | —                               | (3,651)           |
| Acquisition of non-controlling interest                    | —             | —             | (9,322)                          | —                    | —   | —              | —                  | (9,322)   | (9,216)                         | (18,538)          |
| Net income   | —             | —             | —                                | 28,931               | —   | —              | —                  | 28,931  | (33)                            | 28,898            |
| <b>Balance at June 30, 2019</b>                            | <b>95,649</b> | <b>\$ 956</b> | <b>\$ 319,579</b>                | <b>\$ 489,445</b>    | <b>\$ (22,271)</b>                            | <b>(1,555)</b> | <b>\$ (25,773)</b> | <b>\$ 761,936</b>   | <b>\$ —</b>                     | <b>\$ 761,936</b> |

| Shareholders' Equity Callaway Golf Company                 |               |               |                                  |                      |   |                |                    |   |                                 |                   |
|--|---------------|---------------|----------------------------------|----------------------|---|----------------|--------------------|---|---------------------------------|-------------------|
|  | Common Stock  |               | Additional<br>Paid-in<br>Capital | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Loss | Treasury Stock |                    | Total Callaway<br>Golf Company<br>Shareholders'<br>Equity | Non-<br>Controlling<br>Interest | Total             |
|  | Shares        | Amount        |                                  |                      |   | Shares         | Amount             |   |                                 |                   |
| <b>Balance at December 31, 2018</b>                        | <b>95,649</b> | <b>\$ 956</b> | <b>\$ 341,241</b>                | <b>\$ 413,799</b>    | <b>\$ (13,700)</b>                            | <b>(1,138)</b> | <b>\$ (17,722)</b> | <b>\$ 724,574</b>   | <b>\$ 9,734</b>                 | <b>\$ 734,308</b> |
| Acquisition of treasury stock                              | —             | —             | —                                | —                    | —   | (1,655)        | (27,394)           | (27,394)  | —                               | (27,394)          |
| Compensatory awards released from restriction              | —             | —             | (19,304)                         | —                    | —   | 853            | 19,304             | —   | —                               | —                 |
| Share-based compensation                                   | —             | —             | 6,964                            | —                    | —   | —              | —                  | 6,964   | —                               | 6,964             |
| Stock dividends  | —             | —             | —                                | (39)                 | —   | 385            | 39                 | —   | —                               | —                 |
| Cash dividends (\$0.01 per share)                          | —             | —             | —                                | (1,893)              | —   | —              | —                  | (1,893)   | —                               | (1,893)           |
| Equity adjustment from foreign currency translation        | —             | —             | —                                | —                    | (1,318)                                       | —              | —                  | (1,318)   | (339)                           | (1,657)           |
| Change in fair value of derivative instruments, net of tax | —             | —             | —                                | —                    | (7,253)                                       | —              | —                  | (7,253)   | —                               | (7,253)           |
| Acquisition of non-controlling interest                    | —             | —             | (9,322)                          | —                    | —   | —              | —                  | (9,322)   | (9,216)                         | (18,538)          |
| Net income   | —             | —             | —                                | 77,578               | —   | —              | —                  | 77,578  | (179)                           | 77,399            |
| <b>Balance at June 30, 2019</b>                            | <b>95,649</b> | <b>\$ 956</b> | <b>\$ 319,579</b>                | <b>\$ 489,445</b>    | <b>\$ (22,271)</b>                            | <b>(1,555)</b> | <b>\$ (25,773)</b> | <b>\$ 761,936</b>   | <b>\$ —</b>                     | <b>\$ 761,936</b> |

The accompanying notes are an integral part of these financial statements.

**CALLAWAY GOLF COMPANY**  
**CONSOLIDATED CONDENSED STATEMENTS OF SHAREHOLDERS' EQUITY**  
**(Unaudited)**  
**(In thousands)**

| Shareholders' Equity Callaway Golf Company          |               |               |                            |                   |                                      |                |                    |  |                          |                   |
|---|---------------|---------------|----------------------------|-------------------|--------------------------------------|----------------|--------------------|--|--------------------------|-------------------|
|   | Common Stock  |               | Additional Paid-in Capital | Retained Earnings | Accumulated Other Comprehensive Loss | Treasury Stock |                    | Total Callaway Golf Company Shareholders' Equity | Non-Controlling Interest | Total             |
|   | Shares        | Amount        |                            |                   |                                      | Shares         | Amount             |  |                          |                   |
| <b>Balance, March 31, 2018</b>                      | <b>95,649</b> | <b>\$ 956</b> | <b>\$ 333,385</b>          | <b>\$ 374,758</b> | <b>\$ (3,839)</b>                    | <b>(1,228)</b> | <b>\$ (18,958)</b> | <b>\$ 686,302</b>                                | <b>\$ 10,209</b>         | <b>\$ 696,511</b> |
| Acquisition of treasury stock                       | —             | —             | —                          | —                 | —                                    | (131)          | (2,178)            | (2,178)  | —                        | (2,178)           |
| Exercise of stock options                           | —             | —             | (703)                      | —                 | —                                    | 77             | 1,209              | 506  | —                        | 506               |
| Compensatory awards released from restriction       | —             | —             | (1,122)                    | (8)               | —                                    | 73             | 1,130              | —  | —                        | —                 |
| Share-based compensation                            | —             | —             | 3,465                      | —                 | —                                    | —              | —                  | 3,465  | —                        | 3,465             |
| Cash dividends (\$0.01 per share)                   | —             | —             | —                          | (943)             | —                                    | —              | —                  | (943)  | —                        | (943)             |
| Equity adjustment from foreign currency translation | —             | —             | —                          | —                 | (9,310)                              | —              | —                  | (9,310)  | (401)                    | (9,711)           |
| Change in fair value of derivative instruments      | —             | —             | —                          | —                 | 1,973                                | —              | —                  | 1,973  | —                        | 1,973             |
| Distributions to non-controlling interests          | —             | —             | —                          | —                 | —                                    | —              | —                  | —  | (821)                    | (821)             |
| Net Income  | —             | —             | —                          | 60,867            | —                                    | —              | —                  | 60,867   | 67                       | 60,934            |
| <b>Balance, June 30, 2018</b>                       | <b>95,649</b> | <b>\$ 956</b> | <b>\$ 335,025</b>          | <b>\$ 434,674</b> | <b>\$ (11,176)</b>                   | <b>(1,209)</b> | <b>\$ (18,797)</b> | <b>\$ 740,682</b>                                | <b>\$ 9,054</b>          | <b>\$ 749,736</b> |

| Shareholders' Equity Callaway Golf Company          |               |               |                            |                   |                                      |                |                    |  |                          |                   |
|---|---------------|---------------|----------------------------|-------------------|--------------------------------------|----------------|--------------------|--|--------------------------|-------------------|
|   | Common Stock  |               | Additional Paid-in Capital | Retained Earnings | Accumulated Other Comprehensive Loss | Treasury Stock |                    | Total Callaway Golf Company Shareholders' Equity | Non-Controlling Interest | Total             |
|   | Shares        | Amount        |                            |                   |                                      | Shares         | Amount             |  |                          |                   |
| <b>Balance, December 31, 2017</b>                   | <b>95,043</b> | <b>\$ 950</b> | <b>\$ 335,222</b>          | <b>\$ 324,081</b> | <b>\$ (6,166)</b>                    | <b>(411)</b>   | <b>\$ (4,456)</b>  | <b>\$ 649,631</b>                                | <b>\$ 9,744</b>          | <b>\$ 659,375</b> |
| Adoption of accounting standard                     | —             | —             | —                          | (11,185)          | —                                    | —              | —                  | (11,185)   | —                        | (11,185)          |
| Acquisition of treasury stock                       | —             | —             | —                          | —                 | —                                    | (1,404)        | (22,301)           | (22,301)   | —                        | (22,301)          |
| Exercise of stock options                           | —             | —             | (1,241)                    | —                 | —                                    | 175            | 2,499              | 1,258  | —                        | 1,258             |
| Compensatory awards released from restriction       | 606           | 6             | (5,420)                    | (47)              | —                                    | 431            | 5,461              | —  | —                        | —                 |
| Share-based compensation                            | —             | —             | 6,464                      | —                 | —                                    | —              | —                  | 6,464  | —                        | 6,464             |
| Cash dividends (\$0.01 per share)                   | —             | —             | —                          | (1,897)           | —                                    | —              | —                  | (1,897)  | —                        | (1,897)           |
| Equity adjustment from foreign currency translation | —             | —             | —                          | —                 | (5,178)                              | —              | —                  | (5,178)  | 188                      | (4,990)           |
| Change in fair value of derivative instruments      | —             | —             | —                          | —                 | 168                                  | —              | —                  | 168  | —                        | 168               |
| Distributions to non-controlling interests          | —             | —             | —                          | —                 | —                                    | —              | —                  | —  | (821)                    | (821)             |
| Net Income  | —             | —             | —                          | 123,722           | —                                    | —              | —                  | 123,722  | (57)                     | 123,665           |
| <b>Balance, June 30, 2018</b>                       | <b>95,649</b> | <b>\$ 956</b> | <b>\$ 335,025</b>          | <b>\$ 434,674</b> | <b>\$ (11,176)</b>                   | <b>(1,209)</b> | <b>\$ (18,797)</b> | <b>\$ 740,682</b>                                | <b>\$ 9,054</b>          | <b>\$ 749,736</b> |

The accompanying notes are an integral part of these financial statements.

**CALLAWAY GOLF COMPANY**  
**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS**  
**(Unaudited)**

**Note 1. Basis of Presentation**

The accompanying unaudited consolidated condensed financial statements have been prepared by Callaway Golf Company (the “Company” or “Callaway Golf”) pursuant to the rules and regulations of the Securities and Exchange Commission (the “Commission”). Accordingly, certain information and disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States (“U.S. GAAP”) have been condensed or omitted. These consolidated condensed financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2018 filed with the Commission. These consolidated condensed financial statements, in the opinion of management, include all the normal and recurring adjustments necessary for the fair presentation of the financial position, results of operations and cash flows for the periods and dates presented. Interim operating results are not necessarily indicative of operating results for the full year.

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and judgments that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances. Examples of such estimates include provisions for warranty, uncollectible accounts receivable, inventory obsolescence, sales returns, and tax contingencies and estimates related to the Tax Act enacted in December 2017, and estimates on the valuation of share-based awards and recoverability of long-lived assets and investments. Actual results may materially differ from these estimates. On an ongoing basis, the Company reviews its estimates to ensure that these estimates appropriately reflect changes in its business or as new information becomes available.

**Recent Accounting Standards**

In August 2018, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2018-13, “Fair Value Measurement (Topic 820): Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement.” The amendments in this ASU will remove, modify or add to the disclosure requirements for fair value measurements in Accounting Standards Codification (“ASC”) Topic 820, “Fair Value Measurement” (“Topic 820”). The amendments are effective for all entities for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. An entity is permitted to early adopt the removed or modified disclosures upon the issuance of this ASU and may delay adoption of the additional disclosures required for public companies until the effective date of this ASU. The Company is currently evaluating the impact this ASU will have on its consolidated condensed financial statements and disclosures.

In June 2016, the FASB issued ASU No. 2016-13, “Financial Instruments —Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.” This ASU is intended to improve financial reporting by requiring timelier recording of credit losses on loans and other financial instruments held by financial institutions and other organizations. The ASU requires the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to better inform their credit loss estimates. Additionally, this ASU requires enhanced disclosures to help investors and other financial statement users better understand significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an organization’s portfolio. These disclosures include qualitative and quantitative requirements that provide additional information about the amounts recorded in the financial statements. ASU 2016-13 is effective for public filers for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. The Company is currently evaluating the impact this ASU will have on its consolidated condensed financial statements and disclosures.

***Adoption of New Accounting Standards***

On January 1, 2019, the Company adopted ASU No. 2016-02, “Leases (Topic 842)” (“Topic 842”) utilizing the modified retrospective adoption method, and the targeted improvement amendments under ASU 2018-11, which allows entities to change their date of initial application to January 1, 2019 and not restate the comparative prior periods in the period of adoption when transitioning to Topic 842. Under Topic 842, the Company elected the transition relief package to not reassess (1) any expired or existing contracts that are leases or contain leases, (2) the classification of any expired or existing leases and (3) initial direct costs for any existing leases. Therefore, the consolidated condensed financial statements for 2019 are presented under the new standard,

while the comparative periods presented are not adjusted and continue to be reported in accordance with the Company's historical accounting policy. This standard requires all lessees to recognize a right-of-use asset and a lease liability, initially measured at the present value of the lease payments, for all leases with a term greater than 12 months. The adoption of the new lease standard had a significant impact on the Company's consolidated condensed balance sheets due to the recognition of \$133,632,000 of right-of-use assets for operating leases and a corresponding lease obligation of \$136,290,000. The accounting for finance leases is substantially unchanged. The adoption of Topic 842 did not have a material impact on the Company's lease classification or on its statements of operations and liquidity. Additionally, adoption of Topic 842 did not have a material impact on the Company's debt-covenant compliance under its current agreements. See to Note 2, "Leases," for information regarding the Company's adoption of Topic 842 and the Company's undiscounted future lease payments and the timing of those payments.

On January 1, 2019, the Company adopted ASU No. 2017-12, "Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities." The new standard refined and expanded hedge accounting for both financial (e.g., interest rate) and commodity risks to create more transparency around how economic results are presented, both on the face of the financial statements and in the footnotes. It also targeted improvements to simplify the application of hedge accounting guidance. Based on the Company's assessment, this new standard did not have a material impact on the Company's consolidated condensed financial statements and disclosures.

## Note 2. Leases

The Company leases office space, manufacturing plants, warehouses, distribution centers and vehicles and equipment, as well as retail and/or outlet locations related to the TravisMathew and Jack Wolfskin businesses and the apparel business in Japan. Certain real estate leases include one or more options to renew, with renewal terms that can extend the lease term for up to eight years. The exercise of lease renewal options are at the Company's sole discretion. Certain leases also include options to purchase the leased property. When deemed reasonably certain of exercise, the renewal and purchase options are included in the determination of the lease term and lease payment obligation, respectively. The depreciable life of assets and leasehold improvements are limited by the expected lease term, unless there is a transfer of title or purchase option reasonably certain of exercise. The Company's lease agreements do not contain any material residual value guarantees or material restrictive covenants.

Right-of-use ("ROU") assets represent the right to use an underlying asset for the lease term and lease liabilities represent the obligation to make lease payments arising from the lease. Operating lease ROU assets and liabilities are recognized at the commencement date of the lease based on the present value of lease payments over the lease term. When readily determinable, the Company uses the rate implicit in the lease contract in determining the present value of lease payments. If the implicit rate is not provided, the Company uses its incremental borrowing rate based on information available at the lease commencement date, including the lease term. The operating lease ROU asset also includes any lease payments made and excludes lease incentives. Lease expense for lease payments is recognized on a straight-line basis over the lease term. The Company has lease agreements with lease and non-lease components, which are generally accounted for separately. For vehicle leases, the Company accounts for the lease and non-lease components as a single lease component. In addition, select lease agreements include rental payments based on a percentage of retail sales over contractual levels and others include rental payments adjusted periodically for inflation.

Supplemental balance sheet information related to leases is as follows (in thousands):

|                               | Balance Sheet Location                  | June 30, 2019 |
|-------------------------------|---|---------------|
| <b>Operating leases</b>       |   |               |
| ROU assets, net               | Operating lease ROU assets, net         | \$ 167,585    |
| Lease liabilities, short-term | Operating lease liabilities, short-term | \$ 27,253     |
| Lease liabilities, long-term  | Operating lease liabilities, long-term  | \$ 143,717    |
| <b>Finance Leases</b>         |   |               |
| ROU assets, net,              | Other assets                            | \$ 1,504      |
| Lease liabilities, short-term | Accounts payable and accrued expenses   | \$ 663        |
| Lease liabilities, long-term  | Long-term other                         | \$ 829        |

The components of lease expense are as follows (in thousands):

|                                     | Three Months<br>Ended<br>June 30, 2019 | Six Months Ended<br>June 30, 2019 |
|-------------------------------------|--|-----------------------------------|
| Operating lease costs               | \$ 10,702                              | \$ 19,599                         |
| Financing lease costs:              |  |                                   |
| Amortization of right-of-use assets | 220                                    | 477                               |
| Interest on lease liabilities       | 30                                     | 55                                |
| Total financing lease costs         | 250                                    | 532                               |
| Variable lease costs                | 846                                    | 2,186                             |
| Total lease costs                   | <u>\$ 11,798</u>                       | <u>\$ 22,317</u>                  |

Other information related to leases was as follows (in thousands):

| Supplemental Cash Flows Information                                     | June 30,<br>2019 |
|---|------------------|
| Cash paid for amounts included in the measurement of lease liabilities: |                  |
| Operating cash flows from operating leases                              | \$ 20,100        |
| Operating cash flows from finance leases                                | \$ 55            |
| Financing cash flows from finance leases                                | \$ 232           |
| Lease liabilities arising from new ROU assets:                          |                  |
| Operating leases  | \$ 7,679         |
| Finance leases  | \$ 81            |
| Weighted average remaining lease term (years):                          |                  |
| Operating leases  | 9.5              |
| Finance leases  | 2.7              |
| Weighted average discount rate:   |                  |
| Operating leases  | 5.7%             |
| Finance leases  | 4.6%             |

Future minimum lease obligations as of June 30, 2019 were as follows (in thousands):

|                             | Operating<br>Leases | Finance Leases  |
|-----------------------------|---------------------|-----------------|
| Remainder of 2019           | \$ 19,837           | \$ 494          |
| 2020                        | 33,476              | 606             |
| 2021                        | 27,911              | 217             |
| 2022                        | 23,166              | 176             |
| 2023                        | 20,457              | 71              |
| Thereafter                  | 99,478              | 5               |
| Total future lease payments | 224,325             | 1,569           |
| Less: imputed interest      | 53,355              | 77              |
| Total                       | <u>\$ 170,970</u>   | <u>\$ 1,492</u> |

### Note 3. Revenue Recognition

The Company recognizes revenue from the sale of its products, which include golf clubs, golf balls and other lifestyle and golf-related apparel and accessories. The Company sells its products to customers, which include on- and off-course golf shops

and national retail stores, as well as to consumers through its e-commerce business and at its apparel retail locations. In addition, the Company recognizes royalty income from the sale by third-party licensees of certain soft goods products, as well as revenue from the sale of gift cards.

The Company's contracts with customers are generally in the form of a purchase order. In certain cases, the Company enters into sales agreements containing specific terms, discounts and allowances. In addition, the Company enters into licensing agreements with certain distributors.

The following table presents the Company's revenue disaggregated by major product category and operating and reportable segment (in thousands):

| For the Three Months Ended June 30, | Operating Segments <sup>(1)</sup> |                       |                   |
|-------------------------------------|-----------------------------------|-----------------------|-------------------|
|                                     | Golf Equipment                    | Apparel, Gear & Other | Total             |
| <b>2019</b>                         |                                   |                       |                   |
| Golf Clubs                          | \$ 223,741                        | \$ —                  | \$ 223,741        |
| Golf Balls                          | 68,612                            | —                     | 68,612            |
| Apparel                             | —                                 | 73,195                | 73,195            |
| Gear, Accessories & Other           | —                                 | 81,160                | 81,160            |
|                                     | <u>\$ 292,353</u>                 | <u>\$ 154,355</u>     | <u>\$ 446,708</u> |
| <b>2018</b>                         |                                   |                       |                   |
| Golf Clubs                          | \$ 232,802                        | \$ —                  | \$ 232,802        |
| Golf Balls                          | 65,882                            | —                     | 65,882            |
| Apparel                             | —                                 | 30,779                | 30,779            |
| Gear, Accessories & Other           | —                                 | 66,848                | 66,848            |
|                                     | <u>\$ 298,684</u>                 | <u>\$ 97,627</u>      | <u>\$ 396,311</u> |
| For the Six Months Ended June 30,   | Operating Segments <sup>(1)</sup> |                       |                   |
|                                     | Golf Equipment                    | Apparel, Gear & Other | Total             |
| <b>2019</b>                         |                                   |                       |                   |
| Golf Clubs                          | \$ 485,526                        | \$ —                  | \$ 485,526        |
| Golf Balls                          | 130,446                           | —                     | 130,446           |
| Apparel                             | —                                 | 169,441               | 169,441           |
| Gear, Accessories & Other           | —                                 | 177,492               | 177,492           |
|                                     | <u>\$ 615,972</u>                 | <u>\$ 346,933</u>     | <u>\$ 962,905</u> |
| <b>2018</b>                         |                                   |                       |                   |
| Golf Clubs                          | \$ 490,243                        | \$ —                  | \$ 490,243        |
| Golf Balls                          | 120,804                           | —                     | 120,804           |
| Apparel                             | —                                 | 57,120                | 57,120            |
| Gear, Accessories & Other           | —                                 | 131,335               | 131,335           |
|                                     | <u>\$ 611,047</u>                 | <u>\$ 188,455</u>     | <u>\$ 799,502</u> |

(1) The Company changed its operating segments as of January 1, 2019 (see Note 18). Accordingly, prior period amounts have been reclassified to conform with the current period presentation.

The Company sells its golf equipment products and apparel, gear and other products in the United States and internationally, with its principal international regions being Japan and Europe. Sales of golf equipment in each region are generally proportional to the Company's consolidated net sales by operating segment as a percentage of total consolidated net sales. Sales of apparel, gear and other are proportionately higher in Europe as a result of the Jack Wolfskin acquisition completed in January 2019.



The following table presents information about the geographical areas in which the Company operates. Revenues are attributed to the location to which the product was shipped (in thousands):

|   | Three Months Ended<br>June 30, |                   |
|---|--------------------------------|-------------------|
|   | 2019                           | 2018              |
| Major Geographic Region:                |                                |                   |
| United States                           | \$ 247,419                     | \$ 233,373        |
| Europe                                  | 81,630                         | 46,325            |
| Japan                                   | 55,676                         | 59,666            |
| Rest of World                           | 61,983                         | 56,947            |
|   | <u>\$ 446,708</u>              | <u>\$ 396,311</u> |
|   |                                |                   |
|   | Six Months Ended<br>June 30,   |                   |
|   | 2019                           | 2018              |
| Major Geographic Region: <sup>(1)</sup> |                                |                   |
| United States                           | \$ 496,420                     | \$ 468,534        |
| Europe                                  | 208,243                        | 97,527            |
| Japan                                   | 128,904                        | 128,941           |
| Rest of World                           | 129,338                        | 104,500           |
|   | <u>\$ 962,905</u>              | <u>\$ 799,502</u> |

(1) In connection with the Company's assessment of its reportable operating segments the Company also reassessed its reportable regions. As a result, starting on January 1, 2019, the Company will report regional sales previously reported in Rest of Asia and Other Foreign Countries in Rest of World. Accordingly, the prior period amounts have been reclassified to conform to current year presentation of regional sales.

#### *Product Sales*

The Company recognizes revenue from the sale of its products when it satisfies the terms of a sales order from a customer, and transfers control of the products ordered to the customer. Control transfers when products are shipped, and in certain cases, when products are received by customers. In addition, the Company recognizes revenue at the point of sale on transactions with consumers at its retail locations. Sales taxes, value added taxes and other taxes that are collected in connection with revenue transactions are withheld and remitted to the respective taxing authorities. As such, these taxes are excluded from revenue. The Company elected to account for shipping and handling as activities to fulfill the promise to transfer the good. Therefore, shipping and handling fees that are billed to customers are recognized in revenue and the associated shipping and handling costs are recognized in cost of goods sold as soon as control of the goods transfers to the customer.

#### *Royalty Income*

Royalty income is recognized over time in net sales as underlying product sales occur, subject to certain minimum royalties, in accordance with the related licensing arrangements and is included in the Company's Apparel, Gear and Other operating segment. Total royalty income for the three months ended June 30, 2019 and 2018 was \$5,467,000 and \$4,750,000, respectively, and total royalty income for the six months ended June 30, 2019 and 2018 was \$10,145,000 and \$9,594,000, respectively.

#### *Gift Cards*

Revenues from gift cards are deferred and recognized when the cards are redeemed. The Company's gift cards have no expiration date. The Company recognizes revenue from unredeemed gift cards, otherwise known as breakage, when the likelihood of redemption becomes remote and under circumstances that comply with any applicable state escheatment laws. To determine when redemption is remote, the Company analyzes an aging of unredeemed cards (based on the date the card was last used or the activation date if the card has never been used) and compares that information with historical redemption trends. The Company uses this historical redemption rate to recognize breakage on unredeemed gift cards over the redemption period. The Company does not believe there is a reasonable likelihood that there will be a material change in the future estimates or assumptions used to determine the timing of recognition of gift card revenues. As of December 31, 2018 and 2017, the total amount of deferred

revenue on gift cards was \$1,096,000 and \$971,000, respectively, of which \$657,000 and \$562,000 was recognized into revenue during the three months ended June 30, 2019 and 2018, respectively, and \$987,000 and \$1,063,000 was recognized into revenue during the six months ended June 30, 2019 and 2018, respectively. At June 30, 2019, the total amount of deferred revenue on gift cards was \$1,090,000.

#### *Variable Consideration*

The amount of revenue the Company recognizes is based on the amount of consideration it expects to receive from customers. The amount of consideration is the sales price adjusted for estimates of variable consideration, including sales returns, discounts and allowances as well as sales programs, sales promotions and price concessions that are offered by the Company as described below. These estimates are based on the amounts earned or to be claimed by customers on the related sales, and are therefore recorded as reductions to sales and trade accounts receivable.

The Company's primary sales program, the "Preferred Retailer Program," offers potential rebates and discounts for participating retailers in exchange for providing certain benefits to the Company, including the maintenance of agreed upon inventory levels, prime product placement and retailer staff training. Under this program, qualifying retailers can earn either discounts or rebates based upon the amount of product purchased. Discounts are applied and recorded at the time of sale. For rebates, the Company estimates the amount of variable consideration related to the rebate at the time of sale based on the customer's estimated qualifying current year product purchases. The estimate is based on the historical level of purchases, adjusted for any factors expected to affect the current year purchase levels. The estimated year-end rebate is adjusted quarterly based on actual purchase levels, as necessary. The Preferred Retailer Program is generally short-term in nature and the actual amount of rebate to be paid under this program is known as of the end of the year and paid to customers shortly after year-end. Historically, the Company's actual amount of variable consideration related to its Preferred Retailer Program has not been materially different from its estimates.

The Company also offers short-term sales program incentives, which include sell-through promotions and price concessions or price reductions. Sell-through promotions are generally offered throughout the product's life cycle of approximately two years, and price concessions or price reductions are generally offered at the end of the product's life cycle. The estimated variable consideration related to these programs is based on a rate that includes historical and forecasted data. The Company records a reduction to net sales using this rate at the time of the sale. The Company monitors this rate against actual results and forecasted estimates, and adjusts the rate as deemed necessary in order to reflect the amount of consideration it expects to receive from its customers. There were no material changes to the rate during the three and six months ended June 30, 2019. Historically, the Company's actual amount of variable consideration related to these sales programs has not been materially different from its estimates.

The Company records an estimate for anticipated returns as a reduction of sales and cost of sales, and accounts receivable, in the period that the related sales are recorded. Sales returns are estimated based upon historical returns, current economic trends, changes in customer demands and sell-through of products. The Company also offers its customers sales programs that allow for specific returns. The Company records a return liability as an offset to accounts receivable for anticipated returns related to these sales programs at the time of the sale based on the terms of the sales program. The cost recovery of inventory associated with this reserve is accounted for in other current assets. Historically, the Company's actual sales returns have not been materially different from management's original estimates.

#### *Credit Losses*

The Company's trade accounts receivable are recorded at net realizable value, which includes an appropriate allowance for estimated credit losses, as well as reserves related to product returns and sales programs as described above. The estimate of credit losses is based upon historical bad debts, current customer receivable balances, age of customer receivable balances, the customer's financial condition and current economic trends, all of which are subject to change. Actual uncollected amounts have historically been consistent with the Company's expectations. The Company's payment terms on its receivables from customers are generally 60 days or less.

The following table provides a reconciliation of the activity related to the Company's allowance for credit losses (in thousands):

|   | Three Months Ended<br>June 30, |                 | Six Months Ended<br>June 30, |                 |
|---|--------------------------------|-----------------|------------------------------|-----------------|
|   | 2019                           | 2018            | 2019                         | 2018            |
|   | <i>(in thousands)</i>          |                 |                              |                 |
| Beginning balance                                     | \$ 5,474                       | \$ 3,809        | \$ 5,610                     | \$ 4,447        |
| Provision for credit losses                           | 265                            | 311             | 142                          | (284)           |
| Write-off of uncollectible amounts, net of recoveries | (240)                          | (445)           | (253)                        | (488)           |
| Ending balance  | <u>\$ 5,499</u>                | <u>\$ 3,675</u> | <u>\$ 5,499</u>              | <u>\$ 3,675</u> |

The Company has a two-year stated product warranty on its golf clubs and Jack Wolfskin gear, as well as a limited lifetime warranty for its OGIO non-golf line of products. The estimated cost associated with its product warranty continues to be recognized at the time of the sale. See Note 11 for further information.

#### Note 4. Business Combinations

##### *Acquisition of JW Stargazer Holding GmbH*

In January 2019, the Company completed the acquisition of JW Stargazer Holding GmbH, the owner of the international, premium outdoor apparel, footwear and equipment brand, Jack Wolfskin, for €457,394,000 (including cash acquired of €50,984,000) or approximately \$521,201,000 (including cash acquired of \$58,096,000) (using the exchange rate in effect on the acquisition date), subject to working capital adjustments. The Company financed the acquisition with a Term Loan B facility in the aggregate principal amount of \$480,000,000 (see Note 5). Jack Wolfskin designs premium outdoor apparel, footwear and equipment targeted at the active outdoor and urban outdoor customer categories. This acquisition is expected to further enhance the Company's lifestyle category and provide a platform for future growth in the active outdoor and urban outdoor categories, which the Company believes are complementary to its portfolio of brands and product capabilities. In addition, the Company anticipates it will realize synergies with respect to supply chain operations as well as warehousing and distribution activities.

The purchase price of an acquisition is allocated to the underlying assets acquired and liabilities assumed based upon their estimated fair values as of the date of acquisition in accordance with Topic 820. To the extent the purchase price exceeds the fair value of the net identifiable tangible and intangible assets acquired and liabilities assumed, such excess is allocated to goodwill. The Company determines the estimated fair values after review and consideration of relevant information, including discounted cash flows, quoted market prices and estimates made by management. The Company may adjust the preliminary purchase price allocation as soon as practicable during the measurement period of up to one year after the acquisition closing date as it obtains more information as to facts and circumstances existing as of the acquisition date.

The allocation of the purchase price presented below is based on management's estimate of the fair values using valuation techniques including income, cost and market approaches. In estimating the fair value of the acquired assets and assumed liabilities, the fair value estimates are based on, but not limited to, expected future revenue and cash flows, expected future growth rates and estimated discount rates. Current and noncurrent assets and current and other liabilities are valued at historical carrying values, which approximates fair value. Inventory was valued using the net realizable value approach, which was based on the estimated selling price in the ordinary course of business less reasonable disposal costs and a profit on the disposal efforts. The customer and distributor relationships were valued under the income approach based on the present value of future earnings. The Company will amortize the fair value of these relationships over a 10-year period. The trade name was valued under the royalty savings income approach method, which is equal to the present value of the after-tax royalty savings attributable to owning the trade name as opposed to paying a third party for its use. For this valuation the Company used a royalty rate of 5.0%, which is reflective of royalty rates paid in market transactions, and a discount rate of 10.0% on the future cash flows generated by the net after-tax savings. The goodwill of \$154,234,000 arising from the acquisition consists largely of the synergies expected from combining the operations of the Company and Jack Wolfskin. As of June 30, 2019, the Company has not completed its assessment of the fair value of the operating leases assumed in connection with the acquisition. The Company is also in the process of determining whether the terms of each of these operating leases are favorable or unfavorable compared with the market terms of leases of the same or similar items at the acquisition date. Upon the completion of its assessment, the Company will recognize an intangible asset if the terms of an operating lease are favorable relative to market terms and a liability if the terms are unfavorable relative to market terms. In addition, the Company will adjust the fair value of the deferred taxes acquired and recognized in connection with the acquisition should the Company make any changes to the preliminary purchase price allocation of the underlying acquired

assets and liabilities. As a non-taxable stock acquisition, the Company does not expect the value attributable to the acquired intangibles and goodwill to be tax deductible. All of the goodwill was assigned to the Apparel, Gear and Other operating segment.

In connection with the acquisition, the Company recognized transaction costs of approximately \$9,987,000, of which \$1,603,000 and \$6,326,000 was recognized in general and administrative expenses during the three and six months ended June 30, 2019, respectively, and \$3,661,000 was recognized in 2018. In addition, the Company recorded a loss of \$3,215,000 in other income (expense) in the first quarter of 2019 upon the settlement of a foreign currency forward contract to mitigate the risk of foreign currency fluctuations on the purchase price, which was denominated in Euros. In December 2018, the Company had recognized an unrealized gain of \$4,409,000 in connection with this foreign currency forward contract.

The following table summarizes the fair values of the assets acquired and liabilities assumed as of the acquisition date based on the purchase price allocation (in thousands):

|  | At January 4,<br>2019 |
|--|-----------------------|
| <b>Assets Acquired</b>                               |                       |
| Cash   | \$ 58,096             |
| Accounts receivable                                  | 36,521                |
| Inventories  | 90,849                |
| Other current assets                                 | 7,400                 |
| Property and equipment                               | 26,180                |
| Deferred tax assets                                  | 2,557                 |
| Other assets   | 24                    |
| Intangibles - trade name                             | 239,295               |
| Intangibles - franchisee & distributor relationships | 38,743                |
| Goodwill   | 154,234               |
| Total assets acquired                                | 653,899               |
| <b>Liabilities Assumed</b>                           |                       |
| Accounts Payable and accrued liabilities             | 48,487                |
| Deferred tax liabilities                             | 84,210                |
| Net assets acquired                                  | <u>\$ 521,202</u>     |

#### ***Supplemental Pro-Forma Information (Unaudited)***

The following table presents supplemental pro-forma information for the three and six months ended June 30, 2019 and 2018 as if the Jack Wolfskin acquisition had occurred on January 1, 2018. These amounts have been calculated after applying the Company's accounting policies and are based upon currently available information. For this analysis, the Company assumed that costs associated with the acquisition, including the amortization of intangible assets and the step-up of inventory, as well as the tax effect on those costs, were recognized as of January 1, 2018. Pre-acquisition net sales and net income amounts for Jack Wolfskin were derived from the books and records of Jack Wolfskin prepared prior to the acquisition and are presented for informational purposes only and do not purport to be indicative of the results of future operations or of the results that would have occurred had the acquisition taken place as of the dates noted below.

|  | Three Months Ended<br>June 30, |            | Six Months Ended<br>June 30, |            |
|--|--------------------------------|------------|------------------------------|------------|
|  | 2019                           | 2018       | 2019                         | 2018       |
|  | <i>(in thousands)</i>          |            |                              |            |
| Net sales  | \$ 446,708                     | \$ 440,128 | \$ 962,905                   | \$ 947,383 |
| Net income attributable to Callaway Golf Company | \$ 33,684                      | \$ 22,649  | \$ 92,261                    | \$ 76,529  |

For the three months ended June 30, 2019, the Company's consolidated results of operations included net sales of \$48,406,000 and a net loss of \$22,503,000 attributable to Jack Wolfskin. For the six months ended June 30, 2019, the Company's consolidated results of operations included net sales of \$141,115,000 and a net loss of \$28,280,000 attributable to Jack Wolfskin. The Jack Wolfskin results for the three and six months ended June 30, 2019 include the recognition of amortization expense of \$6,321,000 and \$12,611,000, respectively, related to the fair value adjustment of the acquired inventory combined with the amortization of

the intangible asset related to distributor relationships, as well as \$1,066,000 and \$1,947,000, respectively, in non-recurring acquisition and transition related costs. These results also reflect the seasonality of the Jack Wolfskin business as many of their product are geared toward the fall/winter season.

## **Note 5. Financing Arrangements**

In addition to cash on hand, as well as cash generated from operations, the Company relies on its primary and Japan asset-based revolving credit facilities to manage seasonal fluctuations in liquidity and to provide additional liquidity when the Company's operating cash flows are not sufficient to fund the Company's requirements. As of June 30, 2019, the Company had \$165,467,000 outstanding under these facilities, \$1,177,000 in outstanding letters of credit, and \$81,490,000 in cash and cash equivalents. As of June 30, 2019, the Company's available liquidity, which is comprised of cash on hand and amounts available under both facilities, after letters of credit and outstanding borrowings, was \$273,387,000. As of June 30, 2018, the Company had \$96,140,000 outstanding under these facilities, \$1,231,000 in outstanding letters of credit, and \$57,748,000 in cash and cash equivalents. As of June 30, 2018, the Company's available liquidity, which is comprised of cash on hand and amounts available under both facilities, after letters of credit and outstanding borrowings, was \$301,266,000.

### ***Primary Asset-Based Revolving Credit Facility***

In May 2019, the Company amended and restated its primary credit facility (the Fourth Amended and Restated Loan and Security Agreement) with Bank of America N.A. and other lenders (the "ABL Facility"), which provides a senior secured asset-based revolving credit facility of up to \$400,000,000, comprised of a \$260,000,000 U.S. facility, a \$70,000,000 German facility, a \$25,000,000 Canadian facility and a \$45,000,000 United Kingdom facility, in each case subject to borrowing base availability under the applicable facility. The amounts outstanding under the ABL Facility are secured by certain assets, including cash (to the extent pledged by the Company), the Company's intellectual property, certain eligible real estate, inventory and accounts receivable of the Company's subsidiaries in the United States, Germany, Canada and the United Kingdom. The real estate and intellectual property components of the borrowing base under the ABL Facility are both amortizing. The amount available for the real estate portion is reduced quarterly over a 15-year period, and the amount available for the intellectual property portion is reduced quarterly over a 3-year period.

As of June 30, 2019, the Company had \$146,003,000 in borrowings outstanding under the ABL Facility and \$1,177,000 in outstanding letters of credit. Amounts available under the ABL Facility fluctuate with the general seasonality of the business and increase and decrease with changes in the Company's inventory and accounts receivable balances. Inventory balances are generally higher in the fourth and first quarters to meet demand during the height of the golf season, and accounts receivable are generally higher during the first half of the year when sales are higher. Average outstanding borrowings during the six months ended June 30, 2019 were \$158,903,000, and average amounts available under the ABL Facility during the six months ended June 30, 2019, after outstanding borrowings and letters of credit, was approximately \$136,329,000. Amounts borrowed under the ABL Facility may be repaid and borrowed as needed. The entire outstanding principal amount (if any) is due and payable in May 2024.

The ABL Facility includes certain restrictions including, among other things, restrictions on the incurrence of additional debt, liens, stock repurchases and other restricted payments, asset sales, investments, mergers, acquisitions and affiliate transactions. In addition, the ABL Facility imposes restrictions on the amount the Company could pay in annual cash dividends, including certain restrictions on the amount of additional indebtedness and requirements to maintain a certain fixed charge coverage ratio under certain circumstances. These restrictions do not materially limit the Company's ability to pay future dividends at the current dividend rate. As of June 30, 2019, the Company was in compliance with all financial covenants of the ABL Facility. Additionally, the Company is subject to compliance with a fixed charge coverage ratio covenant during, and continuing 30 days after, any period in which the Company's borrowing base availability, as amended, falls below 10% of the maximum facility amount or \$40,000,000. The Company's borrowing base availability was above \$40,000,000 during the six months ended June 30, 2019, and the Company was in compliance with the fixed charge coverage ratio as of June 30, 2019. Had the Company not been in compliance with the fixed charge coverage ratio as of June 30, 2019, the maximum amount of additional indebtedness that could have been outstanding on June 30, 2019 would have been reduced by \$40,000,000.

The interest rate applicable to outstanding loans under the ABL Facility fluctuates depending on the Company's "availability ratio," which is expressed as a percentage of (i) the average daily availability under the ABL Facility to (ii) the sum of the Canadian, the German, the U.K. and the U.S. borrowing bases, as adjusted. At June 30, 2019 the Company's trailing 12 month average interest rate applicable to its outstanding loans under the ABL Facility was 4.72%. Additionally, the ABL Facility provides for monthly fees of 0.25% of the unused portion of the ABL Facility.

The fees incurred in connection with the origination and amendment of the ABL Facility totaled \$3,178,000, which are amortized into interest expense over the term of the ABL Facility agreement. Unamortized origination fees at June 30, 2019 and December 31, 2018 were \$2,361,000 and \$1,825,000, respectively, of which \$708,000 and \$476,000, respectively, were included in other current assets and \$1,653,000 and \$1,349,000, respectively, were included in other long-term assets in the accompanying consolidated condensed balance sheets.

#### ***Japan ABL Facilities***

In January 2018, the Company refinanced the asset-based loan agreement between its subsidiary in Japan and The Bank of Tokyo-Mitsubishi UFJ, Ltd (the "Japan ABL Facility"), which provides a credit facility of up to 4,000,000,000 Yen (or U.S. \$37,076,000, using the exchange rate in effect as of June 30, 2019) over a three-year term, subject to borrowing base availability under the facility. The amounts outstanding are secured by certain assets, including eligible inventory and eligible accounts receivable. The Company had 2,100,000,000 Yen (or U.S. \$19,464,000, using the exchange rate in effect as of June 30, 2019) in borrowings outstanding under this facility as of June 30, 2019. The facility also includes certain restrictions including covenants related to certain pledged assets and financial performance metrics. As of June 30, 2019, the Company was in compliance with these covenants. The facility is subject to an effective interest rate equal to the Tokyo Interbank Offered Rate (TIBOR) plus 0.80%. The average interest rate during 2019 was 0.86%. The facility expires in January 2021.

On July 31, 2019, the Company entered into a new one-year asset-based loan facility between its subsidiary in Japan and MUFG Bank, Ltd. for 2,000,000,000 Yen, or approximately U.S. \$18,386,000 (using the exchange rate in effect as of July 31, 2019). The amounts outstanding will be secured by certain assets, including eligible inventory and eligible accounts receivable. The facility is subject to an effective interest rate equal to the TIBOR plus 1.0%, and is subject to certain restrictions including covenants related to certain pledged assets and financial performance metrics.

#### **Long-Term Debt**

##### ***Equipment Note***

In December 2017, the Company entered into a long-term financing agreement (the "Equipment Note") secured by certain equipment at the Company's golf ball manufacturing facility. As of June 30, 2019 and December 31, 2018, the Company had \$8,503,000 and \$9,628,000, respectively, outstanding under the Equipment Note, of which \$2,433,000 and \$2,411,000 was reported in current liabilities, respectively, and \$6,070,000 and \$7,218,000 was reported in long-term liabilities, respectively, in the accompanying consolidated condensed balance sheets. The Company's interest rate applicable to outstanding borrowings was 3.79%. Total interest expense recognized during the six months ended June 30, 2019 was \$173,000. The equipment note amortizes over a 5-year term.

The Equipment Note is subject to compliance with the financial covenants in the Company's ABL Facility. As of June 30, 2019, the Company was in compliance with these covenants.

##### ***Term Loan B Facility***

In January 2019, to fund the purchase price of the Jack Wolfskin acquisition, the Company entered into a Credit Agreement (the "Credit Agreement") with Bank of America, N.A and other lenders party to the Credit Agreement (the "Term Lenders"). The Credit Agreement provides for a Term Loan B facility (the "Term Loan Facility") in an aggregate principal of \$480,000,000, which was issued less \$9,600,000 in original issue discount and other transaction fees. Such principal amount may be increased pursuant to incremental facilities in the form of additional tranches of term loans or new commitments, up to a maximum incremental amount of \$225,000,000, or an unlimited amount subject to compliance with a first lien net leverage ratio of 2.25 to 1.00. The Term Loan Facility is due in January 2026.

As of June 30, 2019, the Company had \$461,966,000 outstanding under the Term Loan Facility net of debt issuance costs, of which \$2,210,000 is reflected in current liabilities. Unamortized debt issuance costs as of June 30, 2019 were \$16,834,000, of which \$2,590,000 was reflected in the short-term portion of the facility, and \$14,244,000 was reflected in the long-term portion of the facility. Total interest and amortization expense recognized during the three and six months ended June 30, 2019 was \$9,062,000 and \$17,842,000, respectively.

Loans under the Term Loan Facility are subject to interest at a rate per annum equal to either, at the Company's option, the LIBOR rate or the base rate, plus 4.50% or 3.50%, respectively, and any amounts outstanding are secured by the Company's assets. Principal payments of \$1,200,000 are due quarterly, and an amount equal to the outstanding unpaid principal is due on the maturity

date. The Company has the option to prepay any outstanding loan balance in whole or in part without premium or penalty. In addition, the Term Loan Facility requires annual excess cash flow payments beginning after December 31, 2019. Subsequent to June 30, 2019, the Company made a payment of \$30,000,000 toward the repayment of this facility.

In order to mitigate the risk of interest rate fluctuations under the Term Loan Facility, the Company entered into agreements with the lenders party to the Credit Agreement to swap the floating rate of LIBOR plus 4.50% to a fixed rate of 4.60% on \$200,357,000 of the total principal outstanding under the Term Loan Facility. This was achieved by entering into an interest rate hedge agreement and a cross-currency debt swap agreement, converting the \$200,357,000 principal into €176,200,000, both of which mature in January 2025. During the three and six months ended June 30, 2019, the Company recognized interest income of \$1,269,000 and \$2,287,000, respectively, under the cross-currency swap to offset the interest expense recognized under the Term Loan Facility.

Loans outstanding under this facility are guaranteed by the Company's domestic subsidiaries. The loans and guaranties are secured by substantially all the assets of the Company and guarantors. In connection with the Credit Agreement, the Company amended its ABL Facility to expand the security interest granted to the ABL Lenders to match the security interest of the Term Lenders.

The Credit Agreement contains a cross-default provision with respect to any indebtedness of the Company as defined in the Credit Agreement, as well as customary representations and warranties and customary affirmative and negative covenants, including, among other things, restrictions on incurrence of additional debt, liens, dividends and other restricted payments, asset sales, investments, mergers, acquisitions and affiliate transactions. Events of default permitting acceleration under the Credit Agreement include, among others, nonpayment of principal or interest, covenant defaults, material breaches of representations and warranties, bankruptcy and insolvency events, certain cross defaults or a change of control.

The following table presents the Company's combined aggregate amount of maturities for its Equipment Note and Term-Loan Facility over the next five years and thereafter as of June 30, 2019. Amounts payable under the Term Loan Facility included below represent the minimum principal repayment obligations. As of June 30, 2019, the Company does not anticipate excess cash flow repayments as defined by the Term Loan Facility.

|                   | <i>(in thousands)</i> |
|-------------------|-----------------------|
| Remainder of 2019 | \$ 3,698              |
| 2020              | 7,396                 |
| 2021              | 7,396                 |
| 2022              | 7,396                 |
| 2023              | 4,800                 |
| 2024              | 4,800                 |
| Thereafter        | <u>\$ 452,600</u>     |

## Note 6. Earnings per Common Share

Basic earnings per common share is computed by dividing net income by the weighted-average number of common shares outstanding for the period.

Diluted earnings per common share takes into account the potential dilution that could occur if outstanding securities were exercised. Dilutive securities are included in the calculation of diluted earnings per common share using the treasury stock method in accordance with ASC Topic 260, "Earnings per Share." Dilutive securities include outstanding stock options, restricted stock units and performance share units granted to employees and non-employee directors (see Note 14).

Weighted-average common shares outstanding—diluted is the same as weighted-average common shares outstanding—basic in periods when a net loss is reported or in periods when anti-dilution occurs.

The following table summarizes the computation of basic and diluted earnings per share (in thousands, except per share data):

|   | Three Months Ended June 30, |           | Six Months Ended June 30, |            |
|---|-----------------------------|-----------|---------------------------|------------|
|   | 2019                        | 2018      | 2019                      | 2018       |
| <b>Earnings per common share—basic</b>                                  |                             |           |                           |            |
| Net income attributable to Callaway Golf Company                        | \$ 28,931                   | \$ 60,867 | \$ 77,578                 | \$ 123,722 |
| Weighted-average common shares outstanding—basic                        | 94,074                      | 94,367    | 94,377                    | 94,670     |
| Basic earnings per common share   | \$ 0.31                     | \$ 0.65   | \$ 0.82                   | \$ 1.31    |
| <b>Earnings per common share—diluted</b>                                |                             |           |                           |            |
| Net income attributable to Callaway Golf Company                        | \$ 28,931                   | \$ 60,867 | \$ 77,578                 | \$ 123,722 |
| Weighted-average common shares outstanding—basic                        | 94,074                      | 94,367    | 94,377                    | 94,670     |
| Outstanding options, restricted stock units and performance share units | 1,817                       | 2,561     | 1,776                     | 2,311      |
| Weighted-average common shares outstanding—diluted                      | 95,891                      | 96,928    | 96,153                    | 96,981     |
| Dilutive earnings per common share                                      | \$ 0.30                     | \$ 0.63   | \$ 0.81                   | \$ 1.28    |

As of June 30, 2019, the Company had a nominal number of securities that had an anti-dilutive effect on the calculation of diluted earnings per common share. Such securities were excluded from the calculation. As of June 30, 2018, there were no anti-dilutive securities and as such, there were no securities excluded from the calculation of diluted earnings per common share.

#### Note 7. Inventories

Inventories are summarized below (in thousands):

|                 | June 30,<br>2019  | December 31,<br>2018 |
|-----------------|-------------------|----------------------|
| Inventories:    |                   |                      |
| Raw materials   | \$ 70,247         | \$ 80,474            |
| Work-in-process | 1,149             | 815                  |
| Finished goods  | 289,071           | 256,768              |
|                 | <u>\$ 360,467</u> | <u>\$ 338,057</u>    |

#### Note 8. Goodwill and Intangible Assets

Goodwill at June 30, 2019 increased to \$209,773,000 from \$55,816,000 at December 31, 2018. This \$153,957,000 increase was primarily due to the Jack Wolfskin acquisition in January 2019 (see Note 4), which increased goodwill by \$154,234,000. The remaining change was related to changes in foreign currency rates period over period. The Company's goodwill is reported in the Golf Equipment and Apparel, Gear and Other operating segments (see Note 18).



In accordance with ASC Topic 350, "Intangibles—Goodwill and Other," the Company's goodwill and non-amortizing intangible assets are subject to an annual impairment test or more frequently when impairment indicators are present. There were no impairment charges recognized during the three and six months ended June 30, 2019. The following sets forth the intangible assets by major asset class (dollars in thousands):

|   | Useful<br>Life<br>(Years) | June 30, 2019 |                             |                   | December 31, 2018 |                             |                   |
|---|---------------------------|---------------|-----------------------------|-------------------|-------------------|-----------------------------|-------------------|
|   |                           | Gross         | Accumulated<br>Amortization | Net Book<br>Value | Gross             | Accumulated<br>Amortization | Net Book<br>Value |
| Non-Amortizing:                                 |                           |               |                             |                   |                   |                             |                   |
| Trade name, trademark and trade dress and other | NA                        | \$ 457,197    | \$ —                        | \$ 457,197        | \$ 218,364        | \$ —                        | \$ 218,364        |
| Amortizing:                                     |                           |               |                             |                   |                   |                             |                   |
| Patents   | 2-16                      | 31,581        | 31,568                      | 13                | 31,581            | 31,543                      | 38                |
| Distributor, customer relationships and other   | 1-10                      | 54,448        | 11,931                      | 42,517            | 15,780            | 9,490                       | 6,290             |
| Total intangible assets                         |                           | \$ 543,226    | \$ 43,499                   | \$ 499,727        | \$ 265,725        | \$ 41,033                   | \$ 224,692        |

Aggregate amortization expense on intangible assets was approximately \$1,246,000 and \$267,000 for the three months ended June 30, 2019 and 2018, respectively, and \$2,466,000 and \$534,000 for the six months ended June 30, 2019 and 2018, respectively.

Amortization expense related to intangible assets at June 30, 2019 in each of the next five fiscal years and beyond is expected to be incurred as follows (in thousands):

|                   |                  |
|-------------------|------------------|
| Remainder of 2019 | \$ 2,427         |
| 2020              | 4,780            |
| 2021              | 4,724            |
| 2022              | 4,548            |
| 2023              | 4,409            |
| Thereafter        | 21,642           |
|                   | <u>\$ 42,530</u> |

#### Note 9. Joint Venture

The Company had a joint venture in Japan, Callaway Apparel K.K., with its long-time apparel licensee, TSI Groove & Sports Co, Ltd., ("TSI") for the design, manufacture and distribution of Callaway-branded apparel, footwear and headwear in Japan. In July 2016, the Company contributed \$10,556,000, primarily in cash, for a 52% ownership of the joint venture, and TSI contributed \$9,744,000, primarily in inventory, for the remaining 48%. In May 2019, the Company entered into a stock purchase agreement with TSI to acquire the remaining shares comprising the 48% ownership in Callaway Apparel K.K. for 2 billion Yen, or approximately \$18,538,000 (using the exchange rate in effect on the acquisition date). The purchase was completed as of May 31, 2019. Pursuant to the stock purchase agreement, the purchase price is due and payable by August 31, 2019, and is therefore included in accounts payable and accrued expenses on the consolidated condensed balance sheet as of June 30, 2019. As of June 30, 2019, the Company owned 100% of this entity and controlled all matters pertaining to its business operations and significant management decisions. Callaway Apparel K.K. is consolidated one month in arrears.

During the three and six months ended June 30, 2019, the Company recorded net income attributable to the non-controlling interest of \$33,000 and \$179,000, respectively, in its consolidated condensed statements of operations. The total non-controlling interest on the Company's consolidated condensed financial statement at December 31, 2018 was \$9,734,000.

#### Note 10. Investments

##### *Investment in Topgolf International, Inc.*

The Company owns a minority interest of approximately 14.0% in Topgolf International, Inc. doing business as the Topgolf Entertainment Group ("Topgolf"), the owner and operator of Topgolf entertainment centers, which ownership consists of common

stock and various classes of preferred stock. In connection with this investment, the Company has a preferred partner agreement with Topgolf in which the Company has preferred signage rights, rights as the preferred supplier of golf products used or offered for use at Topgolf facilities at prices no less than those paid by the Company's customers, preferred retail positioning in Topgolf retail stores, and other rights incidental to those listed above.

Topgolf is a privately held company, and as such, the common and preferred shares comprising the Company's investment are illiquid and their fair value is not readily determinable. The Company accounts for changes in fair value in accordance with ASU No. 2016-01, which requires equity securities without a readily determinable fair value to be measured at cost, less impairments if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or similar investment of the same issuer.

There were no additional investments during the six months ended June 30, 2019. During the six months ended June 30, 2018, the Company invested \$282,000 in shares of Topgolf. The shares that were purchased during the six months ended June 30, 2018 from other Topgolf shareholders were not acquired in orderly transactions as these transactions were not exposed to the market and were not subject to marketing activities. Since the adoption of ASU 2016-01, there were no observable transactions which would provide an estimate of fair value. As such, at June 30, 2019 and December 31, 2018, the Company's investment in Topgolf is reflected at cost less impairments in accordance with ASU No. 2016-01. The Company's total investment in Topgolf as of both June 30, 2019 and December 31, 2018 was \$72,238,000.

As of June 30, 2019, the Company has not recorded any impairments with respect to this investment. If in the future there is an observable price change as a result of an orderly transaction for the identical or similar investment in Topgolf, the Company would be required to assess the fair value impact, if any, on each identified or similar class of Topgolf stock held by the Company, and write such stock up or down to its estimated fair value, which could have a material effect on the Company's financial position and results of operations.

#### Note 11. Product Warranty

The Company has a stated two-year warranty policy for its golf clubs and Jack Wolfskin gear, as well as a limited lifetime warranty for OGIO gear. The Company's policy is to accrue the estimated cost of satisfying future warranty claims at the time the sale is recorded. In estimating its future warranty obligations, the Company considers various relevant factors, including the Company's stated warranty policies and practices, the historical frequency of claims, and the cost to replace or repair its products under warranty. The warranty provision for the three and six months ended June 30, 2019 includes the warranty reserves assumed in connection with the Jack Wolfskin acquisition (see Note 4).

The following table provides a reconciliation of the activity related to the Company's reserve for warranty expense (in thousands):

|  | Three Months Ended June 30, |                 | Six Months Ended June 30, |                 |
|--|-----------------------------|-----------------|---------------------------|-----------------|
|  | 2019                        | 2018            | 2019                      | 2018            |
| Beginning balance                            | \$ 10,783                   | \$ 7,311        | \$ 7,610                  | \$ 6,657        |
| Provision                                    | 2,127                       | 3,157           | 4,606                     | 5,523           |
| Provision liability assumed from acquisition | 273                         | —               | 2,600                     | —               |
| Claims paid/costs incurred                   | (2,207)                     | (2,433)         | (3,840)                   | (4,145)         |
| Ending balance                               | <u>\$ 10,976</u>            | <u>\$ 8,035</u> | <u>\$ 10,976</u>          | <u>\$ 8,035</u> |

#### Note 12. Income Taxes

The Company calculates its interim income tax provision in accordance with ASC Topic 270, "Interim Reporting," and ASC Topic 740 "Accounting for Income Taxes." At the end of each interim period, the Company estimates its annual effective tax rate and applies that rate to its ordinary quarterly earnings to calculate the tax related to ordinary income. The tax effects for other items that are excluded from ordinary income are discretely calculated and recognized in the period in which they occur.

As of June 30, 2019, significant guidance with respect to the Tax Act remains proposed or outstanding. As such, many components of the 2019 tax expense remain estimates and are primarily based on proposed regulations and other guidance as released by the IRS and United States Treasury. The most significant estimate relates to foreign derived intangible income (FDII) and global intangible low taxed income (GILTI).

During the six months ended June 30, 2019, the Company acquired Jack Wolfskin for approximately \$521,201,000 (including cash acquired of \$58,096,000) in a non-taxable acquisition. The Company recorded a deferred tax liability of \$88,392,000 related to the intangibles upon acquisition (see Note 4).

The realization of deferred tax assets, including loss and credit carryforwards, is subject to the Company generating sufficient taxable income during the periods in which the deferred tax assets become realizable. Due to the Company's continued profitability, combined with future projections of profitability, the Company has determined that the majority of its U.S. deferred tax assets are more likely than not to be realized. The valuation allowance on the Company's U.S. deferred tax assets as of June 30, 2019 primarily relates to state net operating loss carryforwards and credits that the Company estimates it may not be able to utilize in future periods. With respect to previously existing non-U.S. entities, there continues to be sufficient positive evidence to conclude that realization of its deferred tax assets is more likely than not under applicable accounting rules, and therefore no significant valuation allowances have been established. The Company is currently assessing the need for valuation allowances within the Jack Wolfskin group. As of June 30, 2019 the Company maintains all valuation allowances established prior to the acquisition and will adjust these balances if necessary as the Company obtains more information within the measurement period.

The income tax provision was \$7,208,000 and \$17,247,000 for the three months ended June 30, 2019 and 2018, respectively, and \$16,764,000 and \$34,466,000 for the six months ended June 30, 2019 and 2018, respectively. The decrease in the provision was primarily due to the reduction of pre-tax income. As a percent of pre-tax income, the Company's effective tax rate declined to 20.0% compared to 22.1% for the second quarter of 2018 primarily due to a shift in the mix of foreign earnings relative to the prior year.

At June 30, 2019, the gross liability for income taxes associated with uncertain tax positions was \$12,308,000. Of this amount, \$6,597,000 would benefit the Company's consolidated condensed financial statements and effective income tax rate if favorably settled. The unrecognized tax liabilities are expected to decrease by approximately \$28,000 during the next 12 months. The gross liability for uncertain tax positions increased by \$187,000 for the three months ended June 30, 2019. The increase was primarily due to increases in tax positions taken in the current quarter. The gross liability for uncertain tax positions increased to \$476,000 for the six months ended June 30, 2019 primarily due to increases in tax positions taken in the current year.

The Company recognizes interest and penalties related to income tax matters in income tax expense. For the three months ended June 30, 2019 and 2018, the Company's provision for income taxes includes a benefit of \$221,000 and \$123,000, respectively, related to the recognition of interest and/or penalties. For the six months ended June 30, 2019 and 2018, the Company's provision for income taxes includes a net benefit of \$189,000 and \$6,000, respectively, related to the recognition of interest and/or penalties. As of June 30, 2019 and December 31, 2018, the gross amount of accrued interest and penalties included in income taxes payable in the accompanying consolidated condensed balance sheets was \$1,471,000 and \$1,660,000, respectively.

The Company files income tax returns in the U.S. federal jurisdiction and various state and foreign jurisdictions. The Company is generally no longer subject to income tax examinations by tax authorities in the following major jurisdictions:

| <b>Tax Jurisdiction</b>    | <b>Years No Longer Subject to Audit</b> |
|----------------------------|---|
| U.S. federal               | 2010 and prior                          |
| California (United States) | 2008 and prior                          |
| Canada                     | 2011 and prior                          |
| Japan                      | 2012 and prior                          |
| South Korea                | 2013 and prior                          |
| United Kingdom             | 2014 and prior                          |

Pursuant to Section 382 of the Internal Revenue Code, use of the Company's net operating losses and credit carry-forwards may be limited significantly if the Company were to experience a cumulative change in ownership of the Company's stock by "5-percent shareholders" that exceeds 50% over a rolling three-year period. The Company does not believe there has been a cumulative change in ownership in excess of 50% during any rolling three-year period, and the Company continues to monitor changes in its ownership. If such a cumulative change did occur in any three-year period and the Company were limited in the amount of losses and credits it could use to offset its tax liabilities, the Company's results of operations and cash flows could be adversely impacted.

**Note 13. Commitments & Contingencies*****Legal Matters***

The Company is subject to routine legal claims, proceedings and investigations incident to its business activities, including claims, proceedings, and investigations relating to commercial disputes and employment matters. The Company also receives from time to time information claiming that products sold by the Company infringe or may infringe patent, trademark or other intellectual property rights of third parties. One or more such claims of potential infringement could lead to litigation, the need to obtain licenses, the need to alter a product to avoid infringement, a settlement or judgment or some other action or material loss by the Company, which also could adversely affect the Company's overall ability to protect its product designs and ultimately limit its future success in the marketplace. In addition, the Company is occasionally subject to non-routine claims, proceedings or investigations.

The Company regularly assesses such matters to determine the degree of probability that the Company will incur a material loss as a result of such matters as well as the range of possible loss. An estimated loss contingency is accrued in the Company's consolidated condensed financial statements if it is probable the Company will incur a loss and the amount of the loss can be reasonably estimated. The Company reviews all claims, proceedings and investigations at least quarterly and establishes or adjusts any accruals for such matters to reflect the impact of negotiations, settlements, advice of legal counsel and other information and events pertaining to a particular matter. All legal costs associated with such matters are expensed as incurred.

Historically, the claims, proceedings and investigations brought against the Company, individually and in the aggregate, have not had a material adverse effect on the consolidated results of operations, cash flows or financial position of the Company. The Company believes that it has valid legal defenses to the matters currently pending against the Company. These matters are inherently unpredictable and the resolutions of these matters are subject to many uncertainties and the outcomes are not predictable with assurance. Consequently, management is unable to estimate the ultimate aggregate amount of monetary loss, amounts covered by insurance or the financial impact that will result from such matters. In addition, the Company cannot assure that it will be able to successfully defend itself in those matters or that any amounts accrued are sufficient. The Company does not believe that the matters currently pending against the Company will have a material adverse effect on the Company's consolidated business, financial condition, cash flows or results of operations on an annual basis.

***Unconditional Purchase Obligations***

During the normal course of its business, the Company enters into agreements to purchase goods and services, including purchase commitments for production materials, as well as endorsement agreements with professional golfers and other endorsers, employment and consulting agreements, and intellectual property licensing agreements pursuant to which the Company is required to pay royalty fees. It is not possible to determine the amounts the Company will ultimately be required to pay under these agreements as they are subject to many variables including performance-based bonuses, severance arrangements, the Company's sales levels, and reductions in payment obligations if designated minimum performance criteria are not achieved. The Company has entered into many of these contractual agreements with terms ranging from one to four years. The minimum obligation that the Company is required to pay as of June 30, 2019 under these agreements is \$95,091,000 over the next four years as follows (in thousands):

|                   |                  |
|-------------------|------------------|
| Remainder of 2019 | \$ 48,211        |
| 2020              | 23,791           |
| 2021              | 14,350           |
| 2022              | 7,148            |
| 2023              | 1,591            |
|                   | <u>\$ 95,091</u> |

In addition, the Company also enters into unconditional purchase obligations with various vendors and suppliers of goods and services in the normal course of operations through purchase orders or other documentation or that are undocumented except for an invoice. Such unconditional purchase obligations are generally outstanding for periods less than a year and are settled by cash payments upon delivery of goods and services and are not reflected in this total.

***Other Contingent Contractual Obligations***

During its normal course of business, the Company has made certain indemnities, commitments and guarantees under which it may be required to make payments in relation to certain transactions. These include (i) intellectual property indemnities to the

Company's customers and licensees in connection with the use, sale and/or license of Company product or trademarks, (ii) indemnities to various lessors in connection with facility leases for certain claims arising from such facilities or leases, (iii) indemnities to vendors and service providers pertaining to the goods and services provided to the Company or based on the negligence or willful misconduct of the Company and (iv) indemnities involving the accuracy of representations and warranties in certain contracts. In addition, the Company has consulting agreements that provide for payment of nominal fees upon the issuance of patents and/or the commercialization of research results. The Company has also issued guarantees in the form of standby letters of credit of \$1,177,000 as of June 30, 2019.

The duration of these indemnities, commitments and guarantees varies, and in certain cases, may be indefinite. The majority of these indemnities, commitments and guarantees do not provide for any limitation on the maximum amount of future payments the Company could be obligated to make. Historically, costs incurred to settle claims related to indemnities have not been material to the Company's financial position, results of operations or cash flows. In addition, the Company believes the likelihood is remote that payments under the commitments and guarantees described above will have a material effect on the Company's consolidated condensed financial statements. The fair value of indemnities, commitments and guarantees that the Company issued as of June 30, 2019 was not material to the Company's financial position, results of operations or cash flows.

### ***Employment Contracts***

In addition, the Company has made contractual commitments to each of its officers and certain other employees providing for severance payments, including salary continuation, upon the termination of employment by the Company without substantial cause or by the officer for good reason or non-renewal. In addition, in order to ensure that the officers would continue to provide independent leadership consistent with the Company's best interests, the contracts also generally provide for certain protections in the event of a change in control of the Company. These protections include the payment of certain severance benefits, such as salary continuation, upon the termination of employment following a change in control.

### **Note 14. Share-Based Employee Compensation**

As of June 30, 2019, the Company had two shareholder approved stock plans under which shares were available for equity-based awards: the Callaway Golf Company Amended and Restated 2004 Incentive Plan (the "2004 Incentive Plan") and the 2013 Non-Employee Directors Stock Incentive Plan (the "2013 Directors Plan"). From time to time, the Company grants stock options, restricted stock units, performance share units, phantom stock units, stock appreciation rights and other awards under these plans.

The table below summarizes the amounts recognized in the financial statements for the three and six months ended June 30, 2019 and 2018 for share-based compensation, including expense for restricted stock units and performance share units (in thousands).

|  | Three Months Ended June 30, |                 | Six Months Ended June 30, |                 |
|--|-----------------------------|-----------------|---------------------------|-----------------|
|  | 2019                        | 2018            | 2019                      | 2018            |
| Cost of sales  | \$ 247                      | \$ 256          | \$ 502                    | \$ 470          |
| Operating expenses   | 3,283                       | 3,208           | 6,463                     | 5,994           |
| Total cost of share-based compensation included in income, before income tax | <u>\$ 3,530</u>             | <u>\$ 3,464</u> | <u>\$ 6,965</u>           | <u>\$ 6,464</u> |

### ***Restricted Stock Units***

Restricted stock units awarded under the 2004 Incentive Plan and the 2013 Directors Plan are valued at the Company's closing stock price on the date of grant. Restricted stock units generally vest over a one- to three-year period. Compensation expense for restricted stock units is recognized on a straight-line basis over the vesting period and is reduced by an estimate for forfeitures. During the three months ended June 30, 2019 and 2018, the Company granted 53,000 and 59,000 shares underlying restricted stock units, respectively, at a weighted average grant-date fair value of \$16.73 and \$17.72 per share, respectively. During the six months ended June 30, 2019 and 2018, the Company granted 452,000 and 419,000 shares underlying restricted stock units, respectively, at a weighted average grant-date fair value of \$15.35 and \$15.22 per share, respectively.

Total compensation expense, net of estimated forfeitures, recognized for restricted stock units during the three months ended June 30, 2019 and 2018 was \$1,683,000 and \$1,463,000, respectively, and \$3,319,000 and \$2,850,000, for the six months ended June 30, 2019 and 2018. At June 30, 2019, the Company had \$22,385,000 of total unamortized compensation expense related to non-vested restricted stock units. That cost is expected to be recognized over a weighted-average period of 2.6 years.

### ***Performance Based Awards***

The Company grants performance share units and awards subject to total shareholder return metrics under the 2004 Incentive Plan.

Performance share units are stock-based awards in which the number of shares ultimately received depends on the Company's performance against specified metrics over a one- to five-year performance period from the date of grant. These performance metrics are established by the Company at the beginning of the performance period. At the end of the performance period, the number of shares of stock that could be issued is fixed based upon the degree of achievement of the performance goals. The number of shares that could be issued can range from 0% to 200% of the participant's target award. Performance share units are initially valued at the Company's closing stock price on the date of grant. Stock compensation expense, net of estimated forfeitures, is recognized on a straight-line basis over the vesting period. The expense recognized over the vesting period is adjusted up or down based on the anticipated performance level during the performance period. If the performance metrics are not probable of achievement during the performance period, compensation expense would be reversed. The awards are forfeited if the threshold performance metrics are not achieved as of the end of the performance period. The performance share units cliff-vest in full over a period of three to five years from the date of grant.

The Company granted 265,000 and 307,000 shares underlying performance share units during the six months ended June 30, 2019 and 2018, respectively, at a weighted average grant-date fair value of \$15.17 and \$14.80 per share, respectively. There were no shares underlying performance share units granted during the three months ended June 30, 2019 and 2018. The awards granted during 2019 and 2018 are subject to a three- to five-year performance period provided that (i) if certain first year performance goals are achieved, the participant could earn up to 50% of the three-year target award shares, subject to continued service through the vesting date, and (ii) if certain cumulative first- and second-year performance goals are achieved, the participant could earn up to an aggregate of 80% of the three-year target award shares (which includes any shares earned during the first year), subject to continued service through the vesting date. Based on the Company's performance, participants earned a minimum of 50% of the target award shares granted in 2018, in each case subject to continued service through the vesting date.

Performance share units with total shareholder return requirements are awards that compare the performance of the Company's common stock over a three-year period to that of the Company's peer group. The fair value of these awards is derived using the Monte Carlo simulation which utilizes the stock volatility, dividend yield and market correlation of the Company and the Company's peer group. During the six months ended June 30, 2019, the Company granted 149,000 shares underlying performance share units subject to total shareholder return requirements at a weighted average grant-date fair value of \$16.96 per share. There were no performance share units granted in the three months ended June 30, 2019 or in the three and six months ended June 30, 2018 that were subject to total shareholder return requirements. Stock compensation expense, net of estimated forfeitures, is recognized on a straight-line basis over a three-year vesting period.

During the three months ended June 30, 2019 and 2018, the Company recognized total compensation expense, net of estimated forfeitures, for performance based awards of \$1,847,000 and \$1,995,000, respectively, and \$3,646,000 and \$3,599,000 for the six months ended June 30, 2019 and 2018, respectively. At June 30, 2019, unamortized compensation expense related to these awards was \$25,793,000, which is expected to be recognized over a weighted-average period of 1.8 years.

### **Note 15. Fair Value of Financial Instruments**

Certain of the Company's financial assets and liabilities are measured at fair value on a recurring and nonrecurring basis. Fair value is defined as the price that would be received to sell an asset or the price paid to transfer a liability (the exit price) in the principal and most advantageous market for the asset or liability in an orderly transaction between market participants. Assets and liabilities carried at fair value are classified using the following three-tier hierarchy:

*Level 1:* Quoted market prices in active markets for identical assets or liabilities;

*Level 2:* Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations in which significant inputs and significant value drivers are observable in active markets; and

*Level 3:* Fair value measurements derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable.

The following table summarizes the valuation of the Company's foreign currency forward contracts (see Note 16) that are measured at fair value on a recurring basis by the above pricing levels at June 30, 2019 and December 31, 2018 (in thousands):

|  | Fair Value        | Level 1     | Level 2           | Level 3     |
|--|-------------------|-------------|-------------------|-------------|
| <b>June 30, 2019</b>                                   |                   |             |                   |             |
| Foreign currency forward contracts—asset position      | \$ 2,084          | \$ —        | \$ 2,084          | \$ —        |
| Foreign currency forward contracts—liability position  | (351)             | —           | (351)             | —           |
| Cross-currency debt swap agreements—asset position     | 5,144             | —           | 5,144             | —           |
| Cross-currency debt swap agreements—liability position | (6,255)           | —           | (6,255)           | —           |
| Interest rate hedge agreements—asset position          | —                 | —           | —                 | —           |
| Interest rate hedge agreements—liability position      | (7,855)           | —           | (7,855)           | —           |
|  | <u>\$ (7,233)</u> | <u>\$ —</u> | <u>\$ (7,233)</u> | <u>\$ —</u> |
| <b>December 31, 2018</b>                               |                   |             |                   |             |
| Foreign currency forward contracts—asset position      | \$ 4,539          | \$ —        | \$ 4,539          | \$ —        |
| Foreign currency forward contracts—liability position  | (236)             | —           | (236)             | —           |
|  | <u>\$ 4,303</u>   | <u>\$ —</u> | <u>\$ 4,303</u>   | <u>\$ —</u> |

The fair value of the Company's foreign currency forward contracts is based on observable inputs that are corroborated by market data. Observable inputs include broker quotes, daily market foreign currency rates and forward pricing curves. Remeasurement gains and losses on foreign currency forward contracts designated as cash flow hedges are recorded in other comprehensive income, and in other income (expense) for non-designated foreign currency forward contracts (see Note 16).

#### ***Disclosures about the Fair Value of Financial Instruments***

The carrying values of cash and cash equivalents at June 30, 2019 and December 31, 2018 are categorized within Level 1 of the fair value hierarchy. The table below summarizes information about fair value relating to the Company's financial assets and liabilities that are recognized in the accompanying consolidated condensed balance sheets as of June 30, 2019 and December 31, 2018, as well as the fair value of contingent contracts that represent financial instruments (in thousands).

|  | June 30, 2019  |            | December 31, 2018 |            |
|--|----------------|------------|-------------------|------------|
|  | Carrying Value | Fair Value | Carrying Value    | Fair Value |
| Term Loan Facility <sup>(1)</sup>                            | \$ 461,966     | \$ 461,966 | \$ —              | \$ —       |
| Primary Asset-Based Revolving Credit Facility <sup>(2)</sup> | \$ 165,467     | \$ 165,467 | \$ 40,300         | \$ 40,300  |
| Equipment Note <sup>(3)</sup>                                | \$ 8,503       | \$ 8,503   | \$ 9,629          | \$ 9,629   |
| Standby letters of credit <sup>(4)</sup>                     | \$ 1,177       | \$ 1,177   | \$ 1,187          | \$ 1,187   |

(1) In January 2019, the Company entered into the Term Loan Facility. The fair value of this debt is categorized within Level 2 of the fair value hierarchy. See Note 5 for further information.

(2) The carrying value of the amounts outstanding under the Company's ABL Facility approximates the fair value due to the short-term nature of these obligations. The fair value of this debt is categorized within Level 2 of the fair value hierarchy. See Note 5 for information on the Company's credit facilities, including certain risks and uncertainties related thereto.

(3) In December 2017, the Company entered into the Equipment Note secured by certain equipment at the Company's golf ball manufacturing facility. The fair value of this debt is categorized within Level 2 of the fair value hierarchy. See Note 5 for further information.

(4) The carrying value of the Company's standby letters of credit approximates the fair value as they represent the Company's contingent obligation to perform in accordance with the underlying contracts. The fair value of this contingent obligation is categorized within Level 2 of the fair value hierarchy.

### Nonrecurring Fair Value Measurements

The Company measures certain assets at fair value on a nonrecurring basis at least annually or more frequently if certain indicators are present. These assets include long-lived assets, goodwill, non-amortizing intangible assets and investments that are written down to fair value when they are held for sale or determined to be impaired. During each of the six months ended June 30, 2019 and 2018, there were no impairment indicators related to the Company's assets that are measured at fair value on a nonrecurring basis. Assets purchased in connection with the acquisitions of Jack Wolfskin were valued at their fair value on the date of purchase (see Note 4).

### Note 16. Derivatives and Hedging

In the normal course of business, the Company is exposed to gains and losses resulting from fluctuations in foreign currency exchange rates relating to transactions of its international subsidiaries. As part of its strategy to manage the level of exposure to the risk of fluctuations in foreign currency exchange rates, the Company uses designated cash flow hedges and non-designated hedges in the form of foreign currency forward contracts to mitigate the impact of foreign currency translation on transactions that are denominated primarily in Japanese Yen, British Pounds, Euros, Canadian Dollars, Australian Dollars and Korean Won, and designated cross-currency debt swaps to mitigate the impact of variable interest rates on long-term debt.

The Company accounts for its foreign currency forward contracts and cross-currency debt swaps in accordance with ASC Topic 815, "Derivatives and Hedging" ("ASC Topic 815"). ASC Topic 815 requires the recognition of all derivative instruments as either assets or liabilities on the balance sheet, the measurement of those instruments at fair value and the recognition of changes in the fair value of derivatives in earnings in the period of change, unless the derivative qualifies as a designated cash flow hedge that offsets certain exposures. Certain criteria must be satisfied in order for derivative financial instruments to be classified and accounted for as a cash flow hedge. Gains and losses from the remeasurement of qualifying cash flow hedges are recorded as a component of other comprehensive income and released into earnings as a component of cost of goods sold or net sales during the period in which the hedged transaction takes place. Gains and losses on the ineffective portion of hedges (hedges that do not meet accounting requirements due to ineffectiveness) and derivatives that are not elected for hedge accounting treatment are immediately recorded in earnings as a component of cost of goods sold and other income (expense), respectively.

Foreign currency forward contracts are used only to meet the Company's objectives of minimizing variability in the Company's operating results arising from foreign exchange rate movements. The Company does not enter into foreign currency forward contracts for speculative purposes. The Company utilizes counterparties for its derivative instruments that it believes are credit-worthy at the time the transactions are entered into and the Company closely monitors the credit ratings of these counterparties.

The following table summarizes the fair value of the Company's derivative instruments as well as the location of the asset and/or liability on the consolidated condensed balance sheets at June 30, 2019 and December 31, 2018 (in thousands):

|   | Asset Derivatives      |                 |                        |              |
|---|------------------------|-----------------|------------------------|--------------|
|   | June 30, 2019          |                 | December 31, 2018      |              |
|   | Balance Sheet Location | Fair Value      | Balance Sheet Location | Fair Value   |
| <b>Derivatives designated as cash flow hedging instruments:</b> |                        |                 |                        |              |
| Foreign currency forward contracts                              | Other current assets   | \$ 479          | Other current assets   | \$ 54        |
| Cross-currency debt swap agreements                             | Other current assets   | 5,144           | Other current assets   | —            |
| Total   |                        | <u>\$ 5,623</u> |                        | <u>\$ 54</u> |
| <b>Derivatives not designated as hedging instruments:</b>       |                        |                 |                        |              |
| Foreign currency forward contracts                              | Other current assets   | \$ 1,605        | Other current assets   | \$ 4,485     |



|   | Liability Derivatives                 |                  |                                       |              |
|---|---------------------------------------|------------------|---------------------------------------|--------------|
|   | June 30, 2019                         |                  | December 31, 2018                     |              |
|   | Balance Sheet Location                | Fair Value       | Balance Sheet Location                | Fair Value   |
| <b>Derivatives designated as cash flow hedging instruments:</b> |                                       |                  |                                       |              |
| Foreign currency forward contracts                              | Accounts payable and accrued expenses | \$ 11            | Accounts payable and accrued expenses | \$ 39        |
| Cross-currency debt swap agreements                             | Accounts payable and accrued expenses | 76               | Accounts payable and accrued expenses | —            |
|   | Other long-term liabilities           | 6,179            | Other long-term liabilities           | —            |
| Interest rate hedge agreements                                  | Accounts payable and accrued expenses | 1,366            | Accounts payable and accrued expenses | —            |
|   | Other long-term liabilities           | 6,489            | Other long-term liabilities           | —            |
| Total   |                                       | <u>\$ 14,121</u> |                                       | <u>\$ 39</u> |
| <b>Derivatives not designated as hedging instruments:</b>       |                                       |                  |                                       |              |
| Foreign currency forward contracts                              | Accounts payable and accrued expenses | \$ 340           | Accounts payable and accrued expenses | \$ 197       |

The Company's derivative instruments are subject to a master netting agreement with each respective counterparty bank and are therefore net settled at their maturity date. Although the Company has the legal right of offset under the master netting agreements, the Company has elected not to present these contracts on a net settlement amount basis, and therefore present these contracts on a gross basis on the accompanying consolidated condensed balance sheets at June 30, 2019 and December 31, 2018.

## Cash Flow Hedging Instruments

### *Hedges of Foreign Currency Exchange Risk*

The Company uses foreign currency derivatives designated as qualifying cash flow hedging instruments, including currency forward contracts and cross-currency swaps, to help mitigate the Company's foreign currency exposure on intercompany sales of inventory to its foreign subsidiaries to mitigate the exposure. These contracts generally mature within 12 to 15 months from their inception. At June 30, 2019, the notional amounts of the Company's foreign currency forward contracts designated as cash flow hedge instruments were approximately \$28,726,000. At December 31, 2018, the Company had no outstanding foreign currency forward contracts designated as cash flow hedges. The reporting of gains and losses on these cash flow hedging instruments depends on whether the gains or losses are effective at offsetting changes in the cash flows of the underlying hedged items. The Company uses the critical terms method to measure the effectiveness of the foreign currency forward contracts and evaluates the effectiveness on a quarterly basis. The effective portion of the gains and losses on the hedging instruments are recorded in other comprehensive income until recognized in earnings during the period that the hedged transactions take place. Any ineffective portion of the gains and losses from the hedging instruments is recognized in earnings immediately. The Company would discontinue hedge accounting prospectively (i) if it is determined that the derivative is no longer effective in offsetting changes in the cash flows of a hedged item, (ii) when the derivative expires or is sold, terminated, or exercised, (iii) if it becomes probable that the forecasted transaction being hedged by the derivative will not occur, (iv) if a hedged firm commitment no longer meets the definition of a firm commitment, or (v) if it is determined that designation of the derivative as a hedge instrument is no longer appropriate. The Company estimates the fair value of its foreign currency forward contracts based on pricing models using current market rates. These contracts are classified under Level 2 of the fair value hierarchy (see Note 15).

As of June 30, 2019, the Company recorded a net gain of \$573,000 in other comprehensive income related to its foreign currency hedging activities. Of this amount, net gains of \$109,000 and net losses of \$202,000 for the three and six months ended June 30, 2019, respectively, were relieved from other comprehensive income and recognized in cost of goods sold for the underlying intercompany sales that were recognized, and net gains of \$242,000 and \$565,000 for the three and six months ended June 30, 2019, respectively, were relieved from other comprehensive income related to the amortization of forward points. The Company recognized net losses of \$155,000 and \$200,000 in cost of goods sold for the three and six months ended June 30, 2018, respectively.

There were no ineffective hedge gains or losses recognized during the six months ended June 30, 2019. Based on the current valuation, the Company expects to reclassify net gains of \$667,000 from accumulated other comprehensive income into net earnings during the next 12 months.

### **Hedges of Interest Rate Risk**

The Company's objectives in using interest rate derivatives are to add stability to interest expense and to manage its exposure to interest rate movements. To accomplish this objective, the Company primarily uses interest rate hedges as part of its interest rate risk management strategy. Interest rate hedges designated as cash flow hedges involve the receipt of variable amounts from a counterparty in exchange for the Company making fixed-rate payments over the life of the agreements without exchange of the underlying notional amount. During 2019, such derivatives were used to hedge the variable cash flows associated with the Company's variable rate \$480,000,000 term loan.

For derivatives designated and that qualify as cash flow hedges of interest rate risk, the gain or loss on the derivative is recorded in Accumulated Other Comprehensive Income and subsequently reclassified into interest income (expense) in the same period(s) during which the hedged transaction affects earnings. Amounts reported in accumulated other comprehensive income related to derivatives will be reclassified to interest income (expense) as interest payments are made or received on the Company's variable-rate debt. Based on the current valuation, the Company expects to reclassify net interest expense of \$278,000 from accumulated other comprehensive income into earnings during the next 12 months.

As of June 30, 2019, the notional amounts of the outstanding interest rate derivatives that were designated as cash flow hedges of interest rate risk were \$199,355,000.

During the six months ended June 30, 2019, the Company recorded a net gain of \$1,164,000 in other comprehensive income (loss) related to its cross currency swap activities, and net losses of \$7,897,000 related to its interest rate hedging activities. Of this amount, net losses of \$1,497,000 and net gains of \$2,207,000 were relieved from other comprehensive income and recognized in other income for the three and six months ended June 30, 2019. There were no ineffective hedge gains or losses recognized during the three and six months ended June 30, 2019.

The following tables summarize the net effect of all cash flow hedges on the consolidated condensed financial statements for the three and six months ended June 30, 2019 (in thousands):

|  | Gain/(Loss) Recognized in Other Comprehensive Income<br>(Effective Portion)                      |                 |                              |                 |
|--|--|-----------------|------------------------------|-----------------|
|  | Three Months Ended<br>June 30,   |                 | Six Months Ended<br>June 30, |                 |
|  | 2019   | 2018            | 2019                         | 2018            |
| <b>Derivatives designated as cash flow hedging instruments</b> |  |                 |                              |                 |
| Foreign currency forward contracts                             | \$ 27  | \$ 1,739        | \$ 573                       | \$ 138          |
| Cross-currency debt swap agreements                            | (2,907)  | —               | 1,164                        | —               |
| Interest rate hedge agreements                                 | (3,956)  | —               | (7,897)                      | —               |
|  | <u>\$ (6,836)</u>  | <u>\$ 1,739</u> | <u>\$ (6,160)</u>            | <u>\$ 138</u>   |
|  |  |                 |                              |                 |
|  | Gain/(Loss) Reclassified from Other Comprehensive Income<br>into Earnings<br>(Effective Portion) |                 |                              |                 |
|  | Three Months Ended<br>June 30,   |                 | Six Months Ended<br>June 30, |                 |
|  | 2019   | 2018            | 2019                         | 2018            |
| <b>Derivatives designated as cash flow hedging instruments</b> |  |                 |                              |                 |
| Foreign currency forward contracts                             | \$ 228   | \$ (155)        | \$ 374                       | \$ (200)        |
| Cross-currency debt swap agreements                            | (1,463)  | —               | 2,251                        | —               |
| Interest rate hedge agreements                                 | (34)   | —               | (44)                         | —               |
|  | <u>\$ (1,269)</u>  | <u>\$ (155)</u> | <u>\$ 2,581</u>              | <u>\$ (200)</u> |

### Foreign Currency Forward Contracts Not Designated as Hedging Instruments

The Company uses foreign currency forward contracts that are not designated as qualifying cash flow hedging instruments to mitigate certain balance sheet exposures (payables and receivables denominated in foreign currencies), as well as gains and losses resulting from the translation of the operating results of the Company's international subsidiaries into U.S. dollars for financial reporting purposes. These contracts generally mature within 12 months from their inception. At June 30, 2019 and December 31, 2018, the notional amounts of the Company's foreign currency forward contracts used to mitigate the exposures discussed above were approximately \$138,000,000 and \$459,600,000, respectively. The Company estimates the fair values of foreign currency forward contracts based on pricing models using current market rates, and records all derivatives on the balance sheet at fair value with changes in fair value recorded in the consolidated condensed statements of operations. The foreign currency contracts are classified under Level 2 of the fair value hierarchy (see Note 15).

The following table summarizes the location of net gains and losses in the consolidated condensed statements of operations that were recognized during the three and six months ended June 30, 2019 and 2018, respectively, in addition to the derivative contract type (in thousands):

| Derivatives not designated as hedging instruments | Location of Net Gain Recognized in Income on Derivative Instruments | Amount of Net Gain Recognized in Income on Derivative Instruments |          |                           |          |
|---|---|---|----------|---------------------------|----------|
|   |   | Three Months Ended June 30,                                       |          | Six Months Ended June 30, |          |
|   |   | 2019  | 2018     | 2019                      | 2018     |
| Foreign currency forward contracts                | Other expense, net  | \$ 691  | \$ 7,220 | \$ 1,441                  | \$ 3,360 |

In addition, for the three and six months ended June 30, 2019, the Company recognized a net foreign currency gain of \$2,729,000 and a net foreign currency loss of \$2,609,000 related to transactions with its foreign subsidiaries, respectively.

### Note 17. Accumulated Other Comprehensive Loss

The following table details the amounts reclassified from accumulated other comprehensive loss to cost of goods sold, as well as changes in foreign currency translation for the three and six months ended June 30, 2019. Amounts are in thousands.

|   | Derivative Instruments | Foreign Currency Translation | Total              |
|---|------------------------|------------------------------|--------------------|
| Accumulated other comprehensive loss, March 31, 2019, after tax           | \$ (3,495)             | \$ (16,677)                  | \$ (20,172)        |
| Change in derivative instruments  | (6,836)                | —                            | (6,836)            |
| Net losses from derivative instruments reclassified to cost of goods sold | 1,269                  | —                            | 1,269              |
| Income tax benefit on derivative instruments                              | 1,916                  | —                            | 1,916              |
| Foreign currency translation adjustments                                  | —                      | 1,552                        | 1,552              |
| Accumulated other comprehensive loss, June 30, 2019, after tax            | <u>\$ (7,146)</u>      | <u>\$ (15,125)</u>           | <u>\$ (22,271)</u> |
|   | Derivative Instruments | Foreign Currency Translation | Total              |
| Accumulated other comprehensive loss, December 31, 2018, after tax        | \$ 107                 | \$ (13,807)                  | \$ (13,700)        |
| Change in derivative instruments  | (6,160)                | —                            | (6,160)            |
| Net gains from derivative instruments reclassified to cost of goods sold  | (2,581)                | —                            | (2,581)            |
| Income tax benefit on derivative instruments                              | 1,488                  | —                            | 1,488              |
| Foreign currency translation adjustments                                  | —                      | (1,318)                      | (1,318)            |
| Accumulated other comprehensive loss, June 30, 2019, after tax            | <u>\$ (7,146)</u>      | <u>\$ (15,125)</u>           | <u>\$ (22,271)</u> |

### Note 18. Segment Information

As of December 31, 2018, the Company had three operating and reportable segments, namely Golf Clubs, Golf Balls and Gear, Accessories and Other. Due to the Company's acquisition of the outdoor apparel company Jack Wolfskin in January 2019, combined with the continued growth of TravisMathew and OGIO branded soft goods, the Company anticipates significant future

growth in its soft goods business. The Company therefore reassessed its operating segments during the first quarter of 2019 and evaluated its global business platform, including its management structure, operations, supply chain and distribution, and changed the composition of its operating and reportable segments on the basis of golf equipment and soft goods products. As a result, and based on the Company's assessment, as of January 1, 2019, the Company has two reportable operating segments, namely the Golf Equipment operating segment and the Apparel, Gear and Other operating segment. The Company's Golf Equipment reportable segment consists of Callaway Golf branded woods, hybrids, irons, wedges, Odyssey putters, including Toulon Design putters by Odyssey, packaged sets, Callaway Golf and Strata branded golf balls and sales of pre-owned golf clubs. The Apparel, Gear and Other reportable segment consists of Jack Wolfskin, TravisMathew and OGIO branded apparel, gear and accessories, and Callaway branded golf apparel and footwear, golf bags, golf gloves, travel gear, headwear and other golf-related accessories, and royalties from licensing of the Company's trademarks and service marks for various soft goods products. Comparative periods have been reclassified to reflect these changes. There are no significant intersegment transactions.

The tables below contain information utilized by management to evaluate its operating segments for the interim periods presented (in thousands).

|                                  | Three Months Ended<br>June 30, |                     | Six Months Ended<br>June 30, |                     |
|----------------------------------|--------------------------------|---------------------|------------------------------|---------------------|
|                                  | 2019                           | 2018 <sup>(1)</sup> | 2019                         | 2018 <sup>(1)</sup> |
| Net sales:                       |                                |                     |                              |                     |
| Golf Equipment                   | \$ 292,353                     | \$ 298,684          | \$ 615,972                   | \$ 611,047          |
| Apparel, Gear and Other          | 154,355                        | 97,627              | 346,933                      | 188,455             |
|                                  | <u>\$ 446,708</u>              | <u>\$ 396,311</u>   | <u>\$ 962,905</u>            | <u>\$ 799,502</u>   |
| Income before income taxes:      |                                |                     |                              |                     |
| Golf Equipment                   | \$ 55,665                      | \$ 63,948           | \$ 125,658                   | \$ 141,457          |
| Apparel, Gear and Other          | 11,314                         | 24,082              | 34,033                       | 43,531              |
| Reconciling items <sup>(2)</sup> | (30,873)                       | (9,849)             | (65,528)                     | (26,857)            |
|                                  | <u>\$ 36,106</u>               | <u>\$ 78,181</u>    | <u>\$ 94,163</u>             | <u>\$ 158,131</u>   |
| Additions to long-lived assets:  |                                |                     |                              |                     |
| Golf Equipment                   | \$ 7,924                       | \$ 8,837            | \$ 13,341                    | \$ 14,270           |
| Apparel, Gear and Other          | 4,289                          | 1,176               | 8,682                        | 2,558               |
|                                  | <u>\$ 12,213</u>               | <u>\$ 10,013</u>    | <u>\$ 22,023</u>             | <u>\$ 16,828</u>    |

(1) The Company changed its operating segments as of January 1, 2019. Accordingly, prior period amounts have been reclassified to conform with the current period presentation.

(2) Reconciling items represent corporate general and administrative expenses and other income (expense) not included by management in determining segment profitability. The increase in reconciling items for the three and six months ended June 30, 2019 compared to 2018 includes incremental corporate general and administrative expenses associated with the addition of the Jack Wolfskin business in January 2019, as well as non-recurring charges of \$1,603,000 and \$6,326,000 for the three and six months ended June 30, 2019, respectively, primarily related to the acquisition of Jack Wolfskin that was completed in January 2019. Reconciling items also include incremental interest expense of \$8,436,000 and \$16,547,000, for the three and six months ended June 30, 2019, respectively, due to the new Term Loan Facility to fund the purchase of Jack Wolfskin combined with higher outstanding borrowings on the Company's credit facilities period over period. See Note 5 for information on the Company's credit facilities and long-term debt obligations.

|                                  | June 30, 2019       | December 31,<br>2018 <sup>(1)</sup> |
|----------------------------------|---------------------|-------------------------------------|
| Total Assets:                    |                     |                                     |
| Golf Equipment                   | \$ 387,501          | \$ 437,604                          |
| Apparel, Gear and Other          | 973,065             | 269,432                             |
| Reconciling items <sup>(2)</sup> | 576,655             | 345,908                             |
|                                  | <u>\$ 1,937,221</u> | <u>\$ 1,052,944</u>                 |
| Goodwill:                        |                     |                                     |
| Golf Equipment                   | \$ 26,204           | \$ 26,183                           |
| Apparel, Gear and Other          | 183,569             | 29,633                              |
|                                  | <u>\$ 209,773</u>   | <u>\$ 55,816</u>                    |

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- (1) The Company changed its operating segments as of January 1, 2019. Accordingly, prior period amounts have been reclassified to conform with the current period presentation.
- (2) Total assets by reportable segment are comprised of net inventory, certain property, plant and equipment, intangible assets and goodwill. Reconciling items represent unallocated corporate assets not segregated between the three segments including cash and cash equivalents, net accounts receivable, and deferred tax assets.

## **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

*The following discussion should be read in conjunction with the Consolidated Condensed Financial Statements and the related notes that appear elsewhere in this report. See also "Important Notice to Investors Regarding Forward-Looking Statements" on page 2 of this report.*

### **Discussion of Non-GAAP Measures**

In addition to the financial results contained in this report, which have been prepared and presented in accordance with the accounting principles generally accepted in the United States ("GAAP"), the Company has also included supplemental information concerning the Company's financial results on a non-GAAP basis. In addition, non-GAAP information includes certain of the Company's financial results on a constant currency basis. This constant currency information estimates what the Company's financial results would have been without changes in foreign currency exchange rates. This information is calculated by taking the current period local currency results and translating them into U.S. dollars based upon the foreign currency exchange rates for the applicable comparable prior period. In addition, this non-GAAP information includes certain of the Company's financial results without transaction costs and transition costs, and purchase accounting amortization expenses associated with the Jack Wolfskin acquisition for the three and six months ended June 30, 2019, and amortization costs of intangible assets associated with the Jack Wolfskin, OGIO and TravisMathew acquisitions for three and six months ended June 30, 2019 and 2018.

The Company has included in this report information to reconcile this non-GAAP information to the most directly comparable GAAP information. The non-GAAP information presented in this report should not be considered in isolation or as a substitute for any measure derived in accordance with GAAP. The non-GAAP information may also be inconsistent with the manner in which similar measures are derived or used by other companies. Management uses such non-GAAP information for financial and operational decision-making purposes and as a means to evaluate period over period comparisons of the underlying performance of its business and in forecasting the Company's business going forward. Management believes that the presentation of such non-GAAP information, when considered in conjunction with the most directly comparable GAAP information, provides additional useful comparative information for investors in their assessment of the underlying performance of the Company's business.

### **Results of Operations**

#### ***Overview of Business and Seasonality***

#### **Products**

The Company designs, manufactures and sells a full line of high quality golf equipment, including golf clubs and golf balls. The Company designs its golf products to be technologically advanced and in this regard invests a considerable amount in research and development each year. The Company designs its golf products for golfers of all skill levels, both amateur and professional. In addition, the Company designs and develops a full line of high quality golf soft goods, including golf bags, apparel, footwear and other golf accessories. In 2017, the Company expanded its soft goods lines with the acquisitions of OGIO and TravisMathew. Under the OGIO brand, the Company offers a full line of premium personal storage gear for sport and personal use, a line of performance outerwear for men, and golf and apparel accessories. TravisMathew offers a full line of premium golf and lifestyle apparel as well as footwear and accessories. In January 2019, the Company completed the acquisition of JW Stargazer Holding GmbH, the owner of the international, premium outdoor apparel, footwear and equipment brand, Jack Wolfskin. The Company expects this acquisition to further enhance the Company's lifestyle category and provide a platform for future growth in the active outdoor and urban outdoor categories. The Company's soft goods under the Callaway, OGIO, TravisMathew and Jack Wolfskin brands are designed and developed internally.

#### **Operating Segments**

As of December 31, 2018, the Company had three operating and reportable segments, namely Golf Clubs, Golf Balls and Gear, Accessories and Other. Due to the Company's acquisition of the outdoor apparel company Jack Wolfskin in January 2019, combined with the continuous growth of TravisMathew and OGIO branded soft goods, the Company anticipates significant future growth in its soft goods business. The Company therefore reassessed its operating segments during the first quarter of 2019 and evaluated its global business platform, including its management structure, operations, supply chain and distribution, and changed the composition of its operating and reportable segments on the basis of golf equipment and soft goods products. As a result, and based on the Company's assessment, as of January 1, 2019, the Company began including sales from its golf clubs and golf balls business in the Golf Equipment reportable operating segment, consisting of Callaway Golf branded woods, hybrids, irons, wedges,

Odyssey putters, including Toulon Design putters by Odyssey, packaged sets, Callaway Golf and Strata branded golf balls and sales of pre-owned golf clubs. Sales of Jack Wolfskin, TravisMathew and OGIO branded apparel, gear and accessories, and Callaway branded golf apparel and footwear, golf bags, golf gloves, travel gear, headwear and other golf-related accessories, and royalties from licensing of the Company's trademarks and service marks for various soft goods products are included in the Apparel, Gear and Other reportable operating segment. Comparative periods have been reclassified to reflect these changes. For further information about the Company's segments, see Note 18 "Segment Information" to the Notes to Consolidated Condensed Financial Statements in Part I, Item 1 of this Form 10-Q.

### **Cost of Sales**

The Company's cost of sales is comprised primarily of material and component costs, distribution and warehousing costs, and overhead. Historically, over 85% of the Company's manufacturing costs, primarily material and component costs, are variable in nature and fluctuate with sales volumes. With respect to the Company's Golf Equipment operating segment, variable costs as a percentage of cost of sales range between 85% to 95% for golf club products and 75% to 85% for golf ball products. Variable costs for soft goods in the Apparel, Gear and Other operating segment are generally greater than 90% as fewer fixed costs are used in the manufacturing of soft goods products. Generally, the relative significance of the components of cost of sales does not vary materially from these percentages from period to period. See "Operating Segments Results for the Three and Six Months Ended June 30, 2019 and 2018—Segment Profitability" below for further discussion of gross margins.

### **Seasonality**

#### ***Golf Equipment***

In most of the regions where the Company conducts business, the game of golf is played primarily on a seasonal basis. Weather conditions generally restrict golf from being played year-round, except in a few markets, with many of the Company's on-course customers closing for the cold weather months. The Company's golf club and golf ball businesses are therefore subject to seasonal fluctuations. In general, during the first quarter, the Company begins selling its golf club and golf ball products into the golf retail channel for the new golf season. This initial sell-in generally continues into the second quarter. Second-quarter sales are significantly affected by the amount of reorder business of the products sold during the first quarter. Third-quarter sales are generally dependent on reorder business but can also include smaller new product launches, typically resulting in lower sales than the second quarter as many retailers begin decreasing their inventory levels in anticipation of the end of the golf season. Fourth-quarter sales are generally less than the other quarters due to the end of the golf season in many of the Company's key regions. However, third-quarter sales can be affected by a mid-year product launch, and fourth-quarter sales can be affected from time to time by the early launch of product introductions related to the new golf season of the subsequent year. This seasonality, and therefore quarter-to-quarter fluctuations, can be affected by many factors, including the timing of new product introductions as well as weather conditions. In general, because of this seasonality, a majority of the Company's sales from its Golf Equipment operating segment and most, if not all, of its profitability from this segment generally occurs during the first half of the year.

#### ***Apparel, Gear and Other***

Sales of the Company's golf gear and accessories generally follow the same seasonality as golf clubs and golf balls, and are therefore generally higher during the first half of the year when the game of golf is mostly played. Sales of lifestyle and premium outdoor apparel, footwear and equipment are impacted by weather and therefore the seasonality of these products vary by region.

### **Foreign Currency**

A majority of the Company's business is conducted outside of the United States in currencies other than the U.S. dollar. As a result, changes in foreign currency rates can have a significant effect on the Company's financial results. The Company enters into foreign currency forward contracts to mitigate the effects of changes in foreign currency rates. While these foreign currency forward contracts can mitigate the effects of changes in foreign currency rates, they do not eliminate those effects, which can be significant. These effects include (i) the translation of results denominated in foreign currency into U.S. dollars for reporting purposes, (ii) the mark-to-market adjustments of certain intercompany balance sheet accounts denominated in foreign currencies and (iii) the mark-to-market adjustments of the Company's foreign currency forward contracts. In general, the Company's overall financial results are affected positively by a weaker U.S. dollar and are affected negatively by a stronger U.S. dollar as compared to the foreign currencies in which the Company conducts its business.

## Executive Summary

The Company's net sales increased 20.4% to \$962.9 million in the first half of 2019 compared to \$799.5 in the comparable period in 2018. These results were achieved despite the negative impact of changes in foreign currency rates of \$24.2 million and reflect an increase in both the Company's Apparel, Gear and Accessories Operating Segment and Golf Equipment Operating Segment. The increases in sales of Apparel, Gear and Accessories was primarily driven by the Jack Wolfskin business, which contributed incremental sales of \$141.1 million for the six months ended June 30, 2019. The Company's Apparel, Gear and Accessories sales were also favorably impacted by the growing success of the Company's TravisMathew apparel business, which grew double-digits during the period. The Company's Golf Equipment sales increased \$5.0 million in the first half of 2019 compared to the same periods in the prior year due to the continued strength of the Company's 2019 golf equipment product line, despite that in 2018, product launches were more heavily weighted in the first half of the year.

The Company's gross margin in the first half of 2019 decreased 300 basis points to 46.2% compared to the first half of 2018. The Company's gross margin for the first half of 2019 includes \$10.7 million (or 110 margin basis points) of amortization charges related to a fair value adjustment to Jack Wolfskin's inventory, recorded as part of the Company's purchase price allocation. The remaining decline resulted from a shift in current year product mix to sales of more premium products, which generally have lower margins due to more advanced technology, combined with the negative impact of unfavorable changes in foreign currency rates. These declines were partially offset by sales growth from the Company's TravisMathew business, which is accretive to gross margin.

Operating expenses increased \$97.5 million to \$330.4 million in the first half of 2019 compared to the respective period in 2018. This increase was driven primarily by \$76.6 million of incremental operating expenses related to the new Jack Wolfskin business, combined with increased investments in the business to sustain the Company's growth, including investments in marketing and tour. Operating expenses in the first half of 2019 also include non-recurring expenses of \$8.7 million related to the Jack Wolfskin acquisition.

Interest expense increased \$17.0 million to \$20.6 million in the first half of 2019 compared to the first half of 2018, primarily due to the recognition of incremental interest expense from the Company's new \$480.0 million Term Loan Facility used to fund the Jack Wolfskin acquisition in January 2019.

The provision for income taxes decreased to \$16.8 million in the first half of 2019 compared to \$34.5 million the first half of 2018. As a percent of pre-tax income, the Company's effective income tax rate declined to 17.8% in the first half of 2019 compared to 21.8% in 2018. This decline was primarily due to a decrease in pre-tax income combined with a shift in the mix of foreign earnings relative to the prior year.

Diluted earnings per share decreased by \$0.47 to \$0.81 in the first half of 2019 compared to \$1.28 in the same period in 2018. The Company's earnings for the first half of 2019 include \$23.3 million of non-recurring costs related to the Jack Wolfskin acquisition, and after-tax purchase accounting amortization expenses related to the Jack Wolfskin, TravisMathew and OGIO acquisitions. Additionally, the Company's first half earnings in 2019 were negatively impacted by the seasonal nature of the Jack Wolfskin business, which is dilutive to earnings during the first half of the year, combined with increased investments in the business to sustain the Company's growth, and an increase in interest expense related to the new term loan entered into in January 2019 to fund the purchase of Jack Wolfskin. The Company anticipates an increase in sales and earnings during the back half of the year relative to 2018 due to incremental Jack Wolfskin sales driven by the sell-in of the fall/winter product line as well as an increase in new Golf Equipment product launches compared to the second half of 2018. In general, Jack Wolfskin generates the majority of its annual profitability in the back half of the year.

### ***Three-Month Periods Ended June 30, 2019 and 2018***

Net sales for the second quarter of 2019 increased by \$50.4 million (12.7%) to \$446.7 million compared to \$396.3 million in the second quarter of 2018 primarily due to the Company's acquisition of the outdoor apparel company, Jack Wolfskin, which added incremental sales of \$48.4 million in the Apparel, Gear and Other operating segment. Excluding this acquisition, sales for this segment increased \$8.4 million (8.6%) in the second quarter of 2019 compared to the same period in 2018, primarily due to the growing success of the TravisMathew apparel business. Net sales in the Golf Equipment operating segment declined \$6.4 million (2.1%) due to a change in product launch cadence in 2019 compared to 2018. In 2018, the Company's new golf equipment launches were more heavily weighted towards the first half of the year, whereas in 2019, the launches are spread more throughout the year. In addition, net sales in the second quarter of 2019 were negatively impacted by \$9.1 million due to fluctuations in foreign currency rates relative to the same period in the prior year.



The Company's net sales by operating segment are presented below (dollars in millions):

|                         | Three Months Ended<br>June 30, |                 | Growth/(Decline) |         |
|-------------------------|--------------------------------|-----------------|------------------|---------|
|                         | 2019                           | 2018            | Dollars          | Percent |
| Net sales:              |                                |                 |                  |         |
| Golf Equipment          | \$ 292.3                       | \$ 298.7        | \$ (6.4)         | (2.1)%  |
| Apparel, Gear and Other | 154.4                          | 97.6            | 56.8             | 58.2%   |
|                         | <u>\$ 446.7</u>                | <u>\$ 396.3</u> | <u>\$ 50.4</u>   | 12.7%   |

(1) The Company changed its operating segments as of January 1, 2019. Accordingly, prior period amounts have been reclassified to conform with the current period presentation.

For further discussion of each operating segment's results, see "Operating Segments Results for the Three Months Ended June 30, 2019 and 2018" below.

Net sales information by region is summarized as follows (dollars in millions):

|               | Three Months Ended<br>June 30, |                 | Growth/(Decline) |              | Constant Currency<br>Growth/(Decline) vs.<br>2018 |
|---------------|--------------------------------|-----------------|------------------|--------------|---|
|               | 2019                           | 2018            | Dollars          | Percent      | Percent   |
| Net sales:    |                                |                 |                  |              |   |
| United States | \$ 247.4                       | \$ 233.4        | \$ 14.0          | 6.0%         | 6.0%  |
| Europe        | 81.6                           | 46.3            | 35.3             | 76.2%        | 86.8%   |
| Japan         | 55.7                           | 59.7            | (4.0)            | (6.7%)       | (5.9)%  |
| Rest of world | 62.0                           | 56.9            | 5.1              | 9.0%         | 15.4%   |
|               | <u>\$ 446.7</u>                | <u>\$ 396.3</u> | <u>\$ 50.4</u>   | <u>12.7%</u> | 15.0%   |

(1) In connection with the Company's assessment of its reportable operating segments the Company also reassessed its reportable regions. As a result, as of January 1, 2019, the Company began to report regional sales previously reported in rest of Asia and other foreign countries in rest of world. Accordingly, the prior period amounts have been reclassified to conform to current year presentation of regional sales.

Net sales in the United States increased \$14.0 million (6.0%) to \$247.4 million during the second quarter of 2019 compared to \$233.4 million in the second quarter of 2018. The Company's sales in regions outside of the United States increased \$36.4 million (22.3%) to \$199.3 million during the second quarter of 2019 compared to \$162.9 million in the second quarter of 2018. Foreign currency fluctuations had an unfavorable impact of \$9.1 million on net sales during the second quarter of 2019 relative to the same period in the prior year. The increase in net sales by region includes the following:

- Net sales in Europe increased primarily due to incremental apparel sales resulting from the Jack Wolfskin acquisition completed in January 2019, partially offset by the unfavorable impact of foreign currency fluctuations on sales.
- In the United States, the increase was primarily due to an increase in apparel sales as a result of the continued growth of the TravisMathew business.
- The increase in rest of world was primarily driven by an increase in apparel sales in China resulting from the Jack Wolfskin acquisition, partially offset by the unfavorable impact of foreign currency fluctuations on sales.
- The decrease in Japan was primarily due to a shift in product launch timing due to the earlier launch of region-specific woods and irons models in the first half of 2018.

Gross profit increased \$14.1 million (7.3%) to \$206.8 million in the second quarter of 2019 compared to \$192.7 million in the second quarter of 2018. Gross profit as a percentage of net sales ("gross margin") declined by 230 basis points to 46.3% in the second quarter of 2019 compared to 48.6% in the second quarter of 2018. The Company's gross margin for the three months ended June 30, 2019 includes \$5.3 million or 120 margin basis points of amortization charges related to a fair value adjustment to Jack Wolfskin's inventory, recorded as part of the Company's purchase price allocation. The remaining 110 basis point decrease was primarily due to a shift in current year product mix to sales of more premium products, which generally have lower margins due

to more advanced technology, combined with the negative impact of unfavorable changes in foreign currency rates. These declines were partially offset by sales growth from the Company's TravisMathew business in addition to the Jack Wolfskin business, both of which are accretive to gross margin in the second quarter of 2019. For further discussion of gross margin, see "Results of Operations—Overview of Business and Seasonality—Cost of Sales" above and "Operating Segments Results for the Three Months Ended June 30, 2019 and 2018—Segment Profitability" below.

Selling expenses increased by \$29.8 million to \$113.1 million (25.3% of net sales) in the second quarter of 2019 compared to \$83.3 million (21.0% of net sales) in the second quarter of 2018. This increase reflects \$27.6 million of incremental costs resulting from the addition of the Jack Wolfskin business, combined with an increase in variable expenses due to higher net sales period over period, as well as increases of \$0.8 million in employee costs and \$0.7 in professional fees.

General and administrative expenses increased by \$11.0 million to \$35.4 million (7.9% of net sales) in the second quarter of 2019 compared to \$24.4 million (6.2% of net sales) in the second quarter of 2018. This increase was primarily due to \$7.7 million of incremental costs resulting from the addition of the Jack Wolfskin business, combined with increases of \$1.6 million in transition costs incurred in the second quarter of 2019 in connection with the Jack Wolfskin acquisition.

Research and development expenses increased by \$2.4 million to \$13.1 million in the second quarter of 2019 compared to \$10.7 million the second quarter of 2018, and decreased slightly as a percentage of net sales to 2.9% from 2.7%. This increase was primarily due to \$2.5 million of incremental costs in the second quarter of 2019 resulting from the addition of the Jack Wolfskin business.

Net interest expense increased by \$8.7 million to \$10.7 million in the second quarter of 2019 compared to \$2.0 million in the second quarter of 2018 primarily due to an increase in interest related to the Company's long-term debt, including \$8.4 million related to the Term Loan Facility the Company entered into in connection with the Jack Wolfskin acquisition (see Note 5 "Financing Arrangements" and Note 4 "Business Combinations" to the Notes to Consolidated Condensed Financial Statements included in Part I, Item 1, of this Form 10-Q).

Other income decreased by \$4.3 million to \$1.2 million in the second quarter of 2019 compared to \$5.5 million in the second quarter of 2018, primarily due to a decrease in net foreign currency gains from non-designated foreign currency hedging contracts.

The Company's provision for income taxes decreased by \$10.0 million to \$7.2 million in the second quarter of 2019, compared to \$17.2 million in the second quarter of 2018 primarily due to a decline in pre-tax income. As a percentage of pre-tax income, the Company's income tax rate declined to 20.0% compared to 22.1% in the second quarter of 2018 primarily due to a shift in the mix of foreign earnings relative to the prior year. For further discussion see Note 12 "Income Taxes" to the Notes to Consolidated Condensed Financial Statements in Part I, Item 1 of this Form 10-Q.

Net income for the second quarter of 2019 decreased \$32.0 million to \$28.9 million compared to \$60.9 million in the second quarter of 2018. Diluted earnings per share decreased \$0.33 to \$0.30 in the second quarter of 2019 compared to \$0.63 in the second quarter of 2018. On a non-GAAP basis, excluding after-tax acquisition related costs related to Jack Wolfskin, and excluding after-tax purchase accounting amortization expenses related to the Jack Wolfskin, TravisMathew and OGIO acquisitions, the Company's net income and diluted earnings per share for the three months ended June 30, 2019 would have been \$35.1 million and \$0.37 per share, respectively, compared to \$61.1 million and \$0.63 per share for the comparative period in 2018. The decreased non-GAAP earnings in 2019 is primarily due to the seasonal nature of the Jack Wolfskin business, which is dilutive to earnings during the second quarter of the year, combined with the \$8.4 million increase in interest expense related to the new term loan entered into in January 2019 to fund the purchase of Jack Wolfskin.

The table below presents a reconciliation of the Company's as-reported results for the three months ended June 30, 2019 and 2018 to the Company's non-GAAP results reported above for the same periods (in millions, except per share information).

|   | Three Months Ended June 30, 2019 |   |  |              | Three Months Ended June 30, 2018 |  |              |
|---|----------------------------------|---|--|--------------|----------------------------------|--|--------------|
|   | As<br>Reported                   | Acquisition and<br>Transition<br>Costs <sup>(1)</sup> | Purchase<br>Accounting<br>Amortization<br>Expense <sup>(2)</sup> | Non-<br>GAAP | As<br>Reported                   | Purchase<br>Accounting<br>Amortization<br>Expense <sup>(2)</sup> | Non-<br>GAAP |
| Net income (loss) attributable to Callaway Golf Company | \$ 28.9                          | \$ (5.0)  | \$ (1.2)   | \$ 35.1      | \$ 60.9                          | \$ (0.2)   | \$ 61.1      |
| Diluted earnings (loss) per share                       | \$ 0.30                          | \$ (0.05)   | \$ (0.02)  | \$ 0.37      | \$ 0.63                          | \$ —   | \$ 0.63      |
| Weighted-average shares outstanding                     | 95.9                             | 95.9  | 95.9   | 95.9         | 96.9                             | 96.9   | 96.9         |

- (1) Represents non-recurring costs associated with the acquisition of Jack Wolfskin completed in January 2019.
- (2) Represents non-cash amortization expense of intangible assets and the step-up of inventory in connection with the Jack Wolfskin acquisition in January 2019, and amortization expense of intangible assets in connection with the TravisMathew and OGIO acquisitions in August 2017 and January 2017, respectively.

### Operating Segments Results for the Three Months Ended June 30, 2019 and 2018

#### Golf Equipment

Golf Equipment sales decreased \$6.4 million to \$292.3 million in the second quarter of 2019 compared to \$298.7 million in the second quarter of 2018 due to a \$9.1 million (3.9%) decrease in golf club sales offset by a \$2.7 million (4.1%) increase in golf ball sales.

Net sales information for the Golf Equipment segment by product category is summarized as follows (dollars in millions):

|            | Three Months Ended<br>June 30, |                 | Growth/(Decline) |               |
|------------|--------------------------------|-----------------|------------------|---------------|
|            | 2019                           | 2018            | Dollars          | Percent       |
| Net sales: |                                |                 |                  |               |
| Golf Clubs | \$ 223.7                       | \$ 232.8        | \$ (9.1)         | (3.9)%        |
| Golf Balls | 68.6                           | 65.9            | 2.7              | 4.1 %         |
|            | <u>\$ 292.3</u>                | <u>\$ 298.7</u> | <u>\$ (6.4)</u>  | <u>(2.1)%</u> |

The \$9.1 million (3.9%) decrease in net sales of golf clubs to \$223.7 million for the quarter ended June 30, 2019, compared to \$232.8 million in the comparable period in 2018, was primarily due to a decrease in sales of woods partially offset by an increase in sales of putters. The decrease in woods was primarily due to the earlier launch timing of region specific woods in the first half of 2018 compared to the same period in 2019. The increase in sales of putters was primarily due to the launch of the Company's Stroke Lab putter in the first quarter of 2019 with no comparable models launched in the first half of 2018.

Net sales of golf balls increased \$2.7 million (4.1%) to 68.6 million for the quarter ended June 30, 2019 compared to 65.9 million in the comparable period in 2018 primarily due to an increase in sales volume driven by the successful launch of the new ERC Triple Track and Supersoft golf balls in the first quarter of 2019 combined with the continued success of the 2018 Truvis and Chrome Soft golf balls, which resulted in an overall increase in market share period over period.

#### Apparel, Gear and Other

Net sales information for the Apparel, Gear and Other segment is summarized as follows (dollars in millions):

|                            | Three Months Ended<br>June 30, |                | Growth         |              |
|----------------------------|--------------------------------|----------------|----------------|--------------|
|                            | 2019                           | 2018           | Dollars        | Percent      |
| Net sales:                 |                                |                |                |              |
| Apparel                    | \$ 73.2                        | \$ 30.8        | \$ 42.4        | 137.7%       |
| Gear, Accessories, & Other | 81.2                           | 66.8           | 14.4           | 21.6%        |
|                            | <u>\$ 154.4</u>                | <u>\$ 97.6</u> | <u>\$ 56.8</u> | <u>58.2%</u> |

Net sales of apparel increased \$42.4 million (137.7%) to \$73.2 million for the quarter ended June 30, 2019 compared to the same period of the prior year, primarily due to incremental sales of outdoor apparel as a result of the Jack Wolfskin acquisition in January 2019, combined with the success of the TravisMathew apparel business, which grew double-digits in the second quarter of 2019 compared to the second quarter of 2018. This increase resulted from brand momentum combined with the opening of three new retail stores in the first half of 2019 and six new retail stores in 2018.

Net sales of gear, accessories and other increased \$14.4 million (21.6%) to \$81.2 million for the quarter ended June 30, 2019 compared to \$66.8 million compared to the same period of the prior year, primarily due incremental sales of Jack Wolfskin gear and accessories combined with an increase in sales of golf gloves.

## Segment Profitability

Profitability by operating segment is summarized as follows (dollars in millions):

|                                  | Three Months Ended<br>June 30, |                | Decline          |                |
|----------------------------------|--------------------------------|----------------|------------------|----------------|
|                                  | 2019                           | 2018           | Dollars          | Percent        |
| Income before income taxes:      |                                |                |                  |                |
| Golf Equipment                   | \$ 55.7                        | \$ 63.9        | \$ (8.2)         | (12.8)%        |
| Apparel, Gear and Other          | 11.3                           | 24.1           | (12.8)           | (53.1)%        |
| Reconciling items <sup>(1)</sup> | (30.9)                         | (9.8)          | (21.1)           | 215.3 %        |
|                                  | <u>\$ 36.1</u>                 | <u>\$ 78.2</u> | <u>\$ (42.1)</u> | <u>(53.8)%</u> |

(1) Reconciling items represent corporate general and administrative expenses and other income (expense) not included by management in determining segment profitability. The \$21.1 million increase in reconciling items in the second quarter of 2019 compared to the second quarter of 2018 was primarily due to incremental corporate general and administrative expenses associated with the addition of the Jack Wolfskin business in January 2019, as well as non-recurring costs in connection with the Jack Wolfskin acquisition, and the amortization of intangible assets associated with the acquisitions of Jack Wolfskin, TravisMathew and OGIO. Reconciling items also include incremental interest expense of \$8.4 million due to the new Term Loan Facility to fund the purchase of Jack Wolfskin.

Pre-tax income from the Golf Equipment operating segment decreased \$8.2 million (12.8)% to \$55.7 million in the second quarter of 2019 from \$63.9 million in the second quarter of 2018. This decrease was primarily due to a \$9.3 million decrease in gross profit resulting from a \$6.4 million decrease in net sales as discussed above. Gross profit as a percentage of net sales ("gross margin") decreased 220 basis points period over period primarily due to a shift in product mix to sales of premium products, which generally have lower margins due to more advanced technology incorporated into these products, combined with the negative impact of fluctuations in foreign currency rates. The decrease in gross margin was offset by a decrease in operating expenses primarily due to a decrease in marketing expenses as a result of the shift in timing of product launches.

Pre-tax income in the Company's Apparel, Gear and Other operating segment decreased \$12.8 million (53.1)% to \$11.3 million in the second quarter of 2019 from \$24.1 million in the second quarter of 2018. This decrease was due to a \$41.7 million increase in operating expenses offset by a \$28.8 million increase in gross profit both primarily due to the addition of the new Jack Wolfskin business acquired in January 2019. Given the seasonal nature of this business as many of their products are geared toward the fall/winter season, Jack Wolfskin generally records operating losses in the second quarter. This decrease was partially offset by an increase in gross profit and operating income from the growing success of the TravisMathew apparel business.

### Six-Month Period Ended June 30, 2019 and 2018

Net sales for the six months ended June 30, 2019 increased \$163.4 million (20.4%) to \$962.9 million compared to \$799.5 million for the six months ended June 30, 2018, primarily due to the Company's acquisition of the outdoor apparel company, Jack Wolfskin, which added incremental sales of \$141.1 million in the Apparel, Gear and Other operating segment. Excluding this acquisition, sales for this segment increased \$17.4 million (9.2%) in the first half of 2019 compared to the same period in 2018, primarily due to the growing success of the TravisMathew apparel business. Net sales in the Golf Equipment operating segment increased \$5.0 million (0.8%) due to the launch of the Stroke Lab premium putters in 2019 with no comparable launch in 2018, in addition to an overall increase in golf ball market share period over period. Net sales in the first half of 2019 were impacted by unfavorable changes in foreign currency rates of \$24.2 million relative to the same period in 2018.

The Company's net sales by operating segment are presented below (dollars in millions):

|                         | Six Months Ended<br>June 30, |                     | Growth          |         |
|-------------------------|------------------------------|---------------------|-----------------|---------|
|                         | 2019                         | 2018 <sup>(1)</sup> | Dollars         | Percent |
| Net sales:              |                              |                     |                 |         |
| Golf Equipment          | \$ 616.0                     | \$ 611.0            | \$ 5.0          | 0.8%    |
| Apparel, Gear and Other | 346.9                        | 188.5               | 158.4           | 84.0%   |
|                         | <u>\$ 962.9</u>              | <u>\$ 799.5</u>     | <u>\$ 163.4</u> | 20.4%   |

(1) The Company changed its operating segments as of January 1, 2019. Accordingly, prior period amounts have been reclassified to conform with the current period presentation.

For further discussion of each operating segment's results, see below "Operating Segments Results for the Six Months Ended June 30, 2019 and 2018."

Net sales information by region is summarized as follows (dollars in millions):

|               | Six Months Ended<br>June 30, |                     | Growth          |         | Constant Currency<br>Growth vs. 2018 |
|---------------|------------------------------|---------------------|-----------------|---------|--------------------------------------|
|               | 2019                         | 2018 <sup>(1)</sup> | Dollars         | Percent | Percent                              |
| Net sales:    |                              |                     |                 |         |                                      |
| United States | \$ 496.4                     | \$ 468.5            | \$ 27.9         | 6.0%    | 6.0%                                 |
| Europe        | 208.2                        | 97.5                | 110.7           | 113.5%  | 129.1%                               |
| Japan         | 128.9                        | 128.9               | —               | —%      | 1.3%                                 |
| Rest of world | 129.4                        | 104.6               | 24.8            | 23.7%   | 30.8%                                |
|               | <u>\$ 962.9</u>              | <u>\$ 799.5</u>     | <u>\$ 163.4</u> | 20.4%   | 23.5%                                |

(1) In connection with the Company's assessment of its reportable operating segments the Company also reassessed its reportable regions. As a result, starting on January 1, 2019, the Company began to report regional sales previously reported in rest of Asia and other foreign countries in rest of world. Accordingly, the prior period amounts have been reclassified to conform to current year presentation of regional sales.

Net sales in the United States increased \$27.9 million (6.0%) to \$496.4 million during the six months ended June 30, 2019 compared to the six months ended June 30, 2018. Net sales in regions outside of the United States increased \$135.5 million (40.9%) to \$466.5 million for the six months ended June 30, 2019 compared to the six months ended June 30, 2018. Fluctuations in foreign currencies had an unfavorable impact on international net sales of \$24.2 million in the first half of 2019 relative to the same period in the prior year. The increase in net sales by region includes the following:

- In the United States, the increase was primarily due to an increase in apparel sales due to the continued growth of the TravisMathew business combined with an increase in sales of golf equipment.
- In Europe, the increase was primarily due to incremental apparel sales resulting from the Jack Wolfskin acquisition completed in January 2019, partially offset by the unfavorable impact of foreign currency fluctuations on sales.
- The increase in rest of world was primarily driven by incremental apparel sales in China resulting from the Jack Wolfskin acquisition completed in January 2019, partially offset by the unfavorable impact of foreign currency fluctuations on sales.

Gross profit increased \$52.1 million (13.2%) to \$445.3 million for the six months ended June 30, 2019 compared to \$393.2 million in the same period of 2018 due to the addition of the Jack Wolfskin business in 2019. Gross margin decreased 300 basis points to 46.2% in the first half of 2019 compared to the same period in 2018. This decrease was primarily due to amortization charges of \$10.7 million related to a fair value adjustment to Jack Wolfskin's inventory recorded as part of the Company's purchase price allocation, which resulted in a negative impact to gross margin of 110 basis points. The remaining 190 decrease in margin basis points was due to a shift in current year product mix to sales of more premium products, which generally have lower margins due to more advanced technology, combined with the negative impact of unfavorable changes in foreign currency rates. These decreases were partially offset by sales growth from the Company's TravisMathew business, which is accretive to gross margin.

For further discussion of gross margin, see above "Results of Operations—Overview of Business and Seasonality—Cost of Sales" and see below "Operating Segments Results for the Six Months Ended June 30, 2019 and 2018—Segment Profitability."

Selling expenses increased by \$66.2 million to \$232.4 million (24.1% of net sales) during the six months ended June 30, 2019 compared to \$166.2 million (20.8% of net sales) in the comparable period of 2018. This increase reflects \$56.1 million of incremental costs resulting from the addition of the Jack Wolfskin business, combined with an increase in variable expenses due to higher net sales period over period, in addition to increases of \$4.7 million in marketing and tour expenses and \$3.6 million in employee costs and consulting expenses.

General and administrative expenses increased by \$26.1 million to \$72.4 million (7.5% of net sales) during the six months ended June 30, 2019 compared to \$46.3 million (5.8% of net sales) in the comparable period of 2018. This increase was primarily due to \$15.6 million of incremental costs resulting from the addition of the Jack Wolfskin business, combined with increases of \$8.7 million in transaction costs related to the Jack Wolfskin acquisition as well as incremental expense from the amortization of intangible assets, \$2.4 million in employee costs and \$1.1 million in professional fees.

Research and development expenses increased by \$5.3 million to \$25.6 million (2.7% of net sales) during the six months ended June 30, 2019 compared to \$20.3 million (2.5% of net sales) in the comparable period of 2018. This increase was primarily due to \$4.9 million of incremental costs resulting from the addition of the Jack Wolfskin business.

Interest expense increased \$17.0 million to \$20.6 million during the six months ended June 30, 2019 compared to \$3.6 million in the comparable period of 2018, primarily due to an increase in interest paid on the Company's long-term debt, including \$16.5 million related to the Term Loan Facility the Company entered into in connection with the Jack Wolfskin acquisition (see Note 5 "Financing Arrangements" and Note 4 "Business Combinations" to the Notes to Consolidated Condensed Financial Statements included in Part I, Item 1, of this Form 10-Q).

Other income/expense, net decreased to other expense of \$0.8 million during the six months ended June 30, 2019 compared to other income of \$1.0 million in the comparable period of 2018. This \$1.8 million decrease was primarily due to an increase in net foreign currency losses from non-designated foreign currency hedging contracts.

The Company's provision for income taxes decreased by \$17.7 million to \$16.8 million for the six months ended June 30, 2019, compared to \$34.5 million in the comparable period of 2018, primarily due to the decline in pre-tax income. As a percent of pre-tax income, the Company's effective tax rate in the first six months of 2019 declined to 17.8% compared to 21.8% in the comparable period of 2018 primarily due to a shift in the mix of foreign earnings relative to the prior year. For further discussion see Note 12 "Income Taxes" to the Notes to Consolidated Condensed Financial Statements in Part I, Item 1 of this Form 10-Q.

Net income for the six months ended June 30, 2019 decreased by \$46.1 million to \$77.6 million compared to \$123.7 million in the comparable period of 2018. Diluted earnings per share decreased by \$0.47 to \$0.81 in the first six months of 2019 compared to \$1.28 in the same period in 2018. On a non-GAAP basis, excluding after-tax acquisition related costs as well as certain hedging losses associated with the purchase price of Jack Wolfskin, and excluding after-tax purchase accounting amortization expenses related to the Jack Wolfskin, TravisMathew and OGIO acquisitions, the Company's net income and diluted earnings per share for the six months ended June 30, 2019 would have been \$95.6 million and \$0.99 per share, respectively, compared to \$124.1 million and \$1.28 per share for the comparative period in 2018. The decreased non-GAAP earnings in 2019 is primarily due to the seasonal nature of the Jack Wolfskin business, which is dilutive to earnings in the first six months of 2019, a shift in product mix to more premium products in the first half of 2019, which generally have lower margins due to added technology, a \$16.5 million increase in interest expense related to the new term loan entered into in January 2019 to fund the purchase of Jack Wolfskin, as well as foreign currency losses recognized in the first six months of 2019 from non-designated hedging contracts. These decreases were partially offset by growth in the TravisMathew business, in addition to a lower tax rate.

The table below presents a reconciliation of the Company's as-reported results for the six months ended June 30, 2019 and 2018 to the Company's non-GAAP results reported above for the same periods (in millions, except per share information).

|   | Six Months Ended June 30, 2019 |   |   |          | Six Months Ended June 30, 2018 |   |          |
|---|--------------------------------|---|---|----------|--------------------------------|---|----------|
|   | As Reported                    | Acquisition and Transition Costs <sup>(1)</sup> | Purchase Accounting Amortization Expense <sup>(2)</sup> | Non-GAAP | As Reported                    | Purchase Accounting Amortization Expense <sup>(2)</sup> | Non-GAAP |
| Net income (loss) attributable to Callaway Golf Company | \$ 77.6                        | \$ (7.9)  | \$ (10.1)   | \$ 95.6  | \$ 123.7                       | \$ (0.4)  | \$ 124.1 |
| Diluted earnings (loss) per share                       | \$ 0.81                        | \$ (0.10)                                       | \$ (0.08)   | \$ 0.99  | \$ 1.28                        | \$ —  | \$ 1.28  |
| Weighted-average shares outstanding                     | 96.2                           | 96.2  | 96.2  | 96.2     | 97.0                           | 97.0  | 97.0     |

(1) Represents non-recurring costs associated with the acquisition of Jack Wolfskin completed in January 2019.

(2) Represents non-cash amortization expense of intangible assets and the step-up of inventory in connection with the Jack Wolfskin acquisition in January 2019, and amortization expense of intangible assets in connection with the TravisMathew and OGIO acquisitions in August 2017 and January 2017, respectively.

### Operating Segments Results for the Six Months Ended June 30, 2019 and 2018

#### Golf Equipment

Golf equipment sales increased \$5.0 million (0.8%) to \$616.0 million for the six-months ended June 30, 2019 compared to \$611.0 million for the same period in 2018 as a result of a \$9.6 million (7.9%) increase in golf ball sales offset by a \$4.6 million (0.9%) decrease in golf club sales.

Net sales information for the Golf Equipment segment by product category is summarized as follows (dollars in millions):

|            | Six Months Ended June 30, |                 | Growth/(Decline) |              |
|------------|---------------------------|-----------------|------------------|--------------|
|            | 2019                      | 2018            | Dollars          | Percent      |
| Net sales: |                           |                 |                  |              |
| Golf Clubs | \$ 485.6                  | \$ 490.2        | \$ (4.6)         | (0.9)%       |
| Golf Balls | 130.4                     | 120.8           | 9.6              | 7.9 %        |
|            | <u>\$ 616.0</u>           | <u>\$ 611.0</u> | <u>\$ 5.0</u>    | <u>0.8 %</u> |

Net sales of golf clubs decreased \$4.6 million (0.9%) to \$485.6 million for the six months ended June 30, 2019 compared to the same period in the prior year primarily due to unfavorable foreign currency fluctuations, which had a negative impact on net sales of golf clubs of \$8.8 million, combined with the earlier timing of regions specific woods products in the first half of 2018 compared to the same period in 2019. These decreases were partially offset by an increase in net sales of putters due to the current year launch of the Stroke Lab putter in the first quarter of 2019 with no comparable models launched in the first half of 2018, combined with the continued success of the Odyssey EXO putters in 2019, in addition to the successful launch of the Apex and Big Bertha premium lines of irons in the first half of 2019, combined with the continued success of the prior year Rogue line of irons.

Net sales of golf balls increased \$9.6 million (7.9%) to \$130.4 million for the six months ended June 30, 2019 compared to the same period in the prior year due to the successful launch of the new ERC Triple Track and Supersoft golf balls in the first half of 2019, combined with the continued success of the 2018 Truvis and Chrome Soft golf balls, which resulted in an overall increase in market share period over period.

## Apparel, Gear and Other

Net sales information for the Apparel, Gear and Other segment is summarized as follows (dollars in millions):

|                            | Six Months Ended<br>June 30, |                 | Growth          |              |
|----------------------------|------------------------------|-----------------|-----------------|--------------|
|                            | 2019                         | 2018            | Dollars         | Percent      |
| Net sales:                 |                              |                 |                 |              |
| Apparel                    | \$ 169.4                     | \$ 57.1         | \$ 112.3        | 196.7%       |
| Gear, Accessories, & Other | 177.5                        | 131.4           | 46.1            | 35.1%        |
|                            | <u>\$ 346.9</u>              | <u>\$ 188.5</u> | <u>\$ 158.4</u> | <u>84.0%</u> |

Net sales of apparel increased \$112.3 million (196.7%) to \$169.4 million for the six months ended June 30, 2019 compared to the same period of the prior year, primarily due to incremental sales related to outdoor apparel as the result of the acquisition of Jack Wolfskin in January 2019, combined with the success of the TravisMathew apparel business, which grew double-digits in the first half of 2019 compared to the same period in 2018. This increase resulted from brand momentum combined with the opening of three new retail stores in the first half of 2019 and six new retail stores in 2018.

Net sales of gear, accessories and other increased \$46.1 million (35.1%) to \$177.5 million for the six months ended June 30, 2019 compared to the same period in the prior year primarily due to the addition of Jack Wolfskin, combined with an increase in sales of golf gloves.

## Segment Profitability

Profitability by operating segment is summarized as follows (dollars in millions):

|                                  | Six Months Ended<br>June 30, |                 | Decline          |                |
|----------------------------------|------------------------------|-----------------|------------------|----------------|
|                                  | 2019                         | 2018            | Dollars          | Percent        |
| Income before income taxes:      |                              |                 |                  |                |
| Golf Equipment                   | \$ 125.7                     | \$ 141.5        | \$ (15.8)        | (11.2)%        |
| Apparel, Gear and Other          | 34.0                         | 43.5            | (9.5)            | (21.8)%        |
| Reconciling items <sup>(1)</sup> | (65.5)                       | (26.9)          | (38.6)           | 143.5 %        |
|                                  | <u>\$ 94.2</u>               | <u>\$ 158.1</u> | <u>\$ (63.9)</u> | <u>(40.4)%</u> |

- (1) Reconciling items represent corporate general and administrative expenses and other income (expense) not included by management in determining segment profitability. The \$38.6 million increase in reconciling items in the first half of 2019 compared to the first half of 2018 includes incremental corporate general and administrative expenses associated with the addition of the Jack Wolfskin business in January 2019, as well as non-recurring costs in connection with the Jack Wolfskin acquisition, and the amortization of intangible assets associated with the acquisitions of Jack Wolfskin, TravisMathew and OGIO. Reconciling items also include incremental interest expense of \$16.5 million due to the new Term Loan Facility to fund the purchase of Jack Wolfskin. For information on the acquisition of Jack Wolfskin and the Company's credit facilities and long-term debt obligations see Note 4 "Business Combinations" and Note 5 "Financing Arrangements" to the Notes to Consolidated Condensed Financial Statements included in Part I, Item 1, of this Form 10-Q.

Pre-tax income from the Golf Equipment operating segment decreased to \$125.7 million for the six months ended June 30, 2019 from \$141.5 million in the comparable period in the prior year primarily due to a \$11.0 million decrease in gross profit and a 220 basis point decrease in gross margin, in addition to a \$4.8 million increase in operating expenses. The decrease in gross margin was due to a shift in product mix to sales of premium products, which generally have lower margins due to the higher cost of more advanced technology, combined with the negative impact of unfavorable changes in foreign currency rates. The increase in operating expenses was primarily due to an increase in marketing expenses.

Pre-tax income from the Apparel, Gear and Other operating segment decreased to \$34.0 million for the six months ended June 30, 2019 from \$43.5 million for the comparable period in the prior year. This decrease was due to a \$83.3 million increase in operating expenses offset by a \$73.8 million increase in gross profit primarily due to the addition of the Jack Wolfskin business in January 2019, combined with the negative impact of unfavorable changes in foreign currency rates. Given the seasonal nature



of this business as many of their products are geared toward the fall/winter season, Jack Wolfskin generally records operating losses in the second quarter. This decrease was partially offset by an increase in gross profit and operating income from the growing success of the TravisMathew apparel business.

### **Financial Condition**

The Company's cash and cash equivalents increased \$17.5 million to \$81.5 million at June 30, 2019 from \$64.0 million at December 31, 2018. The increase in cash in the first half of 2019 reflects the combined cash positions of the Company and Jack Wolfskin, which the Company purchased in January 2019 for \$463.1 million (net of acquired cash). In order to fund the acquisition, including acquisition costs, the Company used proceeds from its credit facilities and entered into a Term Loan Facility for \$480.0 million. Cash used in operating activities decreased to \$50.8 million in the first half of 2019 compared to cash generated from operating activities of \$5.1 million in the first half of 2018 primarily due to a decline in net income period over period. In addition to the purchase of Jack Wolfskin, during the first half of 2019 the Company used its cash and cash equivalents combined with borrowings from its credit facilities to fund its operations and capital expenditures of \$23.4 million primarily for its golf ball operations, as well as to repurchase shares of its common stock for \$27.4 million. Management expects to fund the Company's future operations from current cash balances and cash provided by its operating activities combined with borrowings under its current and future credit facilities, as deemed necessary. See Note 5 "Financing Arrangements" to the Notes to Consolidated Condensed Financial Statements in Part I, Item 1 and "Liquidity and Capital Resources" in Part I, Item 2 of this Form 10-Q for further information on the Company's credit facilities and the Term Loan Facility.

The Company's accounts receivable balance fluctuates throughout the year as a result of the general seasonality of the Company's business. With respect to the Company's Golf Equipment business, the accounts receivable balance will generally be at its highest during the first and second quarters due to the seasonal peak in the golf season, and it will generally decline significantly during the third and fourth quarters as a result of an increase in cash collections and lower sales. Historically, the Company's account receivable with respect to its Gear, Accessories and Other business generally aligned with the seasonality of the golf season. As a result of the Jack Wolfskin acquisition in January 2019, the Company anticipates its account receivable relating to this business to be higher during the second half of the year due to the seasonal nature of the business, as many of their products are geared toward the fall/winter season. As of June 30, 2019, the Company's net accounts receivable increased to \$263.7 million from \$71.4 million as of December 31, 2018. This increase reflects the general seasonality of the Company's golf equipment business combined with the addition of \$21.1 million in net accounts receivable related to Jack Wolfskin. The Company's net accounts receivable as of June 30, 2019 increased by \$21.6 million compared to the Company's net accounts receivable as of June 30, 2018 primarily due to an increase of \$50.4 million (12.7%) in net sales period over period largely due to the acquisition of Jack Wolfskin in January 2019.

The Company's inventory balance fluctuates throughout the year as a result of the general seasonality of the Company's business and is also affected by the timing of new product launches. With respect to the Company's Golf Equipment business, the buildup of inventory levels generally begins during the fourth quarter and continues heavily into the first quarter as well as into the beginning of the second quarter in order to meet demand during the height of the golf season. Inventory levels are also impacted by the timing of new product launches as well as the success of new products. Historically, inventory levels with respect to the Company's Apparel, Gear and Other business generally aligned with the seasonality of the golf season. As a result of the Jack Wolfskin acquisition in January 2019, the Company anticipates the buildup of outdoor apparel inventory to start in the second quarter and continue into the third and fourth quarters due to the seasonal nature of this business, as many of their products are geared toward the fall/winter season. The Company's inventory increased to \$360.5 million as of June 30, 2019 compared to \$338.1 million as of December 31, 2018. This increase primarily reflects the addition of inventory from the Jack Wolfskin acquisition. The Company's inventory as of June 30, 2019 increased by \$123.4 million compared to the Company's inventory as of June 30, 2018 primarily due to the addition of inventory as a result of the Jack Wolfskin acquisition combined with an increase in golf equipment inventory to support the growth in core business year-over-year.

### **Liquidity and Capital Resources**

The Company's principal sources of liquidity consist of its existing cash balances, funds expected to be generated from operations and its credit facilities. Based upon the Company's current cash balances, its estimates of funds expected to be generated from operations in 2019, and current and projected availability under its current or future credit facilities, the Company believes that it will be able to finance current and planned operating requirements, capital expenditures, debt repayments, contractual obligations, and commercial commitments for at least the next 12 months.

Information about the Company's credit facilities and long-term borrowings is presented in Note 5 "Financing Arrangements" to the Notes to Consolidated Condensed Financial Statements included in Part I, Item 1, of this Form 10-Q, which is incorporated herein by this reference.

As of June 30, 2019, approximately 94% of the Company's total cash was held in regions outside of the United States. Due to changes enacted by the Tax Act in December 2017, incremental U.S. federal income tax is no longer a consideration if the Company were to repatriate cash to the United States outside of settling intercompany balances. However, if the Company were to repatriate such cash, it may need to pay incremental foreign withholding taxes. In 2018, the Company repatriated cash from its Canadian subsidiary and remitted the Canadian withholding tax. As such, the Company no longer considers the future earnings of its Canadian subsidiary to be indefinitely reinvested. At this time the Company does not intend to repatriate additional funds to the United States to satisfy domestic liquidity needs arising in the ordinary course of business, including liquidity needs associated with its domestic debt service requirements. Therefore, except for the future earnings of the Company's foreign subsidiary in Canada, the Company considers the undistributed earnings of its foreign subsidiaries to be permanently reinvested and, accordingly, no incremental withholding taxes have been provided thereon. With respect to the Jack Wolfskin acquisition, the Company is still assessing its permanent reinvestment assertion as of June 30, 2019.

#### **Other Significant Cash and Contractual Obligations**

The table set forth below summarizes certain significant cash obligations as of June 30, 2019 that could affect the Company's future liquidity.

|   | Payments Due By Period |                     |                 |                 |                      |
|---|------------------------|---------------------|-----------------|-----------------|----------------------|
|   | Total                  | Less than<br>1 Year | 1-3 Years       | 3-5 Years       | More than<br>5 Years |
|   | (in millions)          |                     |                 |                 |                      |
| Term Loan Facility <sup>(1)</sup>                           | \$ 461.3               | \$ 2.4              | \$ 9.6          | \$ 9.6          | \$ 439.7             |
| Interest on term loan facility                              | 200.4                  | 31.9                | 62.4            | 61.1            | 45.0                 |
| Equipment Note <sup>(2)</sup>                               | 8.5                    | 2.3                 | 4.9             | 1.3             | —                    |
| Interest on equipment note                                  | 0.6                    | 0.3                 | 0.3             | —               | —                    |
| ABL Facility  | 127.1                  | 127.1               | —               | —               | —                    |
| Japan ABL Facility  | 2.1                    | 2.1                 | —               | —               | —                    |
| Finance leases, including imputed interest <sup>(3)</sup>   | 1.6                    | 0.5                 | 0.8             | 0.3             | —                    |
| Operating leases, including imputed interest <sup>(4)</sup> | 224.3                  | 19.8                | 61.4            | 43.6            | 99.5                 |
| Unconditional purchase obligations <sup>(5)</sup>           | 95.0                   | 48.2                | 38.1            | 8.7             | —                    |
| Uncertain tax contingencies <sup>(6)</sup>                  | 4.2                    | 0.1                 | 0.2             | 0.6             | 3.3                  |
| <b>Total</b>  | <b>\$ 1,125.1</b>      | <b>\$ 234.7</b>     | <b>\$ 177.7</b> | <b>\$ 125.2</b> | <b>\$ 587.5</b>      |

- (1) In January 2019, to fund the purchase price of the Jack Wolfskin acquisition, the Company entered into a Credit Agreement which provides for a Term Loan B facility in an aggregate principal of \$480.0 million, which was issued less \$9.6 million in original issue discount and other transaction fees. As of June 30, 2019, the Company had \$462.0 million outstanding under the Term Loan Facility, net of unamortized debt issuance costs of \$16.8 million. For further discussion, see Note 5 "Financing Arrangements" to the Notes to Consolidated Condensed Financial Statements in Part I, Item 1 of this Form 10-Q.
- (2) In December 2017, the Company entered into a long-term financing agreement (the "Equipment Note") secured by certain equipment at the Company's golf ball manufacturing facility. As of June 30, 2019, the Company had \$8.5 million outstanding under the Equipment Note. For further discussion, see Note 5 "Financing Arrangements" to the Notes to Consolidated Condensed Financial Statements in Part I, Item 1 of this Form 10-Q.
- (3) Amounts represent future minimum payments under financing leases. At June 30, 2019, finance lease liabilities of \$1.5 million were reordered in accounts payable and accrued expenses and other long-term liabilities, respectively, in the accompanying consolidated condensed balance sheets. For further discussion, see Note 2 "Leases" to the Notes to Consolidated Condensed Financial Statements in Part I, Item 1 of this Form 10-Q.
- (4) The Company leases certain warehouse, distribution and office facilities, vehicles and office equipment under operating leases. The amounts presented in this line item represent commitments for minimum lease payments under non-cancelable operating

leases. At June 30, 2019, short-term and long-term operating lease liabilities of \$27.3 million and \$143.7 million, respectively, were recorded in the accompanying consolidated condensed balance sheets. For further discussion, see Note 2 "Leases" to the Notes to Consolidated Condensed Financial Statements in Part I, Item 1 of this Form 10-Q.

- (5) During the normal course of its business, the Company enters into agreements to purchase goods and services, including purchase commitments for production materials, endorsement agreements with professional golfers and other endorsers, employment and consulting agreements, and intellectual property licensing agreements pursuant to which the Company is required to pay royalty fees. It is not possible to determine the amounts the Company will ultimately be required to pay under these agreements as they are subject to many variables including performance-based bonuses, severance arrangements, the Company's sales levels, and reductions in payment obligations if designated minimum performance criteria are not achieved. The amounts listed approximate minimum purchase obligations, base compensation, and guaranteed minimum royalty payments the Company is obligated to pay under these agreements. The actual amounts paid under some of these agreements may be higher or lower than the amounts included. In the aggregate, the actual amount paid under these obligations is likely to be higher than the amounts listed as a result of the variable nature of these obligations. In addition, the Company also enters into unconditional purchase obligations with various vendors and suppliers of goods and services in the normal course of operations through purchase orders or other documentation or that are undocumented except for an invoice. Such unconditional purchase obligations are generally outstanding for periods less than a year and are settled by cash payments upon delivery of goods and services and are not reflected in this line item.
- (6) Amount represents the current and non-current portions of uncertain income tax positions as recorded on the Company's consolidated condensed balance sheet as of June 30, 2019. Amounts exclude uncertain income tax positions that the Company would be able to offset against deferred taxes. For further discussion, see Note 12 "Income Taxes" to the Notes to Consolidated Condensed Financial Statements in Part I, Item 1 of this Form 10-Q.

During its normal course of business, the Company has made certain indemnities, commitments and guarantees under which it may be required to make payments in relation to certain transactions. These include (i) intellectual property indemnities to the Company's customers and licensees in connection with the use, sale and/or license of Company products or trademarks, (ii) indemnities to various lessors in connection with facility leases for certain claims arising from such facilities or leases, (iii) indemnities to vendors and service providers pertaining to the goods or services provided to the Company or based on the negligence or willful misconduct of the Company, and (iv) indemnities involving the accuracy of representations and warranties in certain contracts. In addition, the Company has made contractual commitments to each of its officers and certain other employees providing for severance payments upon the termination of employment. The Company has also issued guarantees in the form of a standby letter of credit in the amount of \$1.2 million primarily as security for contingent liabilities under certain workers' compensation insurance policies.

The duration of these indemnities, commitments and guarantees varies, and in certain cases may be indefinite. The majority of these indemnities, commitments and guarantees do not provide for any limitation on the maximum amount of future payments the Company could be obligated to make. Historically, costs incurred to settle claims related to indemnities have not been material to the Company's financial position, results of operations or cash flows. In addition, the Company believes the likelihood is remote that payments under the commitments and guarantees described above will have a material effect on the Company's financial condition. The fair value of indemnities, commitments and guarantees that the Company issued during the three and six months ended June 30, 2019 was not material to the Company's financial position, results of operations or cash flows.

In addition to the contractual obligations listed above, the Company's liquidity could also be adversely affected by an unfavorable outcome with respect to claims and litigation that the Company is subject to from time to time (see Note 13 "Commitments & Contingencies" to the Notes to Consolidated Condensed Financial Statements in Part I, Item 1 and "Legal Proceedings" in Part II, Item 1 of this Form 10-Q).

### ***Capital Expenditures***

The Company does not currently have any material commitments for capital expenditures. The Company expects to have capital expenditures in the range of approximately \$55.0 million to \$60.0 million for the year ending December 31, 2019.

### ***Off-Balance Sheet Arrangements***

The Company has no material off-balance sheet arrangements as defined in Regulation S-K Item 303(a)(4)(ii).

## **Critical Accounting Policies and Estimates**

There have been no material changes to the Company's critical accounting policies and estimates from the information provided in Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations," included in the Company's Form 10-K for the fiscal year ended December 31, 2018, except for the Company's adoption of the Accounting Standards Update ("ASU") No. 2016-02, "Leases (Topic 842)," and ASU No. 2017-12, "Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities," both of which became effective as of January 1, 2019. For further discussion on the adoption of these new accounting standards please see Note 1 "Basis of Presentation" to the Notes to Consolidated Condensed Financial Statements in Part I, Item 1 of this Form 10-Q.

### **Item 3. *Quantitative and Qualitative Disclosures about Market Risk***

The Company uses derivative financial instruments to mitigate its exposure to changes in foreign currency exchange rates and interest rates. Transactions involving these financial instruments are with creditworthy banks, including one of the banks that is party to the Company's ABL Facility (see Note 5 "Financing Arrangements" to the Notes to Consolidated Condensed Financial Statements in Part I, Item 1 of this Form 10-Q). The use of these instruments exposes the Company to market and credit risk which may at times be concentrated with certain counterparties, although counterparty nonperformance is not anticipated.

#### **Foreign Currency Fluctuations**

Information about the Company's foreign currency hedging activities is set forth in Note 16 "Derivatives and Hedging," to the Notes to Consolidated Condensed Financial Statements included in Part I, Item 1, of this Form 10-Q, which is incorporated herein by this reference.

As part of the Company's risk management procedure, a sensitivity analysis model is used to measure the potential loss in future earnings of market-sensitive instruments resulting from one or more selected hypothetical changes in interest rates or foreign currency values. The sensitivity analysis model quantifies the estimated potential effect of unfavorable movements of 10% in foreign currencies to which the Company was exposed at June 30, 2019 through its foreign currency forward contracts.

The estimated maximum one-day loss from the Company's foreign currency forward contracts, calculated using the sensitivity analysis model described above, is \$3.1 million at June 30, 2019. The Company believes that such a hypothetical loss from its foreign currency forward contracts would be partially offset by increases in the value of the underlying transactions being hedged.

The sensitivity analysis model is a risk analysis tool and does not purport to represent actual losses in earnings that will be incurred by the Company, nor does it consider the potential effect of favorable changes in market rates. It also does not represent the maximum possible loss that may occur. Actual future gains and losses will differ from those estimated because of changes or differences in market rates and interrelationships, hedging instruments and hedge percentages, timing and other factors.

#### **Interest Rate Fluctuations**

The Company is exposed to interest rate risk from its credit facilities and long-term borrowing commitments. Outstanding borrowings under these credit facilities and long-term borrowing commitments accrue interest as described in Note 5 "Financing Arrangements" to the Notes to Consolidated Condensed Financial Statements in Part I, Item 1, and in "Liquidity and Capital Resources" in Part I, Item 2 of this Form 10-Q. The Company's long-term borrowing commitments are subject to interest rate fluctuations, which could be material to the Company's cash flows and results of operations. In order to mitigate this risk, the Company enters into interest rate hedges as part of its interest rate risk management strategy. Information about the Company's interest rate hedges is provided in Note 16 "Derivatives and Hedging" to the Notes to Consolidated Condensed Financial Statements in Part I, Item 1 of this Form 10-Q. In order to determine the impact of unfavorable changes in interest rates on the Company's cash flows and result of operations, the Company performed a sensitivity analysis as part of its risk management procedures. The sensitivity analysis quantified that the incremental expense incurred by a 10% increase in interest rates would be \$0.3 million over the 12-month period ending on June 30, 2019.

### **Item 4. *Controls and Procedures***

*Disclosure Controls and Procedures.* The Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness, as of June 30, 2019, of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended). Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective as of June 30, 2019.

*Changes in Internal Control over Financial Reporting.* In January 2019, the Company completed the acquisition of Wolfskin. See Note 4 “Business Combinations” to the Notes to Consolidated Condensed Financial Statements in Part I, Item 1 of this Form 10-Q. The Company is in the process of integrating the Jack Wolfskin business and evaluating its internal controls over financial reporting. As a result of these integration activities, certain controls will be evaluated and may be revised. Except as otherwise noted, during the quarter ended June 30, 2019, there were no changes in the Company’s internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, the Company’s internal control over financial reporting.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

## PART II. OTHER INFORMATION

### Item 1. Legal Proceedings

The information set forth in Note 13 “Commitments & Contingencies,” to the Notes to Consolidated Condensed Financial Statements included in Part I, Item 1, of this Form 10-Q, is incorporated herein by this reference.

#### Item 1A. Risk Factors

##### Certain Factors Affecting Callaway Golf Company

The Company has included in Part I, Item 1A of its Annual Report on Form 10-K for the year ended December 31, 2018, a description of certain risks and uncertainties that could affect the Company’s business, future performance or financial condition (the “Risk Factors”). There are no material changes from the disclosure provided in the Form 10-K for the year ended December 31, 2018 with respect to the Risk Factors. Investors should consider the Risk Factors prior to making an investment decision with respect to the Company’s stock.

### Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

#### Stock Purchases

In May 2018, the Company's Board of Directors authorized a \$50.0 million share repurchase program (the "2018 Repurchase Program") under which the Company was authorized to repurchase shares of its common stock in the open market or in private transactions, subject to the Company's assessment of market conditions and buying opportunities. The Company repurchased \$27.7 million of its common stock under this program. The 2018 Repurchase Program remained in effect until it was canceled and replaced by a newly authorized \$100.0 million share repurchase program in August 2019 (the "2019 Repurchase Program"), under which the Company is authorized to repurchase shares of its common stock in the open market or in private transactions, subject to the Company's assessment of market conditions and buying opportunities. Accordingly, as of the date of this report, the Company had \$100.0 million of purchase authority remaining under the 2019 Repurchase Program. Repurchases under both the 2018 Repurchase Program and 2019 Repurchase Program are made consistent with the terms of the Company's ABL Facility which limits the amount of stock that can be repurchased. The 2019 Repurchase Program will remain in effect until completed or until terminated by the Board of Directors.

The following table summarizes the purchases by the Company during the second quarter of 2019 under the 2018 Repurchase Program for shares the Company withheld to satisfy payroll tax withholding obligations in connection with the vesting and settlement of employee restricted stock unit awards and performance share unit awards. The Company’s repurchases of shares of common stock are recorded at cost and result in a reduction of shareholders’ equity.

|  | Three Months Ended June 30, 2019 |                                       |  |  |
|--|----------------------------------|---------------------------------------|--|--|
|  | Total Number of Shares Purchased | Weighted Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Program | Maximum Dollar Value that May Yet Be Purchased Under the Program |
| <i>(in thousands, except per share data)</i> |                                  |                                       |  |  |
| April 1, 2019-April 30, 2019                 | 1                                | \$ 15.80                              | 1  | \$ 22,333  |
| May 1, 2019-May 31, 2019                     | —                                | \$ —                                  | —  | \$ 22,333  |
| June 1, 2019-June 30, 2019                   | 1                                | \$ 14.70                              | 1  | \$ 22,325  |
| Total  | 2                                | \$ 15.23                              | 2  | \$ 22,325 <sup>(1)</sup>   |

(1) Subsequent to June 30, 2019, the Company canceled the remaining \$22.3 million authorized under the 2018 Repurchase Program and implemented the new \$100.0 million 2019 Repurchase Program as noted above.

### Item 3. Defaults upon Senior Securities

None.

**Item 4. *Mine Safety Disclosures***

None

**Item 5. *Other Information***

Effective August 6, 2019, the Company's Board of Directors approved and adopted amendments to the existing Bylaws of the Company (as so amended, the "Bylaws").

The amendments revise the advance notice disclosure requirements contained in the Bylaws to require the stockholder proposing business or nominating directors to provide additional information about the stockholder's ownership of securities in the Company (including ownership of derivative securities) and material litigation, relationships and interests in material agreements with or involving the Company. Further, the Bylaws require the stockholder to provide additional information regarding any candidate the stockholder proposes to nominate for election as a director, including all information with respect to such nominee that would be required to be set forth in a stockholder's notice if such nominee were a stockholder delivering such notice and a description of any direct or indirect material interest in any material contract or agreement between or among the nominating stockholder and each nominee or his or her respective associates. Additionally, the Bylaws require any candidate for the Board, whether nominated by a stockholder or the Board, to provide certain background information and representations regarding disclosure of voting or compensation arrangements, compliance with the Company's policies and guidelines and intent to serve the entire term. The Bylaws also require the stockholder to provide additional information regarding the proposed business and any related agreements between the stockholder and any other beneficial holder.

In addition, the amendments revise the deadline in the Bylaws for advance notice of director nominations for a special meeting of stockholders where directors will be elected to not earlier than 120 days prior to such special meeting and not later than 90 days prior to such special meeting, or, if later, the tenth day following public disclosure of the special meeting. The deadline for advance notice of business and nominations for an annual meeting of stockholders was not revised. The amendments also prohibit stockholders from submitting more nominees than the number of directors up for election at the applicable meeting.

The amendments also added a forum selection provision, which provides that, unless the Company consents in writing to the selection of another forum, the Delaware Court of Chancery will be the sole and exclusive forum for the following actions: (i) any derivative action or proceeding brought by or on behalf of the Company; (ii) any action asserting a claim for breach of a fiduciary duty owed by any director, officer or other employee of the Company to the Company or the Company's stockholders; (iii) any action arising pursuant to any provision of the General Corporation Law of the State of Delaware or the Company's certificate of incorporation or bylaws; and (iv) any action asserting a claim against the Company governed by the internal affairs doctrine. Additionally, the amendments include language pursuant to which stockholders are deemed to have consented to personal jurisdiction in the Delaware Court of Chancery and to service of process on their counsel in any action initiated in violation of the forum selection provision.

The amendments also (i) permit the Board, the chairman of a meeting or the majority of the stockholders in attendance at a meeting to adjourn such meeting at any time and (ii) revise the number of directors required to call a special meeting of the Board to a majority of directors then in office. The amendments also include certain technical, conforming, modernizing and clarifying changes to the Bylaws.

The foregoing description of the amendments is qualified in its entirety by reference to the full text of the Bylaws, a copy of which is attached as Exhibit 3.2 to this Quarterly Report on Form 10-Q and incorporated herein by reference.

**Item 6. Exhibits**

- 3.1 Certificate of Incorporation, incorporated herein by this reference to Exhibit 3.1 to the Company's Current Report on Form 8-K, as filed with the Commission on July 1, 1999 (file no. 1-10962).
- 3.2 [Sixth Amended and Restated Bylaws, as amended and restated as of August 1, 2019.](#)†
- 10.1 [Fourth Amended and Restated Loan and Security Agreement, dated as of May 17, 2019, among Callaway Golf Company, Callaway Golf Sales Company, Callaway Golf Ball Operations, Inc., Ogio International, Inc., Travis Mathew, LLC, Callaway Golf Canada Ltd., Callaway Golf Europe Ltd., JACK WOLFSKIN Ausrüstung für Draussen GmbH & Co. KGaA, Callaway Golf Interactive, Inc., Callaway Golf International Sales Company, Callaway Golf European Holding Company Limited, Callaway Germany Holdco GmbH, JW STARGAZER Holding GmbH, SKYRAGER GmbH, Jack Wolfskin Retail GmbH, Bank of America, N.A., as administrative agent and collateral agent, MUFG Union Bank, as syndication agent, SunTrust Bank, as documentation agent, Bank of America, N.A., as sole lead arranger and sole bookrunner and each of Bank of America, N.A., Bank of America, N.A. \(acting through its London branch\), Bank of America, N.A. \(acting through its Canada branch\), SunTrust Bank, MUFG Union Bank N.A., JPMorgan Chase Bank, N.A., JPMorgan Chase Bank, N.A., London Branch and JPMorgan Chase Bank, N.A., Toronto Branch, as lenders, incorporated herein by this reference to Exhibit 10.1 of the Company's Current Report on Form 8-K, as filed with the Commission on May 22, 2019 \(file no. 1-10962\).](#)
- 10.2 [Third Amendment to the Managing Director Agreement, effective June 5, 2019, by and between Skyrager GmbH and Melody Harris-Hensbach.](#)†
- 31.1 Certification of Oliver G. Brewer III pursuant to Rule 13a-14(a) or 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Brian P. Lynch pursuant to Rule 13a-14(a) or 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Oliver G. Brewer III and Brian P. Lynch pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 101.1 XBRL Instance Document - the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document.
- 101.2 XBRL Taxonomy Extension Schema Document †
- 101.3 XBRL Taxonomy Extension Calculation Linkbase Document †
- 101.4 XBRL Taxonomy Extension Definition Linkbase Document †
- 101.5 XBRL Taxonomy Extension Label Linkbase Document †
- 101.6 XBRL Taxonomy Extension Presentation Linkbase Document †

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(†) Included with this Report.



## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

CALLAWAY GOLF COMPANY

By:                     /s/ Jennifer Thomas                    

**Jennifer Thomas**  
**Vice President and**  
**Chief Accounting Officer**

Date: August 9, 2019

**SIXTH AMENDED AND RESTATED  
BYLAWS  
OF  
CALLAWAY GOLF COMPANY  
(A DELAWARE CORPORATION)  
(as Amended and Restated Effective August 1, 2019)**

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## Article I Corporate Offices

### 1.1 Registered Office

The registered office of the corporation shall be fixed in the certificate of incorporation of the corporation.

### 1.2 Other Offices

The board of directors may at any time establish branch or subordinate offices at any place or places where the corporation is qualified to do business.

## Article II

## **Meetings of Stockholders**

### **2.1 Place of Meetings**

Meetings of stockholders shall be held at any place within or outside the State of Delaware designated by the board of directors, or if so determined by the board of directors, by means of remote communication as set forth in Section 2.18 below. In the absence of any such designation, stockholders' meetings shall be held at the principal executive office of the corporation.

### **2.2 Annual Meeting**

The annual meeting of stockholders shall be held each year on a date and at a time designated by the board of directors. At the meeting, directors shall be elected, and any other business properly brought before the meeting may be transacted.

### **2.3 Special Meeting**

A special meeting of the stockholders may be called at any time by the board of directors, or by the chairman of the board, or by the president. No other person or persons are permitted to call a special meeting. The board of directors may postpone, recess, reschedule or cancel any previously scheduled special meeting of stockholders. Only such business shall be conducted at a special meeting as shall have been brought before the meeting pursuant to the corporation's notice of meeting.

### **2.4 Notice of Business to be Brought Before a Meeting**

(a) At an annual meeting of the stockholders, only such business shall be conducted as shall have been properly brought before the meeting. To be properly brought before an annual meeting, business must be (i) specified in the notice of meeting given by or at the direction of the board of directors, (ii) if not specified in the notice of meeting, otherwise brought before the meeting by the board of directors or the chairman of the board or (iii) otherwise properly brought before the meeting by a stockholder present in person who (A) (1) was a beneficial owner of

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shares of the corporation both at the time of giving the notice provided for in this Section 2.4 and at the time of the meeting, (2) is entitled to vote at the meeting, and (3) has complied with this Section 2.4 in all applicable respects or (B) properly made such proposal in accordance with Rule 14a-8 under the Securities Exchange Act of 1934, as amended, and the rules and regulations thereunder (as so amended and inclusive of such rules and regulations, the "Exchange Act"). The foregoing clause (iii) shall be the exclusive means for a stockholder to propose business to be brought before an annual meeting of the stockholders. The only matters that may be brought before a special meeting are the matters specified in the notice of meeting given by or at the direction of the person calling the meeting pursuant to Section 2.3, and stockholders shall not be permitted to propose business to be brought before a special meeting of the stockholders. For purposes of this Section 2.4, "present in person" shall mean that the stockholder proposing that the business be brought before the annual meeting of the corporation, or a qualified representative of such proposing stockholder, appear at such annual meeting. A "qualified representative" of such proposing stockholder shall be a duly authorized officer, manager or partner of such stockholder or any other person authorized by a writing executed by such stockholder or an electronic transmission delivered by such stockholder to act for such stockholder as proxy at the meeting of stockholders and such person must produce such writing or electronic transmission, or a reliable reproduction of the writing or electronic transmission, at the meeting of stockholders. Stockholders seeking to nominate persons for election to the board of directors must comply with Section 2.5 and Section 2.6, and this Section 2.4 shall not be applicable to nominations except as expressly provided in Section 2.5 and Section 2.6.

(b) Without qualification, for business to be properly brought before an annual meeting by a stockholder, the stockholder must (i) provide Timely Notice (as defined below) thereof in writing and in proper form to the secretary of the corporation and (ii) provide any updates or supplements to such notice at the times and in the forms required by this Section 2.4. To be timely, a stockholder's notice must be delivered to, or mailed and received at, the principal executive offices of the corporation not less than ninety (90) days nor more than one hundred twenty (120) days prior to the one-year anniversary of the preceding year's annual meeting; provided, however, that if the date of the annual meeting is more than thirty (30) days before or more than sixty (60) days after such anniversary date, notice by the stockholder to be timely must be so delivered, or mailed and received, not later than the ninetieth (90th) day prior to such annual meeting or, if later, the tenth (10th) day following the day on which public disclosure (as defined below) of the date of such annual meeting was first made (such notice within such time periods, "Timely Notice"). In no event shall any adjournment or postponement of an annual meeting or the announcement thereof commence a new time period for the giving of Timely Notice as described above.

(c) To be in proper form for purposes of this Section 2.4, a stockholder's notice to the secretary shall set forth:  
(i) As to each Proposing Person (as defined below), (A) the name and address of such Proposing Person (including, if applicable, the name and address that appear on the corporation's books and records) and (B) the class or series and number of shares of the corporation that are, directly or indirectly, owned of record or beneficially owned (within the meaning of Rule 13d-3 under the Exchange Act) by such Proposing Person, except that such

Proposing Person shall in all events be deemed to beneficially own any shares of any class or series of the corporation as to which such Proposing Person has a right to acquire beneficial ownership at any time in the future (the disclosures to be made pursuant to the foregoing clauses (A) and (B) are referred to as “Stockholder Information”);

(ii) As to each Proposing Person, (A) the full notional amount of any securities that, directly or indirectly, underlie any “derivative security” (as such term is defined in Rule 16a-1(c) under the Exchange Act) that constitutes a “call equivalent position” (as such term is defined in Rule 16a-1(b) under the Exchange Act) (“Synthetic Equity Position”) and that is, directly or indirectly, held or maintained by such Proposing Person with respect to any shares of any class or series of shares of the corporation; provided that, for the purposes of the definition of “Synthetic Equity Position,” the term “derivative security” shall also include any security or instrument that would not otherwise constitute a “derivative security” as a result of any feature that would make any conversion, exercise or similar right or privilege of such security or instrument becoming determinable only at some future date or upon the happening of a future occurrence, in which case the determination of the amount of securities into which such security or instrument would be convertible or exercisable shall be made assuming that such security or instrument is immediately convertible or exercisable at the time of such determination; and, provided, further, that any Proposing Person satisfying the requirements of Rule 13d-1(b)(1) under the Exchange Act (other than a Proposing Person that so satisfies Rule 13d-1(b)(1) under the Exchange Act solely by reason of Rule 13d-1(b)(1)(ii)(E)) shall not be deemed to hold or maintain the notional amount of any securities that underlie a Synthetic Equity Position held by such Proposing Person as a hedge with respect to a bona fide derivatives trade or position of such Proposing Person arising in the ordinary course of such Proposing Person’s business as a derivatives dealer, (B) any rights to dividends on the shares of any class or series of shares of the corporation owned beneficially by such Proposing Person that are separated or separable from the underlying shares of the corporation, (C) any material pending or threatened legal proceeding in which such Proposing Person is a party or material participant involving the corporation or any of its officers or directors, or any affiliate of the corporation, (D) any other material relationship between such Proposing Person, on the one hand, and the corporation or any affiliate of the corporation, on the other hand, (E) any direct or indirect material interest in any material contract or agreement of such Proposing Person with the corporation or any affiliate of the corporation (including, in any such case, any employment agreement, collective bargaining agreement or consulting agreement), (F) a representation that such Proposing Person intends or is part of a group which intends to deliver a proxy statement or form of proxy to holders of at least the percentage of the corporation’s outstanding capital stock required to approve or adopt the proposal or otherwise solicit proxies from stockholders in support of such proposal and (G) any other information relating to such Proposing Person that would be required to be disclosed in a proxy statement or other filing required to be made in connection with solicitations of proxies or consents by such Proposing Person in support of the business proposed to be brought before the meeting pursuant to Section 14(a) of the Exchange Act (the disclosures to be made pursuant to the foregoing clauses (A) through (G) are referred to as “Disclosable Interests”); provided, however, that Disclosable Interests shall not include any such disclosures with respect to the ordinary course business activities of any broker, dealer, commercial bank, trust company or other nominee who is a Proposing Person solely as a result of being the stockholder directed to prepare and submit the notice required by these bylaws on behalf of a beneficial owner; and

(iii) As to each item of business that the stockholder proposes to bring before the annual meeting, (A) a brief description of the business desired to be brought before the annual meeting, the reasons for conducting such business at the annual meeting and any material interest in such business of each Proposing Person, (B) the text of the proposal or business (including the text of any resolutions proposed for consideration), (C) a reasonably detailed description of all agreements, arrangements and understandings (x) between or among any of the Proposing Persons or (y) between or among any Proposing Person and any other record or beneficial holder(s) or persons(s) who have a right to acquire beneficial ownership at any time in the future of the shares of any class or series of the corporation or any other person or entity (including their names) in connection with the proposal of such business by such stockholder, and (D) any other information relating to such item of business that would be required to be disclosed in a proxy statement or other filing required to be made in connection with solicitations of proxies in support of the business proposed to be brought before the meeting pursuant to Section 14(a) of the Exchange Act; provided, however, that the disclosures required by this paragraph (iii) shall not include any disclosures with respect to any broker, dealer, commercial bank, trust company or other nominee who is a Proposing Person solely as a result of being the stockholder directed to prepare and submit the notice required by these bylaws on behalf of a beneficial owner.

For purposes of this Section 2.4, the term “Proposing Person” shall mean (i) the stockholder providing the notice of business proposed to be brought before an annual meeting, (ii) the beneficial owner or beneficial owners, if different, on whose behalf the notice of the business proposed to be brought before the annual meeting is made, and (iii) any participant (as defined in paragraphs (a)(ii)-(vi) of Instruction 3 to Item 4 of Schedule 14A) with such stockholder in such solicitation.

(d) A Proposing Person shall update and supplement its notice to the corporation of its intent to propose business at an annual meeting, if necessary, so that the information provided or required to be provided in such notice pursuant to this Section 2.4 shall be true and correct as of the record date for stockholders entitled to vote at the meeting and as of the date that is ten (10) business days prior to the meeting or any adjournment or postponement thereof, and such update and supplement shall be delivered to, or mailed and received by, the secretary at the principal executive offices of the corporation not later than five (5) business days after the record date for stockholders entitled to vote at the meeting (in the case of the update and supplement required to be made as of such record date), and not later than eight (8) business days prior to the date for the meeting or, if practicable, any adjournment or postponement thereof (and, if not practicable, on the first practicable date prior to the date to which the meeting has been adjourned or postponed) (in the case of the update and supplement required to be made as of ten (10) business days prior to the meeting or any adjournment or postponement thereof). For the avoidance of doubt, the obligation to update and supplement as set forth in this paragraph or any other Section of these bylaws shall not limit the corporation’s rights with respect to any deficiencies in any notice provided by a stockholder, extend any applicable deadlines hereunder or enable or be deemed to permit a stockholder who has previously submitted notice hereunder to amend or update any proposal or to submit any new proposal, including by changing or adding matters, business or resolutions proposed to be brought before a meeting of the stockholders.



(e) Notwithstanding anything in these bylaws to the contrary, no business shall be conducted at an annual meeting that is not properly brought before the meeting in accordance with this Section 2.4. The presiding officer of the meeting shall, if the facts warrant, determine that the business was not properly brought before the meeting in accordance with this Section 2.4, and if he or she should so determine, he or she shall so declare to the meeting and any such business not properly brought before the meeting shall not be transacted.

(f) This Section 2.4 is expressly intended to apply to any business proposed to be brought before an annual meeting of stockholders other than any proposal made in accordance with Rule 14a-8 under the Exchange Act and included in the corporation's proxy statement. In addition to the requirements of this Section 2.4 with respect to any business proposed to be brought before an annual meeting, each Proposing Person shall comply with all applicable requirements of the Exchange Act with respect to any such business. Nothing in this Section 2.4 shall be deemed to affect the rights of stockholders to request inclusion of proposals in the corporation's proxy statement pursuant to Rule 14a-8 under the Exchange Act.

(g) For purposes of these bylaws, "public disclosure" shall mean disclosure in a press release reported by a national news service or in a document publicly filed by the corporation with the Securities and Exchange Commission pursuant to Section 13, 14 or 15(d) of the Exchange Act.

## **2.5 Notice of Nominations for Election to the Board of Directors**

(a) Nominations of any person for election to the board of directors at an annual meeting or at a special meeting (but only if the election of directors is a matter specified in the notice of meeting given by or at the direction of the person calling such special meeting) may be made at such meeting only (i) by or at the direction of the board of directors, including by any committee or persons authorized to do so by the board of directors or these bylaws, or (ii) by a stockholder present in person (A) who was a beneficial owner of shares of the corporation both at the time of giving the notice provided for in this Section 2.5 and at the time of the meeting, (B) is entitled to vote at the meeting, and (C) has complied with this Section 2.5 and Section 2.6 as to such notice and nomination. For purposes of this Section 2.5, "present in person" shall mean that the stockholder proposing that the business be brought before the meeting of the corporation, or a qualified representative of such stockholder, appear at such meeting. A "qualified representative" of such proposing stockholder shall be a duly authorized officer, manager or partner of such stockholder or any other person authorized by a writing executed by such stockholder or an electronic transmission delivered by such stockholder to act for such stockholder as proxy at the meeting of stockholders and such person must produce such writing or electronic transmission, or a reliable reproduction of the writing or electronic transmission, at the meeting of stockholders. The foregoing clause (ii) shall be the exclusive means for a stockholder to make any nomination of a person or persons for election to the board of directors at an annual meeting or special meeting.

(b)  
(i) Without qualification, for a stockholder to make any nomination of a person or persons for election to the board of directors at an annual meeting, the stockholder must (1) provide Timely Notice (as defined in Section 2.4) thereof in writing and in proper form to the secretary of the corporation, (2) provide the information, agreements and questionnaires with respect to such stockholder and its candidate for nomination required by this Section 2.5 and Section 2.6 and (3) provide any updates or supplements to such notice at the times and in the forms required by this Section 2.5 and Section 2.6.

(ii) Without qualification, if the election of directors is a matter specified in the notice of meeting given by or at the direction of the person calling a special meeting, then for a stockholder to make any nomination of a person or persons for election to the board of directors at a special meeting, the stockholder must (i) provide timely notice thereof in writing and in proper form to the secretary of the corporation at the principal executive offices of the corporation, (ii) provide the information with respect to such stockholder and its candidate for nomination required by this Section 2.5 and Section 2.6 and (iii) provide any updates or supplements to such notice at the times and in the forms required by this Section 2.5. To be timely for purposes of this Section 2.5(b)(ii), a stockholder's notice for nominations to be made at a special meeting must be delivered to, or mailed and received at, the principal executive offices of the corporation not earlier than the one hundred twentieth (120th) day prior to such special meeting and not later than the ninetieth (90th) day prior to such special meeting or, if later, the tenth (10th) day following the day on which public disclosure (as defined in Section 2.4) of the date of such special meeting was first made.

(iii) In no event shall any adjournment or postponement of an annual meeting or special meeting or the announcement thereof commence a new time period for the giving of a stockholder's notice as described above.

(iv) In no event may a Nominating Person (as defined below) provide notice under this Section 2.5 or otherwise with respect to a greater number of director candidates than are subject to election by stockholders at the applicable meeting. If the corporation shall, subsequent to such notice, increase the number of directors subject to election at the meeting, such notice as to any additional nominees shall be due on the later of (i) the conclusion of the time period for Timely Notice (with respect to an annual meeting), (ii) the date set forth in Section 2.5(b)(ii) (with respect to a special meeting) or (iii) the tenth (10th) day following the date of public disclosure (as defined in Section 2.4) of such increase.

(c) To be in proper form for purposes of this Section 2.5, a stockholder's notice to the secretary shall set forth:

(i) As to each Nominating Person, the Stockholder Information (as defined in Section 2.4(c)(i), except that for purposes of this Section 2.5 the term "Nominating Person" shall be substituted for the term "Proposing Person" in all places it appears in Section 2.4(c)(i));

(ii) As to each Nominating Person, any Disclosable Interests (as defined in Section 2.4(c)(ii), except that for purposes of this Section 2.5 the term "Nominating Person" shall be substituted for the term "Proposing Person" in all places it appears in Section 2.4(c)(ii) and the

disclosure with respect to the business to be brought before the meeting in Section 2.4(c)(ii) shall be made with respect to the election of directors at the meeting); and

(iii) As to each candidate whom a Nominating Person proposes to nominate for election as a director, (A) all information with respect to such candidate for nomination that would be required to be set forth in a stockholder's notice pursuant to this Section 2.5 and Section 2.6 if such candidate for nomination were a Nominating Person, (B) all information relating to such candidate for nomination that is required to be disclosed in a proxy statement or other filings required to be made in connection with solicitations of proxies for election of directors in a contested election pursuant to Section 14(a) under the Exchange Act (including such candidate's written consent to being named in the proxy statement as a nominee and to serving as a director if elected), (C) a description of any direct or indirect material interest in any material contract or agreement between or among any Nominating Person, on the one hand, and each candidate for nomination or his or her respective associates or any other participants in such solicitation, on the other hand, including, without limitation, all information that would be required to be disclosed pursuant to Item 404 under Regulation S-K if such Nominating Person were the "registrant" for purposes of such rule and the candidate for nomination were a director or executive officer of such registrant (the disclosures to be made pursuant to the foregoing clauses (A) through (C) are referred to as "Nominee Information"), and (D) a completed and signed questionnaire, representation and agreement as provided in Section 2.6(a).

For purposes of this Section 2.5, the term "Nominating Person" shall mean (i) the stockholder providing the notice of the nomination proposed to be made at the meeting, (ii) the beneficial owner or beneficial owners, if different, on whose behalf the notice of the nomination proposed to be made at the meeting is made, and (iii) any participant (as defined in paragraphs (a)(ii)-(vi) of Instruction 3 to Item 4 of Schedule 14A) with such stockholder in such solicitation.

(d) A stockholder providing notice of any nomination proposed to be made at a meeting shall further update and supplement such notice, if necessary, so that the information provided or required to be provided in such notice pursuant to this Section 2.5 shall be true and correct as of the record date for stockholders entitled to vote at the meeting and as of the date that is ten (10) business days prior to the meeting or any adjournment or postponement thereof, and such update and supplement shall be delivered to, or mailed and received by, the secretary at the principal executive offices of the corporation not later than five (5) business days after the record date for stockholders entitled to vote at the meeting (in the case of the update and supplement required to be made as of such record date), and not later than eight (8) business days prior to the date for the meeting or, if practicable, any adjournment or postponement thereof (and, if not practicable, on the first practicable date prior to the date to which the meeting has been adjourned or postponed) (in the case of the update and supplement required to be made as of ten (10) business days prior to the meeting or any adjournment or postponement thereof). For the avoidance of doubt, the obligation to update and supplement as set forth in this paragraph or any other Section of these bylaws shall not limit the corporation's rights with respect to any deficiencies in any notice provided by a stockholder, extend any applicable deadlines hereunder or enable or be deemed to permit a stockholder who has previously submitted notice hereunder to amend or update any nomination or to submit any new nomination.

(e) In addition to the requirements of this Section 2.5 with respect to any nomination proposed to be made at a meeting, each Nominating Person shall comply with all applicable requirements of the Exchange Act with respect to any such nominations.

**2.6 Additional Requirements for Valid Nomination of Candidates to Serve as Director and, if Elected, to be Seated as Directors**

(a) To be eligible to be a candidate for election as a director of the corporation at an annual or special meeting, a candidate must be nominated in the manner prescribed in Section 2.5 and the candidate for nomination, whether nominated by the board of directors or by a stockholder of record, must have previously delivered (in accordance with the time period prescribed for delivery in a notice to such candidate given by or on behalf of the board of directors), to the secretary at the principal executive offices of the corporation, (i) a completed written questionnaire (in a form provided by the corporation) with respect to the background, qualifications, stock ownership and independence of such proposed nominee and (ii) a written representation and agreement (in form provided by the corporation) that such candidate for nomination (A) is not and, if elected as a director during his or her term of office, will not become a party to (1) any agreement, arrangement or understanding with, and has not given and will not give any commitment or assurance to, any person or entity as to how such proposed nominee, if elected as a director of the corporation, will act or vote on any issue or question (a "Voting Commitment") or (2) any Voting Commitment that could limit or interfere with such proposed nominee's ability to comply, if elected as a director of the corporation, with such proposed nominee's fiduciary duties under applicable law, (B) is not, and will not become a party to, any agreement, arrangement or understanding with any person or entity other than the corporation with respect to any direct or indirect compensation or reimbursement for service as a director that has not been disclosed therein or to the corporation, (C) if elected as a director of the corporation, will comply with all applicable corporate governance, conflict of interest, confidentiality, stock ownership and trading and other policies and guidelines of the corporation applicable to directors and in effect during such person's term in office as a director (and, if requested by any candidate for nomination, the secretary of the corporation shall provide to such candidate for nomination all such policies and guidelines then in effect), and (D) if elected as director of the corporation, intends to serve the entire term until the next meeting at which such candidate would face re-election.

(b) The board of directors may also require any proposed candidate for nomination as a director to furnish such other information as may reasonably be requested by the board of directors in writing prior to the meeting of stockholders at which such candidate's nomination is to be acted upon in order for the board of directors to determine the eligibility of such candidate for nomination to be an independent director of the corporation.

(c) A candidate for nomination as a director shall further update and supplement the materials delivered pursuant to this Section 2.6, if necessary, so that the information provided or required to be provided pursuant to this Section 2.6 shall be true and correct as of the record date for stockholders entitled to vote at the meeting and as of the date that is ten (10) business days

prior to the meeting or any adjournment or postponement thereof, and such update and supplement shall be delivered to, or mailed and received by, the secretary at the principal executive offices of the corporation (or any other office specified by the corporation in any public disclosure (as defined in Section 2.4)) not later than five (5) business days after the record date for stockholders entitled to vote at the meeting (in the case of the update and supplement required to be made as of such record date), and not later than eight (8) business days prior to the date for the meeting or, if practicable, any adjournment or postponement thereof (and, if not practicable, on the first practicable date prior to the date to which the meeting has been adjourned or postponed) (in the case of the update and supplement required to be made as of ten (10) business days prior to the meeting or any adjournment or postponement thereof). For the avoidance of doubt, the obligation to update and supplement as set forth in this paragraph or any other Section of these bylaws shall not limit the corporation's rights with respect to any deficiencies in any notice provided by a stockholder, extend any applicable deadlines hereunder or enable or be deemed to permit a stockholder who has previously submitted notice hereunder to amend or update any proposal or to submit any new proposal, including by changing or adding nominees, matters, business or resolutions proposed to be brought before a meeting of the stockholders.

(d) No candidate shall be eligible for nomination as a director of the corporation unless such candidate for nomination and the Nominating Person seeking to place such candidate's name in nomination has complied with Section 2.5 and this Section 2.6, as applicable. The presiding officer at the meeting shall, if the facts warrant, determine that a nomination was not properly made in accordance with Section 2.5 and this Section 2.6, and if he or she should so determine, he or she shall so declare such determination to the meeting, the defective nomination shall be disregarded and any ballots cast for the candidate in question (but in the case of any form of ballot listing other qualified nominees, only the ballots cast for the nominee in question) shall be void and of no force or effect.

(e) Notwithstanding anything in these bylaws to the contrary, no candidate for nomination shall be eligible to be seated as a director of the corporation unless nominated and elected in accordance with Section 2.5 and this Section 2.6.

## **2.7 Notice of Stockholders' Meetings**

All notices of meetings of stockholders shall be sent or otherwise given in accordance with Section 2.9 of these bylaws not less than ten (10) nor more than sixty (60) days before the date of the meeting. The notice shall specify the place, date, and hour of the meeting and the means of remote communication, if any, by which stockholders and proxyholders may be deemed to be present in person and vote at such meeting, and (i) in the case of a special meeting, the purpose or purposes for which the meeting is called (no business other than that specified in the notice may be transacted) or (ii) in the case of the annual meeting, those matters which the board of directors, at the time of giving the notice, intends to present for action by the stockholders (but any proper matter may be presented at the meeting for such action). The notice of any meeting at which directors are to be elected shall include the name of any nominee or nominees who, at the time of the notice, the board intends to present for election.

## 2.8 **Conduct of Meeting**

The board of directors may adopt by resolution such rules and regulations for the conduct of the meeting of stockholders as it shall deem appropriate. Except to the extent inconsistent with such rules and regulations as adopted by the board, the chairman of any meeting of stockholders shall have the right and authority to prescribe such rules, regulations and procedures and to do all such acts as, in the judgment of such chairman, are appropriate for the proper conduct of the meeting. Such rules, regulations or procedures, whether adopted by the board or prescribed by the chairman of the meeting, may include, without limitation, the following: (i) the establishment of an agenda or order of business for the meeting; (ii) rules and procedures for maintaining order at the meeting and the safety of those present; (iii) limitations on attendance at or participation in the meeting to stockholders of record of the corporation, their duly authorized and constituted proxies or such other persons as the chairman of the meeting shall determine; (iv) restrictions on entry to the meeting after the time fixed for the commencement thereof; and (v) limitations on the time allotted to questions or comments by participants. Unless and to the extent determined by the board or the chairman of the meeting, meetings of stockholders shall not be required to be held in accordance with the rules of parliamentary procedure.

## 2.9 **Manner of Giving Notice; Affidavit of Notice**

Notice of any meeting of stockholders shall be given either personally or by mail or by electronic transmission in accordance with Section 232 of the General Corporation Law of Delaware or other written communication. Notices not personally delivered, or sent by electronic transmission, shall be sent charges prepaid and shall be addressed to the stockholder at the address of that stockholder appearing on the books of the corporation or given by the stockholder to the corporation for the purpose of notice. Notice shall be deemed to have been given at the time when delivered personally or deposited in the mail or sent by electronic transmission or other means of written communication. Notice by electronic transmission shall be deemed given as provided in Section 232 of the General Corporation Law of Delaware; provided that any notice by electronic transmission will include a prominent legend that the communication is an important notice regarding the corporation.

An affidavit of the mailing or other means of giving any notice of any stockholders' meeting, executed by the secretary, assistant secretary or any transfer agent of the corporation giving the notice, shall be prima facie evidence of the giving of such notice.

For purposes of these bylaws, "electronic transmission" means any form of communication, not directly involving the physical transmission of paper, that creates a record that may be retained, retrieved, and reviewed by a recipient thereof, and that may be directly reproduced in paper form by such a recipient through an automated process.

## 2.10 **Quorum**

The holders of a majority in voting power of the stock issued and outstanding and entitled to vote thereat, present in person or represented by proxy, shall constitute a quorum at all

meetings of the stockholders for the transaction of business except as otherwise provided by statute or by the certificate of incorporation.

When a quorum is present at any meeting, the vote of the holders of a majority of the stock having voting power present in person or represented by proxy shall decide any question brought before such meeting, unless the question is one upon which, by express provision of the laws of the State of Delaware or of the certificate of incorporation or these bylaws, a different vote is required, in which case such express provision shall govern and control the decision of the question.

If a quorum be initially present, the stockholders may continue to transact business until adjournment, notwithstanding the withdrawal of enough stockholders to leave less than a quorum, if any action taken is approved by a majority of the stockholders initially constituting the quorum.

#### **2.11 Adjourned Meeting; Notice**

(a) Any meeting of stockholders, annual or special, may be adjourned from time to time to any other time and to any other place at which a meeting of stockholders may be held under these bylaws by the board of directors, the chairman of the meeting or, if directed to be voted on by the chairman of the meeting, by the stockholders present or represented at the meeting and entitled to vote thereon, although less than a quorum.

(b) When a meeting is adjourned to another time and place, unless these bylaws otherwise require, notice need not be given of the adjourned meeting if the time and place thereof, if any, and the means of remote communications, if any, by which stockholders and proxyholders may be deemed to be present in person and vote at such adjourned meeting are announced at the meeting at which the adjournment is taken. At the adjourned meeting the corporation may transact any business that might have been transacted at the original meeting. If the adjournment is for more than thirty (30) days, or if after the adjournment a new record date is fixed for the adjourned meeting, a notice of the adjourned meeting shall be given to each stockholder of record entitled to vote at the meeting.

#### **2.12 Voting**

The stockholders entitled to vote at any meeting of stockholders shall be determined in accordance with the provisions of Section 2.15 of these bylaws, subject to the provisions of Sections 217 and 218 of the General Corporation Law of Delaware (relating to voting rights of fiduciaries, pledgors and joint owners, and to voting trusts and other voting agreements).

Except as may be otherwise provided in the certificate of incorporation or these bylaws, each stockholder shall be entitled to one vote for each share of capital stock held by such stockholder.

## 2.13 Waiver of Notice

Whenever notice is required to be given under any provision of the General Corporation Law of Delaware or of the certificate of incorporation or these bylaws, a written waiver thereof, signed by the person entitled to notice, whether before or after the time stated therein, shall be deemed equivalent to notice. Attendance of a person at a meeting shall constitute a waiver of notice of such meeting, except when the person attends a meeting for the express purpose of objecting, at the beginning of the meeting, to the transaction of any business because the meeting is not lawfully called or convened. Neither the business to be transacted at, nor the purpose of, any regular or special meeting of the stockholders need be specified in any written waiver of notice unless so required by the certificate of incorporation or these bylaws.

## 2.14 Stockholder Action By Written Consent

(a) Except as may be otherwise provided in the certificate of incorporation, any action which may be taken at any annual or special meeting of stockholders may be taken without a meeting and without prior notice, if a consent in writing, setting forth the action so taken, is signed by the holders of record on the record date established pursuant to Section 2.14(b) (the "Written Consent Record Date") outstanding shares having not less than the minimum number of votes that would be necessary to authorize or take that action at a meeting at which all shares entitled to vote on that action were present and voted. In the case of election of directors, if the certificate of incorporation so provides, such a consent shall be effective only if signed by the holders of all outstanding shares entitled to vote for the election of directors; provided, however, that a director may be elected at any time to fill a vacancy on the board of directors (other than a vacancy created by the removal of a director) that has not been filled by the directors, by the written consent of the holders of a majority of the outstanding shares entitled to vote for the election of directors. To be effective, a written consent must be delivered to the corporation by delivery to its registered office, its principal place of business or an officer or agent of the corporation having custody of the books in which proceedings of meetings of stockholders are recorded. Delivery made to the corporation's registered office shall be by hand or by certified or registered mail, return receipt requested. Every written consent shall bear the date of signature of each stockholder who signs the consent and no written consent shall be effective to take the corporate action referred to therein unless, within sixty (60) days of the earliest dated consent delivered in the manner required by this Section 2.14 to the corporation, written consents signed by a sufficient number of holders to take action are delivered to the corporation in accordance with this Section 2.14. Any stockholder giving a written consent, or the stockholder's proxy holders, may revoke the consent by a writing received by the secretary of the corporation before written consents of the number of shares required to authorize the proposed action have been filed with the secretary.

(b) Without qualification, any stockholder of record seeking to have the stockholders authorize or take any action by written consent shall first request in writing that the board of directors fix a Written Consent Record Date for the purpose of determining the stockholders entitled to take such action, which request shall be in proper form and delivered to, or mailed and received by, the secretary of the corporation at the principal executive offices of the corporation.



Within ten (10) days after receipt of a request in proper form and otherwise in compliance with this Section 2.14(b) from any such stockholder, the board of directors may adopt a resolution fixing a Written Consent Record Date for the purpose of determining the stockholders entitled to take such action, which date shall not be more than ten (10) days after the date upon which the resolution fixing the record date is adopted by the board of directors. If no resolution fixing a record date has been adopted by the board of directors within such ten (10) day period after the date on which such a request is received, (i) the Written Consent Record Date for determining stockholders entitled to consent to such action, when no prior action of the board of directors is required by applicable law, shall be the first date on which valid signed written consents constituting not less than the minimum number of votes that would be necessary to authorize or take that action at a meeting at which all shares entitled to vote on that action were present and voted and setting forth the action taken or proposed to be taken is delivered to the corporation in the manner described in Section 2.14(a), and (ii) the Written Consent Record Date for determining stockholders entitled to consent to such action, when prior action by the board of directors is required by applicable law, shall be at the close of business on the date on which the board of directors adopts the resolution taking such prior action.

(c) Any electronic transmission consenting to an action to be taken and transmitted by a stockholder or proxyholder, or by a person or persons authorized to act for a stockholder or proxyholder, shall be deemed written, signed and dated for purposes of this Section 2.14, provided that any such electronic transmission sets forth or is delivered with information from which the corporation can determine: (i) that the electronic transmission was transmitted by the stockholder or proxyholder or by a person or persons authorized to act for the stockholder or proxyholder; and (ii) the date on which such stockholder or proxyholder or authorized person or persons transmitted such electronic transmission. The date on which such electronic transmission is transmitted shall be deemed to be the date on which such consent was signed.

(d) Any copy, facsimile or other reliable reproduction of a consent in writing may be substituted or used in lieu of the original writing for any and all purposes for which the original writing could be used, provided that such copy, facsimile or other reproduction shall be a complete reproduction of the entire writing.

(e) If the consents of all stockholders entitled to vote have not been solicited in writing, and if the unanimous written consent of all such stockholders shall not have been received, the secretary shall give prompt notice of the corporate action approved by the stockholders without a meeting.

## **2.15 Record Date for Stockholder Notice; Voting**

(a)  
(i) For purposes of determining the stockholders entitled to notice of any meeting or to vote thereat, the board of directors may fix, in advance, a record date, which shall not precede the date upon which the resolution fixing the record date is adopted by the board of directors and which shall not be more than sixty (60) days nor less than ten (10) days before the date of any such meeting, and in such event only stockholders of record on the date so fixed are entitled to

notice and to vote, notwithstanding any transfer of any shares on the books of the corporation after the record date.

(ii) If the board of directors does not so fix a record date, the record date for determining stockholders entitled to notice of or to vote at a meeting of stockholders shall be at the close of business on the business day next preceding the day on which notice is given, or, if notice is waived, at the close of business on the business day next preceding the day on which the meeting is held.

(iii) A determination of stockholders of record entitled to notice of or to vote at a meeting of stockholders shall apply to any adjournment of the meeting unless the board of directors fixes a new record date for the adjourned meeting, but the board of directors shall fix a new record date if the meeting is adjourned for more than thirty (30) days from the date set for the original meeting.

(b) The record date for any other purpose shall be as provided in Section 8.1 of these bylaws.

#### **2.16 Proxies**

Every person entitled to vote for directors, or on any other matter, shall have the right to do so either in person or by proxy authorized by an instrument in writing or by a transmission permitted by law filed in accordance with the procedure established for the meeting signed by the person and filed with the secretary of the corporation, but no such proxy shall be voted or acted upon after three (3) years from its date unless the proxy provides for a longer period. A proxy shall be deemed signed if the stockholder's name is placed on the proxy (whether by manual signature, electronic signature or otherwise) by the stockholder or the stockholder's attorney-in-fact. The revocability of a proxy that states on its face that it is irrevocable shall be governed by the provisions of Section 212(e) of the General Corporation Law of Delaware. Any copy, facsimile or other reliable reproduction of the writing or transmission created pursuant to this paragraph may be substituted or used in lieu of the original writing or transmission for any and all purposes for which the original writing or transmission could be used, provided that such copy, facsimile or other reproduction shall be a complete reproduction of the entire writing or transmission and that such copy, facsimile or other reproduction set forth or be submitted with information from which it can be determined that such copy, facsimile or other reproduction was authorized by the stockholder.

#### **2.17 List of Stockholders Entitled to Vote**

The officer who has charge of the stock ledger of the corporation shall prepare and make, at least ten (10) days before every meeting of stockholders, a complete list of the stockholders entitled to vote at the meeting, arranged in alphabetical order, and showing the address of each stockholder and the number of shares registered in the name of each stockholder. Such list shall be open to the examination of any stockholder, for any purpose germane to the meeting, during ordinary business hours, for a period of at least ten (10) days prior to the meeting, either at a

place within the city where the meeting is to be held, which place shall be specified in the notice of the meeting, or, if not so specified, at the place where the meeting is to be held. The list shall also be produced and kept at the time and place of the meeting during the whole time thereof, and may be inspected by any stockholder who is present.

#### **2.18 Meeting By Remote Communications**

The board of directors may, in its sole discretion, determine that a meeting of stockholders shall not be held at any place, but may instead be held solely by means of remote communication in accordance with Section 211(a)(2) of the General Corporation Law of Delaware. If authorized by the board of directors in its sole discretion, and subject to such guidelines and procedures as the board of directors may adopt, stockholders and proxyholders not physically present at a meeting of stockholders may, by means of remote communication (a) participate in a meeting of stockholders; and (b) be deemed present in person and vote at a meeting of stockholders, whether such meeting is to be held at a designated place or solely by means of remote communication, provided that (i) the corporation shall implement reasonable measures to verify that each person deemed present and permitted to vote at the meeting by means of remote communication is a stockholder or proxyholder; (ii) the corporation shall implement reasonable measures to provide such stockholders and proxyholders a reasonable opportunity to participate in the meeting and to vote on matters submitted to the stockholders, including an opportunity to read or hear the proceedings of the meeting substantially concurrently with such proceedings; and (iii) if any stockholder or proxyholder votes or takes other action at the meeting by means of remote communication, a record of such vote or other action shall be maintained by the corporation.

### **Article III DIRECTORS**

#### **3.1 Powers**

Subject to the provisions of the General Corporation Law of Delaware and any limitations in the certificate of incorporation and these bylaws relating to action required to be approved by the stockholders or by the outstanding shares, the business and affairs of the corporation shall be managed and all corporate powers shall be exercised by or under the direction of the board of directors.

#### **3.2 Number of Directors; Independence**

(a) The board of directors shall consist of not less than six (6) nor more than fifteen (15) members, with the exact number within that range to be set from time to time exclusively by resolution of the board of directors.

(b) A substantial majority of the members of the board of directors shall be independent as determined by the board of directors or as otherwise required by applicable law, regulation or listing standard of the New York Stock Exchange.

### **3.3 Election and Term of Office of Directors**

Except as provided in Section 3.4 of these bylaws, directors shall be elected at each annual meeting of stockholders to hold office until the next annual meeting. Each director, including a director elected or appointed to fill a vacancy, shall hold office until the expiration of the term for which elected and until a successor has been elected and qualified.

### **3.4 Resignation and Vacancies**

Any director may resign effective on giving notice in writing or by electronic transmission to the chairman of the board, the president, the secretary or the board of directors, unless the notice specifies a later time for that resignation to become effective. If the resignation of a director is effective at a future time, the board of directors may elect a successor to take office when the resignation becomes effective.

All vacancies in the board of directors may be filled by a majority of the remaining directors, even if less than a quorum, or by a sole remaining director; provided, that whenever the holders of any class or classes of stock or series thereof are entitled to elect one or more directors by the provisions of the certificate of incorporation, vacancies and newly created directorships of such class or classes or series may be filled by a majority of the directors elected by such class or classes or series thereof then in office, or by a sole remaining director so elected.

### **3.5 Place of Meetings; Meetings by Telephone**

Regular meetings of the board of directors may be held at any place within or outside the State of Delaware that has been designated from time to time by resolution of the board. In the absence of such a designation, regular meetings shall be held at the principal executive office of the corporation. Special meetings of the board may be held at any place within or outside the State of Delaware that has been designated in the notice of the meeting or, if not stated in the notice or if there is no notice, at the principal executive office of the corporation.

Any meeting, regular or special, may be held by conference telephone or similar communication equipment, so long as all directors participating in the meeting can hear one another; and all such directors shall be deemed to be present in person at the meeting.

### **3.6 Regular Meetings**

Regular meetings of the board of directors may be held without notice if the times of such meetings are fixed by the board of directors. If any regular meeting day shall fall on a legal holiday, then the meeting shall be held next succeeding full business day.

### **3.7 Special Meetings; Notice**

Special meetings of the board of directors for any purpose or purposes may be called at any time by the chairman of the board, the president or a majority of the directors.

Notice of the time and place of special meetings shall be delivered personally or by telephone, electronic transmission or other form of recorded communication to each director or sent by mail, charges prepaid, addressed to each director at that director's address as it is shown on the records of the corporation. If the notice is mailed, it shall be deposited in the United States mail at least four (4) days before the time of the holding of the meeting. If the notice is delivered personally or by telephone or electronic transmission, it shall be delivered personally or by telephone or electronic transmission, at least forty-eight (48) hours before the time of the holding of the meeting. Any oral notice given personally or by telephone or electronic transmission, may be communicated either to the director or to a person at the office of the director who the person giving the notice has reason to believe will promptly communicate it to the director. The notice need not specify the purpose or the place of the meeting, if the meeting is to be held at the principal executive office of the corporation.

### 3.8 **Quorum**

A majority of the authorized number of directors shall constitute a quorum for the transaction of business, except to adjourn as provided in Section 3.10 of these bylaws. Every act or decision done or made by a majority of the directors present at a duly held meeting at which a quorum is present shall be regarded as the act of the board of directors, subject to the provisions of the certificate of incorporation and other applicable law.

A meeting at which a quorum is initially present may continue to transact business notwithstanding the withdrawal of directors, if any action taken is approved by at least a majority of the required quorum for that meeting.

### 3.9 **Waiver of Notice**

Notice of a meeting need not be given to any director (i) who signs a waiver of notice or a consent to holding the meeting or an approval of the minutes thereof, whether before or after the meeting, or (ii) who attends the meeting without protesting, prior thereto or at its commencement, the lack of notice to such directors. All such waivers, consents, and approvals shall be filed with the corporate records or made part of the minutes of the meeting. A waiver of notice need not specify the purpose of any regular or special meeting of the board of directors.

### 3.10 **Adjournment**

A majority of the directors present, whether or not constituting a quorum, may adjourn any meeting to another time and place.

### 3.11 **Notice of Adjournment**

Notice of the time and place of holding an adjourned meeting need not be given unless the meeting is adjourned for more than twenty-four (24) hours. If the meeting is adjourned for more than twenty-four (24) hours, then notice of the time and place of the adjourned meeting shall be given before the adjourned meeting takes place, in the manner specified in Section 3.7 of these bylaws, to the directors who were not present at the time of the adjournment.

### **3.12 Board Action by Written Consent Without a Meeting**

Any action required or permitted to be taken by the board of directors may be taken without a meeting, provided that all members of the board individually or collectively consent in writing or by electronic transmission to that action. Such action by written consent shall have the same force and effect as a unanimous vote of the board of directors. Such consent or consents and any counterparts thereof shall be filed with the minutes of the proceedings of the board in the same paper or electronic form as the minutes are maintained.

### **3.13 Fees and Compensation of Directors**

Directors and members of committees may receive such compensation, if any, for their services and such reimbursement of expenses as may be fixed or determined by resolution of the board of directors. This Section 3.13 shall not be construed to preclude any director from serving the corporation in any other capacity as an officer, agent, employee or otherwise and receiving compensation for those services.

### **3.14 Approval of Loans to Officers**

The corporation may lend money to, or guarantee any obligation of, or otherwise assist any officer or other employee of the corporation or any of its subsidiaries, including any officer or employee who is a director of the corporation or any of its subsidiaries, whenever, in the judgment of the directors, such loan, guaranty or assistance may reasonably be expected to benefit the corporation. The loan, guaranty or other assistance may be with or without interest and may be unsecured, or secured in such manner as the board of directors shall approve, including, without limitation, a pledge of shares of stock of the corporation. Nothing contained in this Section shall be deemed to deny, limit or restrict the powers of guaranty or warranty of the corporation at common law or under any statute.

## **Article IV Committees**

### **4.1 Committees of Directors**

The board of directors may, by resolution adopted by a majority of the authorized number of directors, designate one (1) or more committees, each consisting of one or more directors, to serve at the pleasure of the board. The board may designate one (1) or more directors as alternate members of any committee, who may replace any absent or disqualified member at any meeting of the committee. The appointment of members or alternate members of a committee requires the vote of a majority of the authorized number of directors. Any committee, to the extent provided in the resolution of the board, shall have and may exercise all the powers and authority of the board, but no such committee shall have the power or authority to:

- a. approve or adopt, or recommend to the stockholders, any action or matter expressly required by the Delaware General Corporation Law to be submitted to stockholders for approval; or
- b. adopt, amend or repeal any bylaw of the corporation.

#### **4.2 Meetings and Action of Committees**

Meetings and actions of committees shall be governed by, and held and taken in accordance with, the provisions of Article III of these bylaws, Section 3.5 (place of meetings), Section 3.6 (regular meetings), Section 3.7 (special meetings and notice), Section 3.8 (quorum), Section 3.9 (waiver of notice), Section 3.10 (adjournment), Section 3.11 (notice of adjournment), and Section 3.12 (action without meeting), with such changes in the context of those bylaws as are necessary to substitute the committee and its members for the board of directors and its members; provided, however, that the time of regular meetings of committees may be determined either by resolution of the board of directors or by resolution of the committee, that special meetings of committees may also be called by resolution of the board of directors, and that notice of special meetings of committees shall also be given to all alternate members, who shall have the right to attend all meetings of the committee. The board of directors may adopt rules for the government of any committee not inconsistent with the provisions of these bylaws.

#### **4.3 Committee Minutes**

Each committee shall keep regular minutes of its meetings and report the same to the board of directors when requested.

### **Article V Officers**

#### **5.1 Officers**

The officers of the corporation shall be a chief executive officer, a president, a secretary, and a chief financial officer. The corporation may also have, at the discretion of the board of directors, a chairman of the board, one or more vice presidents, and such other officers as may be appointed in accordance with the provisions of Section 5.3 of these bylaws. Any number of offices may be held by the same person.

#### **5.2 Election of Officers**

The officers of the corporation, except such officers as may be appointed in accordance with the provisions of Section 5.3 or Section 5.5 of these bylaws, shall be chosen by the board, subject to the rights, if any, of an officer under any contract of employment.

### 5.3 Subordinate Officers

The board of directors may appoint, or may empower the chief executive officer or president to appoint, such other officers as the business of the corporation may require, each of whom shall hold office for such period, have such authority, and perform such duties as are provided in these bylaws or as the board of directors or such empowered officer may from time to time determine.

### 5.4 Removal and Resignation of Officers

Subject to the rights, if any, of an officer under any contract of employment, any officer may be removed, either with or without cause, by the board of directors at any regular or special meeting of the board or, except in case of an officer chosen by the board of directors, by any officer upon whom such power of removal may be conferred by the board of directors.

Any officer may resign at any time by giving notice to the corporation. Any resignation shall take effect at the date of the receipt of that notice or at any later time specified in that notice; and, unless otherwise specified in that notice, the acceptance of the resignation shall not be necessary to make it effective. Any resignation is without prejudice to the rights, if any, of the corporation under any contract to which the officer is a party.

### 5.5 Vacancies In Offices

A vacancy in any office because of death, resignation, removal, disqualification or any other cause shall be filled in the manner prescribed in these bylaws for regular appointments to that office.

### 5.6 Chairman of the Board

The chairman of the board, if such an officer be elected, shall, if present, preside at meetings of the board of directors and exercise and perform such other powers and duties as may from time to time be assigned by the board of directors or as may be prescribed by these bylaws.

### 5.7 Chief Executive Officer

Subject to the control of the board of directors, the chief executive officer shall have general supervision, direction, and control of the business and the officers of the corporation. The chief executive officer shall have such other duties and powers as may be prescribed from time to time by the board of directors or these bylaws.

### 5.8 President

The president shall have such powers and perform such duties as from time to time may be prescribed by these bylaws, the chief executive officer or the board of directors.



## **5.9 Vice Presidents**

The vice presidents shall have such powers and perform such duties as from time to time may be prescribed for them respectively by these bylaws, the chief executive officer or the board of directors.

## **5.10 Secretary**

The secretary shall keep or cause to be kept, at the principal executive office of the corporation or such other place as the board of directors may direct, a book of minutes of all meetings and actions of directors, committees of directors and stockholders. The minutes shall show the time and place of each meeting, whether regular or special (and, if special, how authorized and the notice given), the names of those present at directors' meetings or committee meetings, the number of shares present or represented at stockholders' meetings, and the proceedings thereof.

The secretary shall keep, or cause to be kept, at the principal executive office of the corporation or at the office of the corporation's transfer agent or registrar, as determined by resolution of the board of directors, a share register, or a duplicate share register, showing the names of all stockholders and their addresses, the number and classes of shares held by each, the number and date of certificates evidencing such shares, and the number and date of cancellation of every certificate surrendered for cancellation.

The secretary shall give, or cause to be given, notice of all meetings of the stockholders and of the board of directors required to be given by law or by these bylaws, shall keep the seal of the corporation, if one be adopted, in safe custody and shall have such other powers and perform such other duties as may be prescribed by the chief executive officer, board of directors or by these bylaws.

## **5.11 Chief Financial Officer**

The chief financial officer shall keep and maintain, or cause to be kept and maintained, adequate and correct books and records of accounts of the properties and business transactions of the corporation, including accounts of its assets, liabilities, receipts, disbursements, gains, losses, capital, retained earnings, and shares. The books of account shall at all reasonable times be open to inspection by any director.

The chief financial officer shall deposit all money and other valuables in the name and to the credit of the corporation with such depositaries as may be designated by the board of directors. The chief financial officer shall disburse the funds of the corporation as may be ordered by the board of directors, shall render to the president and directors, whenever they request it, an account of all transactions effected as chief financial officer and of the financial condition of the corporation, and shall have such other powers and perform such other duties as may be prescribed by the chief executive officer, board of directors or these bylaws.

# **Article VI**

## **Indemnification of Directors, Officers, Employees and Other Agents**

### **6.1 Indemnification of Directors and Officers**

The corporation shall, to the maximum extent and in the manner permitted by the General Corporation Law of Delaware as the same now exists or may hereafter be amended, indemnify any person against expenses (including attorneys' fees), judgments, fines, and amounts actually and reasonably incurred in connection with any threatened, pending or completed action, suit, or proceeding, whether civil, criminal, administrative or investigative, including any settlement thereof, in which such person was or is a party or is threatened to be made a party by reason of the fact that such person is or was a director or officer of the corporation. For purposes of this Article VI, a "director" or "officer" of the corporation shall mean any person (i) who is or was a director or officer of the corporation, (ii) who is or was serving at the request of the corporation as a director or officer of another corporation, partnership, joint venture, trust or other enterprise, or (iii) who was a director or officer of a corporation which was a predecessor corporation of the corporation or of another enterprise at the request of such predecessor corporation.

The corporation shall be required to indemnify a director or officer in connection with an action, suit, or proceeding (or part thereof) initiated by such director or officer only if the initiation of such action, suit, or proceeding (or part thereof) by the director or officer was authorized by the board of directors of the corporation.

The corporation shall pay the expenses (including attorney's fees) incurred by a director or officer of the corporation entitled to indemnification hereunder in defending any action, suit or proceeding referred to in this Section 6.1 in advance of its final disposition; provided, however, that payment of expenses incurred by a director or officer of the corporation in advance of the final disposition of such action, suit or proceeding shall be made only upon receipt of an undertaking by the director or officer to repay all amounts advanced if it should ultimately be determined that the director or officer is not entitled to be indemnified under this Section 6.1 or

otherwise.

This Section shall create a right of indemnification for each person referred to above, whether or not the proceeding to which the indemnification relates arose in whole or in part prior to the adoption of this Section, and in the event of death, such right shall extend to such person's legal representatives. The rights conferred on any person by this Section shall not be exclusive of any other rights which such person may have or hereafter acquire under any statute, provision of the certificate of incorporation, these bylaws, agreement, vote of the stockholders or disinterested directors or otherwise. Any repeal or modification of the foregoing provisions of this Section shall not adversely affect any right or protection hereunder of any person in respect of any act or omission occurring prior to the time of such repeal or modification.

## **6.2 Indemnification of Others**

The corporation shall have the power, to the maximum extent and in the manner permitted by the General Corporation Law of Delaware as the same now exists or may hereafter be amended, to indemnify any person (other than directors and officers) against expenses (including attorneys' fees), judgments, fines, and amounts actually and reasonably incurred in connection with any threatened, pending or completed action, suit, or proceeding, whether civil, criminal, administrative or investigative, including any settlement thereof, in which such person was or is a party or is threatened to be made a party by reason of the fact that such person is or was an employee or agent of the corporation. For purposes of this Article VI, an "employee" or "agent" of the corporation (other than a director or officer) shall mean any person (i) who is or was an employee or agent of the corporation, (ii) who is or was serving at the request of the corporation as an employee or agent of another corporation, partnership, joint venture, trust or other enterprise, or (iii) who was an employee or agent of a corporation which was a predecessor corporation of the corporation or of another enterprise at the request of such predecessor corporation.

## **6.3 Insurance**

The corporation may purchase and maintain insurance on behalf of any person who is or was a director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise against any liability asserted against him or her and incurred by him or her in any such capacity, or arising out of his or her status as such, whether or not the corporation would have the power to indemnify him or her against such liability under the provisions of the General Corporation Law of Delaware.

## **6.4 Claims**

If a claim for indemnification under Section 6.1 (following the final disposition of such proceeding) is not paid in full within sixty (60) days after the corporation has received a claim therefor by a director or officer entitled to indemnification thereunder, or if a claim for any advancement of expenses under Section 6.1 is not paid in full within thirty (30) days after the corporation has received a statement or statements requesting such amounts be advanced, such director or officer shall thereupon (but not before) be entitled to file suit to recover the unpaid amount of such claim. If successful in whole or in part, such director or officer shall be entitled to be paid the expense of prosecuting such claim to the fullest extent permitted by law. In any such action, the corporation shall have the burden of proving that such director or officer is not entitled to the requested indemnification or advancement of expenses under applicable law.

## **Article VII Records and Reports**

### **7.1 Maintenance and Inspection of Records**

The corporation shall, either at its principal executive office or at such place or places as designated by the board of directors, keep a record of its stockholders listing their names and addresses and the number and class of shares held by each stockholder, a copy of these bylaws as amended to date, accounting books and other records of its business and properties.

Any stockholder of record, in person or by attorney or other agent, shall, upon written demand under oath stating the purpose thereof, have the right during the usual hours for business to inspect for any proper purpose the corporation's stock ledger, a list of its stockholders, and its other books and records and to make copies or extracts therefrom. A proper purpose shall mean a purpose reasonably related to such person's interest as a stockholder. In every instance where an attorney or other agent is the person who seeks the right to inspection, the demand under oath shall be accompanied by a power of attorney or such other writing that authorizes the attorney or other agent to so act on behalf of the stockholder. The demand under oath shall be directed to the corporation at its registered office in Delaware or at its principal place of business.

### **7.2 Inspection By Directors**

Any director shall have the right to examine (and to make copies of) the corporation's stock Any director shall have the right to examine (and to make copies of) the corporation's stock ledger, a list of its stockholders and its other books and records for a purpose reasonably related to his or her position as a director.

### **7.3 Representation of Shares of Other Corporations**

The chairman of the board, if any, the president, any vice president, the chief financial officer, the secretary or any assistant secretary of this corporation, or any other person authorized by the board of directors or the president or a vice president, is authorized to vote, represent and exercise on behalf of this corporation all rights incident to any and all shares of the stock of any other corporation or corporations standing in the name of this corporation. The authority herein granted may be exercised either by such person directly or by any other person authorized to do so by proxy or power of attorney duly executed by such person having the authority.

### **7.4 Certification and Inspection of Bylaws**

The original or a copy of these bylaws, as amended or otherwise altered to date, certified by the secretary, shall be kept at the corporation's principal executive office and shall be open to inspection by the stockholders of the corporation, at all reasonable times during office hours.

## **Article VIII General Matters**

### **8.1 Record Date for Purposes Other than Notice and Voting**

For purposes of determining the stockholders entitled to receive payment of any dividend or other distribution or allotment of any rights or the stockholders entitled to exercise any rights in respect of any other lawful action, the board of directors may fix, in advance, a record date, which shall not be more than sixty (60) days before any such action. In that case, only stockholders of record at the close of business on the date so fixed are entitled to receive the dividend, distribution or allotment of rights, or to exercise such rights, as the case may be, notwithstanding any transfer of any shares on the books of the corporation after the record date so fixed, except as otherwise provided in the General Corporation Law of Delaware.

If the board of directors does not so fix a record date, then the record date for determining stockholders for any such purpose shall be at the close of business on the day on which the board adopts the applicable resolution.

### **8.2 Checks; Drafts; Evidences of Indebtedness**

From time to time, the board of directors shall determine by resolution which person or persons may sign or endorse all checks, drafts, other orders for payment of money, notes or other evidences of indebtedness that are issued in the name of or payable to the corporation, and only the persons so authorized shall sign or endorse those instruments.

### **8.3 Corporate Contracts and Instruments: How Executed**

The board of directors, except as otherwise provided in these bylaws, may authorize any officer or officers, or agent or agents, to enter into any contract or execute any instrument in the name of and on behalf of the corporation; such authority may be general or

confined to specific instances. Unless so authorized or ratified by the board of directors or within the agency power of an officer, no officer, agent or employee shall have any power or authority to bind the corporation by any contract or engagement or to pledge its credit or to render it liable for any purpose or for any amount.

#### **8.4 Stock Certificates; Transfer; Partly Paid Shares**

The shares of the corporation shall be represented by certificates, provided that the board of directors of the corporation may provide by resolution or resolutions that some or all of any or all classes or series of its stock shall be uncertificated shares. Any such resolution shall not apply to shares represented by a certificate until such certificate is surrendered to the corporation. Notwithstanding the adoption of such a resolution by the board of directors, every holder of stock represented by certificates and, upon request, every holder of uncertificated shares, shall be entitled to have a certificate signed by, or in the name of the corporation by, the chairman or vice-chairman of the board of directors, or the president or any vice president, and by the

treasurer or an assistant treasurer, or the secretary or an assistant secretary of such corporation representing the number of shares registered in certificate form. Any or all of the signatures on the certificate may be a facsimile.

In case any officer, transfer agent or registrar who has signed or whose facsimile signature has been placed upon a certificate has ceased to be such officer, transfer agent or registrar before such certificate is issued, it may be issued by the corporation with the same effect as if he or she were such officer, transfer agent or registrar at the date of issue.

Certificates for shares shall be of such form and device as the board of directors may designate and shall state the name of the record holder of the shares represented thereby; its number; date of issuance; the number of shares for which it is issued; a summary statement or reference to the powers, designations, preferences or other special rights of such stock and the qualifications, limitations or restrictions of such preferences and/or rights, if any; a statement or summary of liens, if any; a conspicuous notice of restrictions upon transfer or registration of transfer, if any; a statement as to any applicable voting trust agreement; if the shares be assessable, or, if assessments are collectible by personal action, a plain statement of such facts.

Upon surrender to the secretary or transfer agent of the corporation of a certificate for shares duly endorsed or accompanied by proper evidence of succession, assignment or authority to transfer, it shall be the duty of the corporation to issue a new certificate to the person entitled thereto, cancel the old certificate and record the transaction upon its books.

The corporation may issue the whole or any part of its shares as partly paid and subject to call for the remainder of the consideration to be paid therefor. Upon the face or back of each stock certificate issued to represent any such partly paid shares, or upon the books and records of the corporation in the case of uncertificated partly paid shares, the total amount of the consideration to be paid therefor and the amount paid thereon shall be stated. Upon the declaration of any dividend on fully paid shares, the corporation shall declare a dividend upon partly paid shares of the same class, but only upon the basis of the percentage of the consideration actually paid thereon.

#### **8.5 Special Designation On Certificates**

If the corporation is authorized to issue more than one class of stock or more than one series of any class, then the powers, the designations, the preferences and the relative, participating, optional or other special rights of each class of stock or series thereof and the qualifications, limitations or restrictions of such preferences and/or rights shall be set forth in full or summarized on the face or back of the certificate that the corporation shall issue to represent such class or series of stock; provided, however, that, except as otherwise provided in Section 202 of the General Corporation Law of Delaware, in lieu of the foregoing requirements there may be set forth on the face or back of the certificate that the corporation shall issue to represent such class or series of stock a statement that the corporation will furnish without charge to each stockholder who so requests the powers, the designations, the preferences and the relative, participating, optional or other special rights of each class of stock or series thereof and the qualifications, limitations or restrictions of such preferences and/or rights.

## **8.6 Lost Certificates**

Except as provided in this Section 8.6, no new certificates for shares shall be issued to replace a previously issued certificate unless the latter is surrendered to the corporation and cancelled at the same time. The board of directors may, in case any share certificate or certificate for any other security is lost, stolen or destroyed, authorize the issuance of replacement certificates on such terms and conditions as the board may require; the board may require indemnification of the corporation secured by a bond or other adequate security sufficient to protect the corporation against any claim that may be made against it, including any expense or liability, on account of the alleged loss, theft or destruction of the certificate or the issuance of the replacement certificate.

## **8.7 Transfer Agents and Registrars**

The board of directors may appoint one or more transfer agents or transfer clerks, and one or more registrars, each of which shall be an incorporated bank or trust company - either domestic or foreign, who shall be appointed at such times and places as the requirements of the corporation may necessitate and the board of directors may designate.

## **8.8 Construction; Definitions**

Unless the context requires otherwise, the general provisions, rules of construction, and definitions in the General Corporation Law of Delaware shall govern the construction of these bylaws. Without limiting the generality of this provision, the singular number includes the plural, the plural number includes the singular, and the term “person” includes both a corporation and a natural person.

## **8.9 Forum Selection**

Unless the corporation consents in writing to the selection of an alternative forum, the Court of Chancery of the State of Delaware (the “Court of Chancery”) shall be the sole and exclusive forum for any stockholder (including a beneficial owner) to bring (i) any derivative action or proceeding brought on behalf of the corporation, (ii) any action asserting a claim of breach of a fiduciary duty owed by any director, officer or other employee of the corporation to the corporation or the corporation’s stockholders, (iii) any action asserting a claim against the corporation, its directors, officers or employees arising pursuant to any provision of the General Corporation Law of Delaware or the corporation’s certificate of incorporation or bylaws, or (iv) any action asserting a claim against the corporation, its directors, officers or employees governed by the internal affairs doctrine, except as to each of (i) through (iv) above, for any claim as to which the Court of Chancery determines that there is an indispensable party not subject to the jurisdiction of the Court of Chancery (and the indispensable party does not consent to the personal jurisdiction of the Court of Chancery within ten (10) days following such determination), which is vested in the exclusive jurisdiction of a court or forum other than the Court of Chancery, or for which the Court of Chancery does not have subject matter jurisdiction. If any provision or provisions of this Section 8.9 shall be held to be invalid, illegal or

unenforceable as applied to any person or entity or circumstance for any reason whatsoever, then, to the fullest extent permitted by law, the validity, legality and enforceability of such provisions in any other circumstance and of the remaining provisions of this Section 8.9 (including, without limitation, each portion of any sentence of this Section 8.9 containing any such provision held to be invalid, illegal or unenforceable that is not itself held to be invalid, illegal or unenforceable) and the application of such provision to other persons or entities and circumstances shall not in any way be affected or impaired thereby. Any person or entity purchasing or otherwise acquiring any interest in shares of capital stock of the corporation shall be deemed to have notice of and to have consented to this Section. If any action, the subject matter of which is within the scope of the first sentence of this Section, is filed in a court other than the Court of Chancery (a “Foreign Action”) in the name of any stockholder, such stockholder shall be deemed to have consented to (i) the personal jurisdiction of the Court of Chancery in connection with any action brought in any such court to enforce the first sentence of this Section and (ii) having service of process made upon such stockholder in any such action by service upon such stockholder’s counsel in the Foreign Action as agent for such stockholder.

#### **8.10 Electronic Signatures**

Any document, including, without limitation, any consent, agreement, certificate or instrument, required by the General Corporation Law of Delaware, the certificate of incorporation or these bylaws to be executed by any officer, director, stockholder, employee or agent of the corporation may be executed using a facsimile or other form of electronic signature to the fullest extent permitted by applicable law. All other contracts, agreements, certificates or instruments to be executed on behalf of the corporation may be executed using a facsimile or other form of electronic signature to fullest extent permitted by applicable law.

### **Article IX Amendments**

The original or other bylaws of the corporation may be adopted, amended or repealed by the stockholders entitled to vote or by the board of directors of the corporation. The fact that such power has been so conferred upon the directors shall not divest the stockholders of the power, nor limit their power to adopt, amend or repeal bylaws.

Whenever an amendment or new bylaw is adopted, it shall be copied in the book of bylaws with the original bylaws, in the appropriate place. If any bylaw is repealed, the fact of repeal with the date of the meeting at which the repeal was enacted or the filing of the operative written consent(s) shall be stated in said book.



**THIRD AMENDMENT TO THE  
MANAGING DIRECTOR AGREEMENT**

(the "**Third Amendment Agreement**")

between

- (1) SKYRAGER GmbH, Jack-Wolfskin-Kreisel 1, 65510 Idstein, Germany, registered with the commercial register of the local court Wiesbaden under HRB 19424, represented by its sole shareholder JW STARGAZER Holding GmbH

- hereinafter referred to as the "**Company**" -

and

- (2) Ms. Melody Harris-Jensbach, Brabanter Str. 39/ DG, 50672 Cologne, Germany

- hereinafter referred to as "**Ms. Harris-Jensbach**" -

- the Company and Ms. Harris-Jensbach hereinafter individually also referred to as a "**Party**" and collectively as the "**Parties**" -

**PREAMBLE**

The Parties intend to amend the Managing Director Agreement dated September 29, 2014, entered into by Ms. Harris-Jensbach and JW Germany GmbH, amended with Amendment Agreement dated April 11, 2016 ( "First Amendment Agreement"), transferred to the Company with Transfer of Contract Agreement dated May 24, 2017 and further amended with Amendment to the Managing Director Service Agreement dated August 21, 2018 ( "Second Amendment Agreement", and collectively with the First Amendment Agreement, Transfer of Contract Agreement, and this Third Amendment Agreement, the " **Managing Director Agreement**". Capitalized terms used but not otherwise defined herein shall have the meanings assigned to them in the Managing Director Agreement.

The Managing Director Agreement has a fixed term ending December 31, 2019. The Parties have agreed to extend the term of the Managing Director Agreement until December 31, 2020 and to amend the Managing Director Agreement with regards to the reimbursement of travel

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cost. The Parties have furthermore noticed a misleading reference in cl. 1.2 of the Second Amendment Agreement and have agreed to correct such misleading reference through this Third Amendment Agreement. Lastly, the Parties have also agreed to amend cl. 17 of the Managing Director Agreement to add Callaway Germany Holdco GmbH, JW Stargazer Holding GmbH and Jack Wolfskin Ausrüstung für Draussen GmbH & Co. KGaA to the list of entities that the Company may transfer the Managing Director Agreement and the service relationship between the Parties to pursuant to the terms contained therein.

Now therefore, the Parties agree to the following amendment to the Managing Director Agreement:

### 1. AMENDMENT

- 1.1 Clause 1.2, first sentence, of the Second Amendment Agreement incorrectly refers to cl. 3.2.1 instead of cl. 3.2.a. of the Managing Director Agreement. The reference to cl. 3.2.1 in cl. 1.2., first sentence, of the Second Amendment Agreement shall be replaced as follows:

*Clause 3.2.a., first sentence, of the Managing Director Agreement shall be replaced by the following sentence:*

For the avoidance of doubt, all other provisions of cl. 1.2. of the Second Amendment Agreement and the change of the Managing Director Agreement effected with such cl. 1.2 of the Second Amendment Agreement shall remain unchanged.

- 1.2 Clause 3.3 of the Managing Director Agreement shall be deleted in its entirety and replaced by the following cl. 3.3:

*The Parties will enter into negotiations with regards to the prolongation of the Fixed Term of the Managing Director Agreement beyond December 31, 2020 as well as the commercial terms of such prolongation in good faith by no later than September 1, 2019 and shall use reasonable efforts to complete such negotiations by no later than October 31, 2019. However, unless mutually agreed otherwise in writing, there shall be no claim for a prolongation of the Managing Director Agreement beyond the Fixed Term as set forth in cl. 11.1 of the Managing Director Agreement or a change of commercial terms for either Party.*

- 1.3 Clause 6 of the Managing Director Agreement shall be replaced by the following cl. 6:

*Travel cost and miscellaneous expenditures that Ms. Harris-Jensbach incurs in exercising her duties within the scope of her activities for the Company and JW shall be refunded to her. Such travel cost shall include reasonable travel expenses (if any) incurred by Ms. Harris-Jensbach for commuting between the Company's or JW's offices and Ms. Harris-Jensbach's respective domicile. In case of such reimbursement being subject to taxes and/or any other statutory deductions (e.g. wage tax to be withheld by the Company), Ms. Harris-Jensbach shall bear such taxes / deductions. Any reimbursement shall be subject to the provisions of this Managing Director Agreement as well as the respective guidelines of the Company and JW as applicable from time to time whereas*

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*in case of a conflict, the provisions of this Managing Director Agreement shall prevail. For the avoidance of doubt, expenses in relation to the use of the company car as set forth in cl. 5 of the Managing Director Agreement shall be governed by cl. 5 of this Managing Director Agreement only.*

- 1.4 Clause 11.1 of the Managing Director Agreement shall be amended as follows:

*The term of the Managing Director Agreement is prolonged beyond December 31, 2019 by further one (1) year, i.e. the Fixed Term (as defined in the Managing Director Agreement) is extended until December 31, 2020.*

- 1.5 Clause 17 of the Managing Director Agreement shall be deleted in its entirety and replaced by the following cl. 17:

*The Company reserves the right to transfer this Agreement and the service relationship between the Parties, including all rights and obligations, to the following entities at any time during the Fixed Term: (i) Callaway Germany Holdco GmbH, (ii) JW Stargazer Holding GmbH, (iii) Jack Wolfskin Ausrüstung für Draussen GmbH & Co. KGaA, or (iv) SKYRAGER GmbH (each a "**Transfer**"). Ms. Harris-Jensbach hereby agrees to the Transfer. If the Transfer occurs, the Company shall be released from any and all liabilities under or in connection with this Agreement and the service relationship between the Parties. Ms. Harris-Jensbach shall make all declarations and render all actions necessary to effect the Transfer.*

- 1.6 All other provisions of the Managing Director Agreement shall remain unchanged and in full force and effect.

## **2. FINAL PROVISIONS**

- 2.1 This Third Amendment Agreement shall be governed by and construed in accordance with German law.
- 2.2 Amendments and additions to this Third Amendment Agreement shall require written form and the express consent of the shareholders' meeting. This also applies to the cancellation of the written form requirement.
- 2.3 Should any of the provisions of this Third Amendment Agreement be or become ineffective or impracticable in whole or in part, or should the Parties have inadvertently omitted any provision with respect to this Third Amendment Agreement, this shall not affect the validity of the remaining provisions of this Third Amendment Agreement. Any such ineffective or impracticable provision shall be replaced, or any such gap be filled, by an effective and practicable provision that comes closest to the intent and purpose of the ineffective, impracticable or lacking provision.
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Idstein, June 5, 2019

SKYRAGER GmbH

represented by its sole shareholder JW STARGAZER Holding GmbH

/s/ Markus Bötsch                      /s/ Jörg Wahlers

By: Markus Bötsch                      Jörg Wahlers

Title: Managing Director              Title: Managing Director

/s/ Melody Harris-Jensbach  
Melody Harris-Jensbach

**CERTIFICATION**

I, Oliver G. Brewer III, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Callaway Golf Company;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ OLIVER G. BREWER III

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**Oliver G. Brewer III**  
**President and Chief Executive Officer**

Dated: August 9, 2019

**CERTIFICATION**

I, Brian P. Lynch, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Callaway Golf Company;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ BRIAN P. LYNCH

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**Brian P. Lynch**  
Senior Vice President, Chief Financial Officer

Dated: August 9, 2019

**CERTIFICATION PURSUANT  
TO 18 U.S.C. SECTION 1350  
AS ADOPTED PURSUANT TO SECTION 906  
OF THE SARBANES-OXLEY ACT OF 2002**

Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, each of the undersigned officers of Callaway Golf Company, a Delaware corporation (the “Company”), does hereby certify with respect to the Quarterly Report of the Company on Form 10-Q for the quarterly period ended June 30, 2019, as filed with the Securities and Exchange Commission (the “10-Q Report”), that:

- (1) the 10-Q Report fully complies with the requirements of Sections 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- (2) the information contained in the 10-Q Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

The undersigned have executed this Certification effective as of August 9, 2019.

/S/ OLIVER G. BREWER III

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**Oliver G. Brewer III**  
President and Chief Executive Officer

/S/ BRIAN P. LYNCH

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**Brian P. Lynch**  
Senior Vice President, Chief Financial Officer