CALLAWAY GOLF COMPANY FIRST QUARTER 2022
EARNINGS CALL PREPARED REMARKS

Lauren Scott, Director of Investor Relations

Thank you, operator and good afternoon, everyone. Welcome to Callaway's first quarter 2022 earnings conference call. I'm Lauren Scott, the Company's Director of Investor Relations. Joining me as speakers on today's call are Chip Brewer, our President and Chief Executive Officer, and Brian Lynch, our Chief Financial Officer. Patrick Burke, Callaway's SVP of Global Finance, and Jennifer Thomas, our Chief Accounting Officer are also in the room today for Q&A.

Earlier today, the Company issued a press release announcing its first quarter 2022 financial results. In addition, there is a presentation that accompanies today's prepared remarks and may make it easier for you to follow the call. This earnings presentation, as well as the earnings press release, are both available on the Company's Investor Relations website under the "Financial Results" tab.

Most of the financial numbers reported and discussed on today's call are based on U.S. Generally Accepted Accounting Principles. In the instances where we report non-GAAP measures, we have reconciled the non-GAAP measures to the corresponding GAAP measures at the back of the presentation in accordance with Regulation G. Please note that this call will include forward-looking statements that involve risks and uncertainties that could cause actual results to differ materially from management's current expectations. We encourage you to review the safe harbor statements contained in the presentation and the press release for a more complete description.

And with that, I would now like to turn the call over to Chip Brewer.

Chip Brewer, President and Chief Executive Officer

Thank you, Lauren. Good afternoon and thank you for joining us today.

To start, I want to thank all of the analysts and investors who joined us in person or online for our Investor Day on April 26th. I speak for our whole leadership team when I say that we enjoyed having the opportunity to interact with you, and hope you walked away with a better understanding and appreciation of our business strategy and vision for the future. If you missed our event, I encourage you to review the materials on our IR website, as you will continue to hear us reference our growth framework as we track toward our long-term goals.

Shifting to Q1, I am pleased to report a very strong start to the year, with all three of our business segments contributing to our success. Total net revenue was just over one billion dollars, up 60% year-over-year on a reported basis, or up 31% on a pro forma basis, which includes Topgolf revenue for the full quarter of last year. Flowthrough to the bottom line was strong as well, with Adjusted EBITDA of $170 million, up 33% on a reported basis, or up 31% on a pro forma basis. These results clearly show the continued momentum in our business and give us increasing confidence as we look out over the full year and the long-term.

Shifting to our segment overview, I will first start with Topgolf's Q1 results.

The Topgolf team put up another outstanding quarter. At the time of our last earnings report in February, Topgolf's venue business had been impacted by reduced traffic and a lighter events business due to Omicron. However, as the quarter progressed, this early softness was replaced by a strong resurgence in demand. In March alone, same venue sales vs. 2019 were up approximately 10%, which drove full quarter same venue sales up 2%, thus beating our February earnings call forecast of down slightly.

New venue openings remained on track in Q1 and continued to open extremely well. During the quarter, we opened one new owned and operated venue in Ontario, California and one new franchise venue in Germany. Additionally, in mid-April, we opened our new El Segundo location in Los Angeles, California. I am happy to report that all of these locations are exceeding expectations, as the venues team continues to impress, and our brand appears to be building momentum.

As a result of these terrific results, we are increasing our same venue sales projections for Q2 and the balance of the year to up high single digits vs. 2019. This would put our full year, same venue sales up an impressive mid to high single digits. Operating margins also remain healthy, as Artie and the team have been able to take price as well as drive both increased event business and overall venue efficiencies. This combination is allowing our overall margins to outpace any inflationary pressures, all while maintaining a superior guest experience.

Turning to the Toptracer business, we installed 1,159 new bays in Q1 and believe we are on track for 8,000 or more bays this year. Feedback on the product and demand remains strong plus we are building resources to ramp installations.

Taking a step back, I hope we all can agree that this is quickly becoming a proven business and that it has a track record of success across any size, geography, climate – you name it. Our ability to continue to put up quarter-after-quarter of successful results makes us increasingly confident in this unique business and the long-term outlook presented at our Investor Day.

As we look out over the next few years, we believe Topgolf will be a significant source of long-term value creation. Already in 2022 it is forecast to be our largest segment by revenue and, even with the strong growth forecast across our other business segments, this segment alone is expected to account for more than half of our total Adjusted EBITDA by 2025. Topgolf is the keystone of our Modern Golf thesis. It already is the dominant leader in the dynamic off-course golf industry, and we believe it will maintain this position given its significant growth prospects ahead.

Moving to Golf Equipment, this business had another excellent quarter with revenue up 24% year over year; and, as we mentioned at the investor conference, we expect this segment to be up 10% for the full year.

We continue to see strong demand globally for golf equipment, especially from avid golfers. According to Datatech, in the US, despite comparatively poor weather conditions this year, Q1 hard good sell through was down just 2.8% vs. 2021 and remained up 44.5% over 2019. Outside the US, in key markets such as Japan, Korea and Europe; we saw Q1 hard goods sell through up nicely year over year. Also, as the fitting portion of the season opens up, we are seeing market share gains for our 2022 products, especially our Rogue ST drivers and fairway woods, as well as our Chrome Soft golf balls. For Q1, we finished as the # 1 hard goods brand in the US and, in March, we delivered a new record US golf ball market share of 22%.

On the manufacturing side, our supply chain is continuing to perform well; and, although supply has not caught up to demand, we believe our strong partnerships, scale and regional diversification have provided, and will continue to provide, a competitive advantage in being able to deliver products to our customers.

Lastly, the Apparel, Gear and Other Segment had a strong quarter with positive momentum across all of our brands. Callaway's business has remained strong globally, with our apparel business in Asia performing well; and, our gear business – namely golf bags and gloves – delivering both market share and revenue increases. As you may recall from Glenn Hickey's presentation during the Investor Day, increasing our market share in the softgoods category will be a key opportunity within the segment, so we are very pleased with these results.

Meanwhile, TravisMathew had another outstanding quarter, continuing the strong brand momentum across all channels. Our own retail comp store growth was up a stunning 50% in Q1. In addition, TravisMathew announced last week that it is launching its first, dedicated women's apparel collection. While this first rollout is more of a preliminary collection and not a major source of revenue yet; with women accounting for over 25% of the purchases made through TravisMathew's direct to consumer channels, we are both confident in and excited about the opportunity here. Throughout this year we plan to continue to test and expand the offering and we have a more robust launch planned for 2023. As communicated at our Investor Relations day, we see the TravisMathew brand eclipsing $300 million in revenue and $50 million in Adjusted

EBITDA by the end of this year. They have impressive momentum, and we see a clear path to continued growth ahead.

Lastly, the Jack Wolfskin business continues to make good progress. Being a European-based brand, they are dealing with a number of macro headwinds, but I am pleased to report that their new branding campaign and products are being very well received, both based on sell through of current products and pre-books for the future. We believe this brand is on strong footing and positioned for growth ahead. We outlined what we believe is a compelling long-term vision for the brand and its financial objectives at our investor day. When looking at the segment on the whole, we expect the Apparel, Gear & Other segment to deliver approximately $1 billion in net sales for this full year.

In closing, in light of the strong start to the year and our confidence in the key business drivers by segment, we are raising our financial outlook for the balance of the year. We also want to take this moment to reiterate our belief that Callaway is a unique and compelling investment opportunity that will create long-term shareholder value. Our brands have momentum, and they operate in business segments that are attractively positioned in today's world. We are advantaged by scale within the Modern Golf industry, with unmatched global reach to both the traditional golf consumer and the growing off-course player. Our high barriers to entry act as a layer of protection against new competition, and our diversification allows us to mitigate the effects of any potential downturns in any one segment, while also presenting attractive synergy opportunities.

We are confident in our ability to deliver on the growth projections laid out at the Investor Day and believe our 2025 target of surpassing $800 million in Adjusted EBITDA will be achieved by continuing to execute our proven strategy for growth. As stated at the Investor Day, we don't have to do anything fundamentally different, we just have to continue to do the things we have consistently shown that we can and are doing.

And with that, I will hand the call over to Brian to discuss our financials and outlook in more detail.

Brian Lynch, Executive Vice President, Chief Financial Officer & Chief Legal Officer

Thank you, Chip, and good afternoon, everyone.

As Chip mentioned, 2022 is off to a strong start and we are very pleased with our first quarter financial results. We have been saying that we believe there has been a structural shift in the market that will benefit each of our businesses, including increased interest in golf, momentum behind active lifestyle apparel brands and an increased desire for leisure and entertainment such as Topgolf, hiking, and other outdoor activities. And we believe our first quarter results reflect this shift.

Now turning to our financial results in more detail. For the first quarter, consolidated net revenue was $1.04 billion dollars, an increase of 60% compared to our reported Q1 2021 results. As a reminder, we acquired Topgolf on March 8, 2021, and therefore our 2021 first quarter results include only one month of Topgolf. If the full three- month Topgolf results are included, our revenue increased 31% on a pro forma basis. Changes in foreign currency rates had a negative $21.2 million impact on reported first quarter 2022 net revenue compared to the same period in 2021.

Looking at our segment performance, Golf Equipment had another excellent quarter, generating $468 million dollars in revenue, driven by continued high demand and improved supply in our golf clubs and balls business. Topgolf contributed $322 million in revenue and reported same venue sales growth of 2.3% compared to 2019 as guest turnout in the latter part of the quarter, especially in our events business, outpaced some slowness in January and early February due to Omicron. Lastly, Apparel, Gear & Other revenue of $250 million resulted from a 45% increase in apparel sales and a 29% increase in gear and other.

Total cost and expenses were $934 million dollars on a non-GAAP basis in the first quarter of 2022 compared to $555 million dollars in the first quarter of 2021. Of the $379 million dollar increase, Topgolf added an incremental $227 million of total costs and expenses, with the majority of that increase caused by the additional two months of Topgolf costs and expenses versus last year. The balance was driven by variable expenses in the Golf Equipment and Apparel, Gear and Other businesses, increased support at Corporate and the impact of increased freight costs and other inflationary pressures.

First quarter 2022 non-GAAP operating income was $106 million, up $9.5 million year-over-year. Including January and February for Topgolf, pro forma non-GAAP operating income would have increased $27.6 million or 35% year-over-year and operating margins would have increased slightly to 10.2% compared to 9.9% for the first quarter of 2021, despite the negative impact of foreign currency, freight expense and other inflationary pressures previously mentioned.

Diving a bit deeper into some of the inflationary pressures we are seeing. At Topgolf, we are seeing some inflationary pressures on Food and Beverage and Associate wages, which we are more than covering through a combination of sales leverage, operating efficiencies and pricing. We have made relatively modest use of price so far this year, and while our margins are all trending positively, we believe there is an opportunity for additional price increase should we need to offset costs further in the future.

In the non-Topgolf business, we are fully covering the negative impacts of inflationary pressure on raw materials or components via price increases or positive volume variances. Gross margins in the non-Topgolf business, however, were impacted by changes in foreign currency rates as our hedging gains are included in other income. Gross margins were also affected by increased freight costs as freight cost increases ramped throughout 2021 and we also shipped more by air in Q1 2022 to compensate for supply chain disruptions at the end of last year. Year over year comparisons of freight costs should improve as the year progresses.

Overall, we are very pleased with the increase in our consolidated pro forma operating margins and how our businesses are absorbing these various macroeconomic pressures.

Moving back down the income statement, non-GAAP other expense was $22 million in the first quarter, compared to $6 million in Q1 2021, primarily due to a $16 million dollar increase in interest expense related to Topgolf.

Non-GAAP earnings per share was $0.36 on approximately 201 million shares, compared to $0.62 per share on approximately 125 million shares in the first quarter of 2021. The increased share count is primarily related to the issuance of additional shares in connection with the Topgolf merger, along with an accounting change that took effect on January 1, 2022, which requires that we include 14.7 million shares related to the assumed conversion of the Company's convertible notes. I want to remind you that applicable accounting rules do not give any effect to our capped call in calculating EPS, but upon settlement they should reduce the actual number of shares we are required to deliver.

When calculating our earnings per share under this new accounting method, you need to add back approximately $1.6 million of after-tax convertible debt interest expense to Net Income before dividing by the share count. If you are calculating our enterprise value with the convertible note on an if-converted basis, you should exclude the $259 million convertible debt from your calculation and use approximately 200 million as the diluted share count.

Lastly, Q1 Adjusted EBITDA was $170 million, up $42 million, or 33%, over Q1 2021 on an as-reported basis, or up $40 million, or 31%, on a pro forma basis when including Topgolf results for the full three-month period. For Q1 2022, Topgolf contributed $42 million of Adjusted EBITDA.

Turning to certain balance sheet items, we remain in a strong financial position with ample liquidity. As of March 31, 2022, available liquidity, which is comprised of cash-on-hand and availability under our credit facilities, was $576 million dollars compared to $713 million dollars at March 31, 2021. The decrease was driven by planned working capital increases in the Golf Equipment and our soft goods businesses to support growth as well as continued investment in Topgolf. As a reminder, we expect Topgolf to be self-funding in 2023 and cash generating in 2024.

At quarter-end, we had total net debt of $1.710 billion dollars, including venue financing obligations of approximately $625 million related to the development of Topgolf Venues.

Our net debt leverage ratio was approximately 3.5x at March 31, 2022 compared to 5.0x at March 31, 2021.

Our leverage ratio on a funded debt basis was even lower. Consolidated Net Accounts Receivable was $413 million dollars as of March 31, 2022, compared to $329 million dollars at the end of the first quarter of 2021. The increase was primarily driven by the increase in revenue.

Our Inventory balance increased to $552 million dollars at the end of the first quarter of 2022 compared to $534 million at the end of the fourth quarter 2021, as we increased supply to meet forecasted demand. The quality of our inventory is good.

Capital Expenditures for the first quarter 2022 were $74 million dollars, net of REIT reimbursements. This includes $58 million dollars related to Topgolf.

For the full year, we expect total capex of approximately $315 million, net of REIT reimbursements, including approximately $230 million for Topgolf and $85 million for the non-Topgolf business.

Now turning to our full year and second quarter 2022 outlook.

Given our strong Q1 results and confidence in the opportunity for growth throughout the year, we are increasing our full year 2022 revenue expectations to $3.935 billion to $3.970 billion dollars. This estimate assumes approximately $1.56 billion in revenue for Topgolf for the year, approximately $1 billion in revenue from the Apparel, Gear & Other segment, and an increase of approximately 10% in our Golf Equipment segment revenue as compared to full year 2021.

Our full year Adjusted EBITDA also increased and is now projected to be $535 - $555 million dollars, which assumes approximately $225 - $240 million from Topgolf.

To help understand the guidance update, we beat the midpoint of our Q1 guidance range by approximately $32 million. This amount included approximately $10 million in foreign currency benefits, including hedge gains. Excluding these benefits, we beat Q1 by approximately $22 million on an operational basis. We are increasing our full year Adjusted EBITDA guidance by $42.5 million, including an additional estimated $7 million negative foreign currency impact based upon recent rates. In other words, excluding this additional foreign currency impact, we are increasing full year Adjusted EBITDA guidance by approximately $49.5 million from the midpoint on an operational basis. This represents the $22 million non-currency impacted Q1 beat plus an additional non-currency increase of $27.5 million for Q2 to Q4.

For the second quarter, we plan to deliver between $1.085 billion and $1.105 billion dollars of net revenue and $185 to $200 million in Adjusted EBITDA.

We are not immune to foreign currency and inflationary pressures this year, but we believe we can outrun them. The most substantial factor for the year, which we have quantified in our press release today, relates to foreign currency impacts. For the full year, compared to 2021, we expect FX to have a negative revenue impact of approximately $115 million dollars; in Q2, we expect the revenue impact to be approximately $39 million dollars.

Overall, we are pleased with the strong start to the year and are excited about the balance of the year.

That concludes our prepared remarks today and we will now open the call for questions.

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