TOPGOLF CALLAWAY BRANDS CORP. THIRD QUARTER 2022 EARNINGS CALL PREPARED REMARKS

Lauren Scott, Director of Investor Relations

Thank you, operator and good afternoon, everyone. Welcome to Topgolf Callaway Brands' third 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. Jennifer Thomas, our Chief Accounting Officer and Patrick Burke, our Senior Vice President of Global Finance, are also in the room today for Q&A.

Earlier today, the Company issued a press release announcing its third 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 to everyone on our call and thank you for joining us today.

I am pleased to report another quarter of record results for Topgolf Callaway Brands, driven by strength across all of our segments. Total net revenue in the third quarter was $989 million, up 15% year-over-year, or up 21% on a currency neutral basis, while Adjusted EBITDA was $144 million, up 4% year-over-year, or 23% on a currency neutral basis.

The strength of our results underscores our leadership position in the Modern Golf ecosystem and the positive trends we are seeing across our business, highlighted by increased traffic at our Topgolf venues, market share gains in our golf equipment business, and strong brand momentum in our Active Lifestyle segment.

As we look to the balance of this year and into 2023, we are optimistic about our competitive positioning across each segment, the resiliency of our core consumers, and the embedded growth within our business. Over the long term, we believe we can deliver profitable growth across all of our segments as well as a competitive advantage via the scale and synergies of our combined enterprise. We remain confident that off-course golf will continue to be a key driver of growth in the Modern Golf ecosystem and, as our recent rebrand suggests, Topgolf is expected to be an even larger contributor to both top line and bottom-line growth. As you will see in the outlook section, given Topgolf's strong embedded growth, we see that business contributing more than half of our EBITDA in the very near future. An impressive transformation that also demonstrates the long-term advantage of our diversified Modern Golf portfolio.

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

Topgolf venues delivered an impressive 11% same venue sales growth in Q3, driven by a roughly even mix of traffic growth and price. Social events were a particularly strong contributor this quarter, as the venues are increasingly gaining recognition as a preferred place to gather for group events and celebrations.

Looking forward, we believe we can deliver 10% or higher same venue sales for Q4 as well, thus delivering high single digits same venue sales for the full year.

Our strong results and expectations for the business demonstrate Topgolf's distinct position within the market, and underscore its ability to thrive in today's environment. They have created a unique guest experience that makes it easier for players to engage with the sport of golf, while being entertained and socializing with friends.

We remain confident in the sustainable growth outlook for this business, and we believe we have multiple levers still available to positively impact future performance.

For instance, we are continuing to roll out an enhanced digital platform, aimed at increasing our reservation capabilities and bay utilization.

In addition to digital enhancements, Topgolf is also launching an exciting marketing campaign in Q4 of this year. The campaign is intended to further increase both consumer awareness and demand. You will begin to see increased advertisements in select markets as early as this month, with a nationwide rollout early next year.

New venue development remains on schedule, with two new locations opened in Q3, and six new venues scheduled to open in Q4 – the most ever in a single quarter. By the end of the year, we will have 81 total owned venues worldwide, and we are happy to report that our track record for new venues meeting or beating our financial targets remains outstanding.

From an enterprise perspective, investing in the Topgolf venues continues to be our primary use of capital, and one we remain enthusiastic about. The business model is proven, with venues delivering an impressive 40-50% year three cash on cash return and we have a clear roadmap for the growth ahead of us, as we plan to successfully open 11 new venues a year and, at the same time, deliver positive same venue sales growth across existing venues.

Toptracer had a good quarter as well, with approximately 1,600 bays installed. For the full year, we now estimate that we will install between 7,000 and 8,000 new bays. Customer reaction to the product remains strong and we continue to view this as a great long-term opportunity and a key source of synergy between Callaway and Topgolf.

Lastly, we launched a new mobile game just last week called Shankstars. While we have modest financial expectations for this new offering, we believe there will be attractive synergies across the Topgolf business as we leverage the content and characters from the game to enhance the experience at our Venues and Toptracer ranges.

Moving to the Golf Equipment segment, according to Golf Datatech, the US golf equipment market is down only 2.3% through Q3 on a sell through dollar basis and remains up an impressive 41% compared to 2019. This despite relatively poor weather and playable hours in the early part of this year.

The market has clearly not declined meaningfully, as many expected it to with COVID restrictions abating earlier this year, and we have been pleased with the fact that we gained market share as the year progressed. After a slow start to the year, our US hard good market share YTD through Q3 was 23.8%, up 97 basis points year-over-year.

It's clear that interest in golf remains high and that Callaway is outperforming the market, something I believe we have a track record of doing.

With all this, the profitability of our golf equipment business remains high as well.

To both protect and build on this position, we have made some key investments in this business over the last several years. For example, we made key additions to our Tour Team such as Jon Rahm and, new women's world #1, 19 year-old: "Jeeno" Thitikul, as well as investing in our Callaway Next pipeline of up-and-coming young players. In R&D, we continue to invest in new capabilities that are establishing a leadership position in Artificial Intelligence capabilities, an area we believe will be differentiating for the future. In our supply chain, we made significant investments for both clubs and ball, including major upgrades in our Chicopee golf ball plant. These investments, along with our scale advantage, proven business model and iconic brand position, put us in a strong position going forward.

We continue to see this segment as a consistent performer over the long term, generating good growth and even better cash flows. The timing of this couldn't be better as it supports the Topgolf development and the attractive capital deployment opportunities we see there.

Turning to our Active Lifestyle segment, the Callaway apparel business in Asia turned in another strong quarter as did both TravisMathew and Jack Wolfskin.

For Jack Wolfskin, in local currency, both China and Europe grew nicely during Q3. We are proud of this result, as investors will note that many of our competitors are struggling in these markets.

We are also seeing excellent signs of brand health, as a recent third-party research study of consumer preferences showed Jack Wolfskin to be the #1 brand associated with outdoor activities in Germany, and the brand, just earned a prestigious ISPO product award, the gold standard in the outdoor industry, for technical and sustainably conscious product design.

Shifting to TravisMathew, we continue to see outstanding brand momentum across all channels. The brand is delivering strong double-digit revenue and profit growth, and they are experiencing another promising pre-book season for Spring/Summer 2023.

Our Active Lifestyle segment remains a highly profitable segment with excellent growth prospects.

Turning now to our outlook, I'd like to give you some color on the balance of this year, and, due to the level of uncertainties out there, and the difficulty that investors may have in quantifying them, an initial outlook for 2023.

For 2022, we are raising our full year profitability guidance for Topgolf and the total company, despite further FX pressures relative to our last guide. 2022 is clearly going to be another very strong year for us, with positive brand momentum and growth across all segments.

Looking further forward, we, like most companies, are contemplating the impacts of a potential economic slowdown, further inflationary pressure, and foreign exchange movements. Looking at these in turn, while we are not immune from inflationary pressures or macro-economic conditions, our consumers are passionate about traditional golf, the Topgolf experience and our apparel brands. They also generally have the means and desire to continue to enjoy these activities, even amid inflationary pressure or mild economic downturns. We feel this is a key point of strength for our businesses. Looking only at FX now, if current rates hold, it would be a meaningful headwind for us in 2023. However, we view this as a short to mid-term issue, as, over longer periods, rates will either moderate or businesses will adjust.

Even with all of the above, for 2023 we currently expect approximately 10% revenue growth and approximately $600 million in adjusted EBITDA, with Topgolf contributing a little more than half of this EBITDA. This keeps us on track with our long-term goals communicated at our investor day earlier this year. On an FX neutral basis, this would be equivalent to 13% revenue growth and approximately $665 million in adjusted EBITDA. As FX rates and business conditions inevitably continue to change, we will provide an updated forecast as well as our normal segment information and more specific business projections on our February earnings call. We are only providing this high-level snapshot at this time, and only doing so to assist investors in what we believe are unique circumstances.

Thank you and I'll now turn the call to Brian for a review of our financials.

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

Thank you, and good afternoon everyone.

As Chip mentioned, we are very pleased with our performance during the third quarter, as we delivered another period of record results. These results include a 15% increase in revenue while absorbing a $50 million negative impact from changes in foreign currency rates vs 2021. Our adjusted EBITDA also increased 4%, despite the currency impact, or 23% on a constant currency basis. Furthermore, our liquidity and financial position remain strong. All of this gives us the confidence to increase our full year guidance for 2022 and supports our growth estimates for 2023.

With that brief overview, I will now review the quarterly results in more detail.

For the third quarter, consolidated net revenue was a record $989 million dollars, an increase of 15% compared to Q3 2021, or a 21% increase on a constant currency basis. This performance reflects increased revenue in each operating segment and in most major product categories and major regions.

Total non-GAAP costs and expenses were $907 million dollars in the third quarter of 2022 compared to $772 million dollars in the third quarter of 2021. The increase was driven by increased variable expenses, such as venue operating expenses, as well as increased freight and continued investments to support the business.

Third quarter 2022 non-GAAP operating income was $81.1 million, down 4% year over year. This decrease was due to changes in foreign currency rates. On a constant currency basis, non-GAAP operating income would have increased 27% and operating margins would have increased 40 basis points.

Non-GAAP earnings per share was $0.23 on approximately 202 million shares, compared to $0.14 per share on approximately 186 million shares in the third quarter of 2021. The increased share count is primarily related to an accounting rule change that took effect on January 1st, which requires that we include 14.7 million shares related to the assumed conversion of the Company's convertible notes.

Lastly, Q3 Adjusted EBITDA was $144 million, up 4%, over Q3 2021 or up 23% on a constant currency basis.

Now turning to the segment results.

In evaluating the Company's operating segment performance, please keep in mind that the operating segments were impacted by the negative changes in foreign currency rates compared to 2021. The offsetting benefits from the Company's hedging program, however, are recorded in Other Income and are therefore not reflected in the operating segment results. For example, for the three and nine months ended September 30, 2022, there were $6.8 million and $25.4 million, respectively, of foreign currency hedge gains that were not included in the operating segment results for those periods. On a constant currency basis, total segment operating income for the third quarter increased 21.8%.

At the segment level, Topgolf contributed $414 million in revenue in the quarter, a 24% increase over 2021, reflecting strong same venue sales growth and additional new venues. While operating margins decreased slightly during the quarter due to planned increased staffing costs, increased pre-opening expenses as well as increased marketing spend, we expect the full year to show improved operating margins over 2021.

Golf Equipment had another excellent quarter as well, generating $297 million dollars in revenue, a 2.5% increase, or a 9.3% increase on a constant currency basis, both vs. Q3 2021. This was driven by continued high demand, strong market shares and good supply in golf equipment. As I mentioned on the Q2 earnings call, predicting the timing of shipments and supply between quarters can be challenging. During Q3, we received some supply earlier than expected. And if you have orders and have the product, you might as well ship it. As a result, some of the strength we experienced in the quarter was due to a shift in the timing of sales from Q4 to Q3. Golf equipment operating income increased 8% despite the foreign currency headwinds.

Lastly, our Active Lifestyle segment had revenue of $278 million, up 19%, or 31% on a constant currency basis, compared to Q3 2021. This increase was led by momentum in the TravisMathew, Jack Wolfskin and Callaway brands. Active lifestyle operating income decreased $6.5 million in Q3 2022 compared to Q3 2021 but on a constant currency basis would have increased.

Turning now to certain balance sheet items.

We remain in a strong financial position with ample liquidity. As of September 30, 2022, available liquidity, which is comprised of cash-on-hand and availability under our credit facilities, was $659 million dollars compared to $918 million dollars at September 30, 2021. The decrease from last year was due to continued investment in Topgolf and planned working capital increases in the Golf Equipment and Active Lifestyle businesses to support growth. On a year-over-year comparison, we note that last year's working capital was abnormally low due to the disruptions in supply chain related to the pandemic. We expect Topgolf will be cash flow positive and self-funding in 2023.

At quarter-end, we had total net debt of $1.75 billion dollars, including convertible debt of approximately $259 million.

Our Pro Forma Net Debt leverage ratio, which excludes the convertible note, was approximately 2.8x at September 30, 2022 compared to 1.8x at September 30, 2021. The increase was due to the new venue development.

Consolidated Net Accounts Receivable was $275 million dollars as of September 30, 2022, compared to $255 million dollars at the end of the third quarter of 2021. The increase was due to the $132 million dollar increase in revenue compared to Q3 2021 and strong cash collections. Days sales outstanding improved by a day to 52 days in the non-Topgolf business. The quality of the accounts receivable remains strong.

Our Inventory balance increased to $722 million dollars at the end of the third quarter of 2022 compared to $385 million at September 30, 2021. We feel good about the levels of our inventory. Inventory turns and days on hand are roughly consistent with pre-pandemic levels. We also feel good about the quality of our inventory and do not foresee promotional activity based on our current inventory position.

Capital Expenditures for the third quarter were $66 million dollars, net of REIT reimbursements. This includes $48 million dollars related to Topgolf. For the full year, we expect total capex of approximately $325 million, net of REIT reimbursements, including approximately $250 million for Topgolf and $75 million for the non-Topgolf business. The $325 million includes $165 million of growth capex.

Now turning to our balance of the year outlook.

We are raising our full year 2022 revenue expectation to $3.965 billion to $3.985 billion, including approximately $150 million of negative foreign currency impact, which is approximately $21 million more than our last estimate of $129 million. The segment assumptions underlying this guidance are the same as our prior earnings report, with Topgolf segment revenue of approximately $1.56 billion, Golf Equipment segment revenue growth of 12% or more and Active Lifestyle segment revenue reaching approximately $1 billion. The operating segments are covering the increased negative foreign currency impacts.

Our full year Adjusted EBITDA guidance of $560 - $570 million is a $5 million increase compared to the midpoint of our previous guidance. The Golf Equipment business is largely expected to cover the incremental foreign exchange risk. Topgolf is now expected to deliver between $240 - $250 million of Adjusted EBITDA.

To reiterate Chip's comments, for 2023, we expect the business to grow approximately 10% in revenue and to achieve approximately $600 million in Adjusted EBTIDA, using currency spot rates from late October. From a constant currency perspective, that would represent approximately 13% or more revenue growth and approximately $665 million in Adjusted EBITDA. These projections include no hedge gains as our hedging program resets at the beginning of the year, and also takes into account the lapping of the channel fill-in the Golf Equipment business that we had this year as retail inventory has returned to normal levels. Given it is early to provide these metrics, we are not providing segment level detail at this time.

In closing, we have managed to achieve substantial growth year to date, despite the macroeconomic headwinds, thereby demonstrating the resiliency of our core consumers, as well as the benefits of scale and our diversification strategy. We continue to be excited about the growth prospects of our business and are confident that our competitive positioning across each segment and the embedded growth within our business will keep us on track to deliver on our long-term outlook and to create shareholder value.

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

Operator over to you.

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