CALLAWAY GOLF COMPANY SECOND QUARTER 2022 EARNINGS CALL PREPARED REMARKS

Patrick Burke, SVP of Global Finance

Thank you, operator and good afternoon, everyone. Welcome to Callaway's second quarter 2022 earnings conference call. I'm Patrick Burke, the Company's SVP of Global Finance. 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 is also in the room today for Q&A.

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

I am pleased to report strong second quarter results, driven by the continued strength of all three of our business segments. Total net revenue was just over $1.1 billion dollars, up 22% year-over-year. Flowthrough to the bottom line was strong as well, with Adjusted EBITDA of $207 million, up 26% on a reported basis.

These results clearly show continued momentum across our business portfolio and leave us in a position of strength as we look to the full year and the long-term.

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

The Topgolf team put up another outstanding quarter with same venue sales up approximately 8% (versus 2019), consistent with the expectations we provided last quarter. We continue to experience overall strong demand, some of which is offset by staffing challenges that continue to impact us and, as we understand it, the entire restaurant and service industry.

Looking forward, we believe our same venue sales projection for the balance of the year will be positive mid-to-high single digits vs. 2019. This would put our full year, same venue sales up mid-to-high single digits, consistent with our previous guidance.

Like most other businesses, we are seeing continued inflationary pressures across all inputs including wages and cost of goods. To offset this, we are taking low to mid-single digit price increases during this quarter and we will also be raising select hourly wage rates to make sure we remain competitive and that our hourly playmakers are well taken care of. Based on everything we have seen so far, we believe the price increases will be able to offset the inflationary pressures without negatively impacting usable demand. We saw no fall off in demand when we took a similar amount of price at the end of last year and we continue to see excellent demand for the Topgolf experience. Our price increases are also modest relative to others we are hearing about in the market.

New venue openings remained on track in the second quarter and continue to open well. During Q2, we opened two new owned and operated venues, one in Philadelphia and one at the previously mentioned El Segundo, California location. Also, just last week, we opened our newest venue format in the Seattle metropolitan area. This is the first of a new venue format that benefits from a larger more open lobby area that includes golf simulators. This venue format, which we will use in select markets going forward, will add to our cross-brand synergy strategy by including a Callaway branded fitting studio in the lobby.

Looking forward, we plan to open one additional venue in Q3 for a total of two in the quarter. The fourth quarter will then be our largest quarter for openings, with six now planned for that quarter. This will deliver 11 new owned and operated plus two franchised international venues for the full year, the most in our history and another sign of strong performance. Eight of the owned and operated venues will open in the second half of this year; an impressive accomplishment but also one that will lead to lower operating margins in the second half, mostly in Q4, due to the pre-opening expenses associated with these openings.

Our pipeline for future venues remains strong and is developing according to plan.

During Q4 we will also be phasing in a healthier level of marketing investment, highlighted by an exciting new campaign aimed at both brand building and driving long term volume. We view this as a valuable investment into the long-term health of our business and I look forward to sharing the new campaign with you later this year.

As discussed at the Investor Day, Artie and the team have also started to implement new digital reservation technology at the venues to further improve long term efficiencies. Our operating margins have been excellent year to date, and we remain highly confident in our ability to deliver against our stated venue profitability goals both for this full year and long term.

Turning to the Toptracer business, we installed 2,065 bays in the quarter, a new record for us. And, we remain on track for 8,000 or more bays this year. Feedback on the product and demand both remain strong. As evidenced by our Q2 results, we are also making nice progress in ramping our installation capacity.

In the Media business, as discussed at our Investor Day earlier this year, we are working on another mobile game which we expect to launch later this year. While we are currently hesitant to forecast meaningful financial impact from this project, we are excited about it, and it is an excellent example of how we plan to leverage our content creation capabilities across our various platforms.

Before I continue to our other business segments, I want to highlight that our ability to continue to put up quarter-after-quarter of strong results furthers our confidence in the success of this business and the long-term outlook presented at our Investor Day. If some investors initially looked at the Topgolf business as either risky or unproven, I believe the string of consistent results since our merger, should soon begin to change perspectives and valuations.

As we look out over the next few years, we are confident 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.

And, in our forward guidance, I am sure you will notice that we are once again increasing our projected full year EBITDA for this exciting segment of our business.

Moving to Golf Equipment, the business had another excellent quarter with revenue exceeding expectations, up 13% year over year. We now expect this segment to be up 12% or more for the full year, an increase from the approximately 10% we said previously, as demand continues to remain strong in the key US and Asia markets, supply chain restrictions have abated, and we are having strong market share performance. In Q2, we also benefited by supplying the launch of our new Jaws Raw wedge slightly earlier than planned.

According to Datatech, in the US, despite comparatively poor weather conditions this year, second quarter hard goods sell through was down just 2% versus 2021 and remained up 37% over 2019. Outside the US, market conditions varied during the quarter: Japan was up 5% and Korea was up 11%, while the UK and Europe were both down approximately 10%. Overall, we are pleased with market conditions and continue to see the avid golf consumer as healthy and engaged.

We have also been very pleased with the performance of our 2022 products, with sell through trends and overall market shares increasing as the year progresses: especially for our Rogue ST drivers and fairway woods as well as our Chrome Soft golf balls. We finished the second quarter, as the #1 hard goods brand in the US and delivered US golf ball market share of 20.7% YTD. Both of these are record results.

To offset inflationary pressure, we have raised prices nicely this year and, as the avid golf consumer is both affluent and passionate, there has been no discernable pushback. With continued innovation, we expect to be able to continue to offset inflationary pressures in this manner.

On the manufacturing side, supply chain pressures are easing. Our supply chain is continuing to perform well and despite periodic Covid flare ups or other challenges, we expect it to continue to be a source of relative strength going forward.

In the first half of 2022, like other OEMs, we also benefitted from an overall inventory catch up at retail.

We now believe trade inventory levels have largely normalized to appropriate levels, neither too high nor too low in our opinion.

Lastly, the Active Lifestyle segment had a strong quarter with positive momentum across all our brands. Revenues for this segment increased 39% versus second quarter last year.

The Callaway branded business in this segment 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.

Meanwhile, TravisMathew had another outstanding quarter, continuing the strong brand momentum and delivering strong double-digit growth across all channels. This business remains on track to deliver approximately $300 million in revenue this year and $50 million or more in Adjusted EBITDA.

TravisMathew opened three new stores in the second quarter, including our first two stores in New England and one in Ohio. The brand continues to prove itself in all US markets and is also beginning to gain a foothold internationally.

Also during the quarter, we had one of the most exciting product launches in TravisMathew history, TravisMathew Women's. While this launch is a preliminary collection and not a major source of revenue to-date, we are both confident in and excited about the opportunity here, particularly given that women account for over 25% of the purchases made through TravisMathew's direct to consumer channels. Throughout this year we plan to continue to test and collect feedback that will be used in product development and brand direction for our 2023 women's collections.

The Jack Wolfskin business continues to make good progress and showed double digit revenue growth for the quarter despite difficult macro-economic conditions in both China and Europe. Our overall brand strength and pre-books continue to build momentum.

We believe this brand is on strong footing and positioned for growth, even with the challenges presented via current and anticipated macro-economic and FX headwinds in Europe.

When looking at the Active Lifestyle segment on the whole, we are on track to deliver approximately $1 billion in net sales for this fiscal year. No change from our previous forecast.

Turning back to the consolidated business, while I do not want to talk too much about risks because our business is best defined by the vast opportunities in front of us and that is what energizes us and will drive significant value. We are a growth company, and we are proving ourselves here quarter after quarter. However, given the nature of today's uncertain environment and my perception of the investor communities' understandable concerns here, I would like to spend a brief moment giving my perspective on how the current macro-economic risks may impact us.

Earlier this year there was a lot of concern about a reversion in golf consumption. Clearly halfway through the year, the data shows there has been no reversion. Perhaps a small reversion will come at some point and perhaps it will not. However, I can see no evidence of one so far, especially with avid golfers. And, if there is a reversion, I for one would expect it to be modest.

Inflation has been an issue for us, as it is for most companies; but, across all of our business segments, the data thus far shows we can take price to largely offset it.

A recession driven pullback in consumer spending is an ongoing risk, but we also have strong momentum in our business segments and, based on the historical data that we have, our segments overall are not highly sensitive to a mild recession.

FX is a real headwind for us, as it is for all global companies, if rates stay where they are currently, they will have a short-term impact; however, we have managed through large FX movements before and will be able to do so again now. I do not anticipate it having a long-term impact.

I believe it is best to focus on the data and history. These point to the conclusion that we present less risk than most businesses and that our growth is more reliable given it is driven by new venue openings, brands that have significant momentum and our concentration in healthy growing business segments where consumers are both well off and passionate.

In conclusion, with the continued strength we are seeing across our business we are taking up our full year financial guidance. We are specifically increasing our full year forecast for both Topgolf and the Golf Equipment business. Consumer demand remains strong in all of our primary segments and our primary consumers appear to remain passionate, healthy, and engaged.

We are increasingly confident that we are on track to achieve the long-term goals outlined at our Investor Day earlier this year (we are in fact ahead of plan so far) and that we are well positioned to positively work through the current macro-economic climate.

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, we are very pleased with our second quarter results, which were very strong. It is those results, along with improved supply chain conditions, our ability to take pricing to offset inflationary pressures, and our continued strong momentum in each of our operating segments, that gives us the confidence to increase our full year guidance today.

Before discussing our revised guidance in more detail, I will first cover our second quarter results. For the second quarter, consolidated net revenue was $1.12 billion dollars, an increase of 22% compared to Q2 2021. Changes in foreign currency rates had a negative $38.6 million impact on second quarter 2022 net revenue compared to the same period in 2021.

Looking at our segment performance, Topgolf contributed $404 million in revenue in the quarter, a 24% increase over 2021 and reported same venue sales growth of 7.9% compared to 2019. The strong same venue sales performance in the quarter was driven by strong social and corporate events, with the corporate events business showing its first quarter of positive SVS sales since the pandemic began.

Golf Equipment had another excellent quarter, generating $452 million dollars in revenue, a 13% increase over Q2 2021, driven by continued high demand, strong market shares and improved supply in golf equipment which allowed for an inventory catchup at retail.

Lastly, our Active Lifestyle segment had revenue of $260 million, with each of the four Active Lifestyle brands up double digits versus Q2 2021.

Total non-GAAP cost and expenses were $981 million dollars in the second quarter of 2022 compared to $796 million dollars in the second quarter of 2021. The increase was driven by increased variable expenses in our operating segments, as well as increased corporate support, increased freight costs and other inflationary pressures.

Second quarter 2022 non-GAAP operating income was $135.1 million, up $17.1 million year-over-year, a 14.5% increase. Continued strong demand, along with the pricing and other business improvements we implemented this year, have allowed us to outrun the increased operational expenses we are experiencing. While changes in foreign currency exchange rates had an unfavorable impact on operating margins, on a constant currency basis, non-GAAP operating margins increased 40 basis points in the second quarter of 2022 compared to the prior period.

Moving back down the income statement, non-GAAP other expense was $19.5 million in the second quarter of 2022 compared to $27.0 million in Q2 2021. This improvement is primarily due to an increase in gains on foreign currency contracts in the second quarter of 2022, partially offset by higher interest expense.

Non-GAAP earnings per share was $0.47 on approximately 201 million shares, compared to $0.36 per share on approximately 194 million shares in the second quarter of 2021. The increased share count is primarily related to 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 it should reduce the actual number of shares we are required to deliver by approximately 3-5 million shares depending on stock price.

Lastly, Q2 Adjusted EBITDA was $207 million, up $43 million, or 26%, over Q2 2021 and our EBITDA margins improved to 18.6% compared to 18.0% for the same period last year.

Turning to certain balance sheet items.

We remain in a strong financial position with ample liquidity. As of June 30, 2022, available liquidity, which is comprised of cash-on-hand and availability under our credit facilities, was $640 million dollars compared to $877 million dollars at June 30, 2021. The decrease from last year was due to planned working capital increases in the Golf Equipment and Active Lifestyle businesses to support growth as well as continued investment in Topgolf venues. The $640 million dollars of availability was an increase from the end of Q1, when we had $576M of availability. As a reminder, we expect Topgolf will be approximately self-funding in 2023 and cash generating in 2024.

At quarter-end, we had total net debt of $1.7 billion dollars, including venue financing obligations of approximately $670 million related to the development of Topgolf venues and including the convertible debt of approximately $259 million.

Our net debt leverage ratio was approximately 3.2x at June 30, 2022 compared to 2.9x at June 30, 2021. Our leverage ratio on a funded debt basis was below 2.0x.

Consolidated Net Accounts Receivable was $376 million dollars as of June 30, 2022, compared to $325 million dollars at the end of the second quarter of 2021. The increase was primarily due to the increase in revenue. The quality of the accounts receivable remains strong.

Our inventory balance increased to $604 million dollars at the end of the second quarter of 2022 compared to $534 million at the end of the fourth quarter 2021 and $335 million at June 30, 2021. The increase in inventory primarily relates to being under-inventoried in prior periods due to the supply chain disruptions last year. Inventory turns and days inventory on hand are consistent with pre-pandemic levels. We feel very good about the quality of our inventory. As you can imagine, when we were very short on inventory over the last two years during the pandemic, we sold whatever was available and therefore cleaned up any old inventory.

Capital expenditures for the first half 2022 were $154 million dollars, net of REIT reimbursements. This includes $120 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.

Now turning to our balance of the year outlook.

We are revising our full year 2022 revenue expectations to $3.945 billion to $3.970 billion compared to previous guidance of $3.935 billion to $3.970 billion. Changes in foreign currency rates are estimated to have a negative impact of $129 million for the full year. This estimate assumes 12% or more revenue growth for the Golf Equipment segment for the full year which is up from the prior estimate of 10% growth. The guidance also assumes approximately $1.56 billion in revenue for Topgolf this year, consistent with previous guidance, and approximately $1 billion in revenue from the Active Lifestyle segment, which is also consistent with previous guidance.

Our full year Adjusted EBITDA forecast also increased and is now projected to be $555 - $565 million dollars, which assumes approximately $235 - $245 million from Topgolf. At midpoint, this represents a $15 million increase from the previous guidance primarily due to increases in both the Golf Equipment and Topgolf segments. For the full year 2022, Adjusted EBITDA is expected to increase over $100 million compared to 2021.

For the second half, we estimate revenue to be within the range of $1.790 billion to $1.815 billion dollars, which includes an estimated $69 million dollars of negative foreign currency impact. We expect the Topgolf segment to be up approximately 25% driven by same venue sales in the mid to high single digits and by 8 additional venues, with 2 opening in Q3 and 6 opening in Q4. We expect the Golf Equipment segment to be up low to mid single digits and the Active Lifestyle segment to be up mid-teens for the second half of the year. In total, second half revenues are expected to increase by approximately 15% compared to the second half of 2021.

The Company currently estimates that its second half 2022 Adjusted EBITDA will be within the range of $178 - $188 million versus $153 million in the second half of 2021. This represents an approximate 20% increase.

Our business has become increasingly difficult to forecast on a quarterly basis as many factors can cause a shift between quarters, including new product launch timing, marketing campaign timing, weather, timing of venue openings and timing of supply shipments, to name a few. With that said, we are providing some guidance on Q3 and Q4 but please recognize that results could shift between those quarters.

Total Company third quarter 2022 net revenue is estimated to be between $940 - $955 million versus Q3 2021 net revenues of $856 million. This assumes $42 million of negative foreign currency impact for the third quarter of 2022 compared to 2021. Given the second half launch timing of golf equipment products in 2022 versus 2021, we expect Golf Equipment will be down mid to high single digits for the third quarter but is expected to increase double digits in the fourth quarter, resulting in 12% or more growth for the full year. The Topgolf and Active Lifestyle segments are expected to grow double digits in both the third and fourth quarters. In total, third quarter 2022 revenue is estimated to grow approximately 11% compared to 2021.

Given foreign exchange headwinds and difference in product launch timing compared to 2021, we expect 2022 Adjusted EBITDA will decrease in the third quarter but increase in the fourth quarter. Third quarter adjusted EBITDA is estimated to be between $122 - $132 million versus $139 million for the same period in 2021. We expect that Adjusted EBITDA will increase by approximately $40 million in the fourth quarter compared to 2021, resulting in an overall increase of 19% for the second half of 2022.

In summary, we have had a great start to the year and are optimistic about the balance of the year. While we are not immune from foreign currency and inflationary pressures this year, we believe we can continue to manage them. Each of our operating segments are performing well and enjoying strong brand momentum. Consumer interest and demand remain strong across our businesses, giving us the confidence to increase our full year guidance despite the macroeconomic challenges.

Looking even further ahead, we will have some headwinds in 2023. Foreign currency rates are expected to continue to be a headwind and the hedge gains we have this year are not expected to repeat. We will also not have the benefit of the channel fill in the Golf Equipment business that we had this year as retail inventory is generally back to normal levels.

With that said, we believe we will continue to benefit next year from new Topgolf venues, as well as a continued strong consumer desire for leisure and entertainment such as Topgolf, hiking, golf and other outdoor activities. We are fortunate that our consumers are generally well-off and passionate. As a result, we expect to grow in 2023 despite the current macroeconomic headwinds. In addition, we expect to benefit from the additional pricing and other actions we plan to implement, and we expect freight expense to abate somewhat in 2023. Overall, we are optimistic about next year and are confident in our ability to create shareholder value over the long-term.

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

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