

Callaway Golf Company (ELY: \$16.43 Outperform; \$22 PT)

Strong Quarter; Guidance Appears Conservative—Maintaining Our Outperform Rating and Lowering Our Price Target to \$22 from \$25

Figure 1. Callaway Golf Company—Key Company Data, Prices as of Market Close on 2/6/19

Key Data	FY: Dec	2018A		2019E		2020E		
		Old	Actual	Old	New	Old	New	
Price:	\$16.43	GAAP EPS:	0.65A	0.65	0.68	0.46	--	--
Price Target:	\$22.00	Q1	0.65A	0.65	0.68	0.46	--	--
52-Week Range:	14.44-24.67	Q2	0.63A	0.63	0.57	0.26	--	--
Market Cap (\$mn):	1,600	Q3	0.10A	0.10	0.08	0.43	--	--
Shares Out. (mn):	97.4	Q4	(0.33)	(0.30)	(0.21)	(0.14)	--	--
Avg. Daily Vol.:	1,125,000	Year	1.04	1.08	1.12	1.00	1.21	1.15
		Adj EBITDA	na	156	na	211	na	225
Total Debt (\$mn)*:	516	EV/EBITDA		11.3x		8.3x		7.8x
Net Debt (\$mn)*:	452	Revenue (\$mn)						
Est Topgolf Value (\$mn):	300	Q1	403A	403	408	501	--	--
		Q2	396A	396	398	439	--	--
EV (\$mn):	1,752	Q3	263A	263	276	430	--	--
Annual Dividend:	0.04	Q4	173	181	185	315	--	--
Dividend yield:	0.2%	Year	1,235	1,243	1,266	1,684	1,305	1,728

Note I: Debt includes \$476mn for the JW acquisition, which closed after quarter-end.

Note II: EBITDA now excludes SBC, making it incomparable to our previous estimates.

Sources: Company data and Imperial Capital, LLC.

Financial Summary

Callaway Golf Company (ELY) generated revenue of \$1.2bn and adjusted EBITDA of \$156mn in the latest twelve month (LTM) period ended 12/31/18. The company ended the quarter with \$452mn in net debt, inclusive of the Jack Wolfskin financing. Separately, we value ELY's stake in Topgolf at \$300mn.

View and Valuation

We are maintaining our Outperform rating on ELY shares and lowering our one-year price target to \$22 from \$25. Our price target is approximately 34% above the recent share price, and is based on 10x 2020 EBITDA, or 7% free cash flow yield (adjusted for Topgolf).

Rationale

We are maintaining our Outperform rating following a strong 4Q18 report and initial 2019 guide.

Quarterly overview: Callaway reported 4Q18 results on 2/6/19 that exceeded our estimates. Revenue of \$181mn and EPS of (\$0.30) compared to our estimates of \$173mn and (\$0.33), respectively. The company reported strong results across most business segments, especially golf balls, which grew 14% year-over-year and continue taking share.

Guidance and estimate changes: Management provided initial 2019 guidance that now includes Jack Wolfskin (and \$34mn in incremental interest costs) and MSD growth in the organic business. Our estimates change as shown in Figure 1. EBITDA now excludes SBC. Important to note, the company has soundly beat initial annual guidance in both of the past two years.

Balance sheet and FCF: Including the JW acquisition, which closed after year-end, ELY has approximately \$450mn in net debt. We expect debt to fall quickly from free cash flow. Any monetization of ELY's 14% interest in Topgolf would provide additional liquidity.

Organic business: Management appeared upbeat on the earnings conference call regarding the organic golf equipment business. It expects the industry to grow in 2019 and to continue taking share.

George Kelly, CFA
(212) 351-9476
gkelly@imperialcapital.com

Key Data

Symbol: ELY
Price (2/6/19): \$16.43
Rating: Outperform
Price Target: \$22

Estimates:

2018A EBITDA: \$156
2019E EBITDA: \$211
2020E EBITDA: \$225
2018A EV/EBITDA: 11.3
2019E EV/EBITDA: 8.3x
2020E EV/EBITDA: 7.8x

Company Description

Callaway Golf Company is a leading global golf equipment company. It also owns other ancillary businesses, including apparel brands Jack Wolfskin and TravisMathew, and 14% of Topgolf, a rapidly growing golf entertainment business.

Important Disclosures, Certifications and Other Information

See the last page of this report for important disclosures, analyst certifications and other information concerning conflicts of interest that may exist between the subject of this report and Imperial Capital, LLC, Imperial Capital Asset Management, LLC and/or the author(s) of this report.

Additional information is available upon request.

Capitalization

Figure 2. Callaway Golf Company—Capitalization as of 12/31/18, Prices as of Market Close on 2/6/19

			Debt		Net Debt		Net Debt		Price / YTM			Interest Exp.		
			Face		Face		Market		Analysis			Analysis		
LTM Revenue	(12/31/18)	1,243												
LTM EBITDA	(12/31/18)	156												
LTM EBITDA %	(12/31/18)	12.6%												
LTM FCF	(12/31/18)	55												
Settlement Date	NA													
M/S&P	Rating	Balance	Cum. Debt	LTM EBITDA	Net Debt	LTM EBITDA	Debt Mkt	Net Debt Mkt	LTM EBITDA	Price	YTM	Mat.	Rate/Coup.	Est. Int. Exp.
			Face	Mult.	Face	Mult.								
Cash		64												
Asset Based Revolving Facilities														
Asset Based Revolver		40	40	40	(24)	(0.15)	40	(24)	(0.15)	NA	NA	06/23/19	4.43%	1.8
Jack Wolfskin		476	-	476	-	-	476	476	476				7.00%	33.3
Total		516	40	0.3x	(24)	(0.2x)	516	452	2.9x					35.1
Common Equity														
Common Stock (ELY)		1,600												
Total Equity		1,600	1,600	10.3x	2,116	13.6x	16.43	97.4	shares				Interest	35.1

(1) Includes JW financing, which closes after year-end.
 Sources: Company data and Imperial Capital.

Rationale (continued)

Topgolf update: Topgolf continues to see a lot of momentum. New venue openings are robust and its ancillary businesses (Swing Suite, Range, digital products, etc.) appear poised for long-term growth and value creation.

Recent Financial Results

Figure 3. Callaway Golf Company—Quarterly Overview

	Q4'18A	IC Est
Net Sales	180.7	173.3
COGS	110.7	103.0
Gross Profit	70.0	70.4
Gross Margin	38.7%	40.6%
Selling	73.9	67.3
G&A	27.5	31.2
R&D	11.2	10.7
Other	0.0	0.0
Op Income	(42.6)	(38.8)
Net Income	(28.2)	(31.5)
EPS	(0.30)	(0.33)
EBITDA	(31.1)	(34.8)
Guidance		
2019 Revs	1,670	1,700
2019 EBITDA	200	215
Prev Estimates		
2019 Revs	1,266	
2019 EBITDA	168	

Sources: Company data and Imperial Capital, LLC.

Figure 4. Callaway Golf Company—Income Statement, 2017-2020E

Callaway Golf Company (ELY)	2017	1Q18 March	2Q18 June	3Q18 Sept	4Q18 Dec	2018	1Q19E March	2Q19E June	3Q19E Sept	4Q19E Dec	2019E	2020E
Net Sales	1,048,736	403,191	396,311	262,654	180,678	1,242,834	500,657	439,268	429,503	314,643	1,684,071	1,727,694
<i>Growth</i>	20.4%	30.5%	30.1%	7.8%	-5.7%	18.5%	24.2%	10.8%	63.5%	74.1%	35.5%	2.6%
Cost of Sales	568,288	202,729	203,614	147,415	110,707	664,465	270,355	245,990	214,752	163,614	894,710	911,281
Gross Profit	480,448	200,462	192,697	115,239	69,971	578,369	230,302	193,278	214,752	151,028	789,360	816,413
Selling	270,890	82,960	83,261	68,605	73,883	308,709	115,151	107,621	105,228	106,979	434,978	443,881
General and Administrative	94,153	21,894	24,408	26,706	27,458	100,466	32,543	32,945	34,360	39,330	139,178	141,110
Research and Development	36,568	9,624	10,708	9,229	11,191	40,752	12,016	10,982	12,885	12,586	48,468	50,213
Other	0	0	0	0	0	0	7,800	0	0	0	7,800	0
Operating Income	78,837	85,984	74,320	10,699	(42,561)	128,442	62,793	41,730	62,278	(7,866)	158,935	181,209
Other Income	(10,782)	(6,034)	3,861	376	4,627	2,830	(5,500)	(8,500)	(8,500)	(8,500)	(31,000)	(34,000)
Pretax Income	68,055	79,950	78,181	11,075	(37,934)	131,272	57,293	33,230	53,778	(16,366)	127,935	147,209
Taxes	26,388	17,219	17,247	1,335	(9,783)	26,018	12,604	7,311	11,831	(3,601)	28,146	32,386
Net Income	41,667	62,731	60,934	9,740	(28,151)	105,254	44,688	25,920	41,947	(12,766)	99,789	114,823
Convertible Dividends/Other	861	(124)	67	223	348	514	124	354	354	974	1,807	1,807
Net Income	40,806	62,855	60,867	9,517	(28,499)	104,740	44,564	25,565	41,593	(13,740)	97,983	113,016
GAAP EPS	\$0.42	\$0.65	\$0.63	\$0.10	(\$0.30)	\$1.08	\$0.46	\$0.26	\$0.43	(\$0.14)	\$1.00	\$1.15
Shares Outstanding	96,577	97,038	96,928	97,320	94,505	97,153	97,353	97,453	97,553	97,653	97,503	97,903
Adj EBITDA	99,974	89,338	88,269	21,936	(31,106)	168,437	81,969	52,876	73,424	2,660	210,928	225,402
FCF	91,496	(117,238)	105,218	106,816	(39,339)	55,457	(87,936)	73,065	89,093	28,760	102,983	126,016
Expense Ratios												
Gross Margin	45.8%	49.7%	48.6%	43.9%	38.7%	46.5%	46.0%	44.0%	50.0%	48.0%	46.9%	47.3%
Selling	25.8%	20.6%	21.0%	26.1%	40.9%	24.8%	23.0%	24.5%	24.5%	34.0%	25.8%	25.7%
General and Administrative	9.0%	5.4%	6.2%	10.2%	15.2%	8.1%	6.5%	7.5%	8.0%	12.5%	8.3%	8.2%
Research and Development	3.5%	2.4%	2.7%	3.5%	6.2%	3.3%	2.4%	2.5%	3.0%	4.0%	2.9%	2.9%
Taxes	38.8%	21.5%	22.1%	12.1%	25.8%	19.8%	22.0%	22.0%	22.0%	22.0%	22.0%	22.0%
Operating Margin	7.5%	21.3%	18.8%	4.1%	-23.6%	10.3%	12.5%	9.5%	14.5%	-2.5%	9.4%	10.5%
EBITDA Margin	9.5%	22.2%	22.3%	8.4%	-17.2%	13.6%	16.4%	12.0%	17.1%	0.8%	12.5%	13.0%

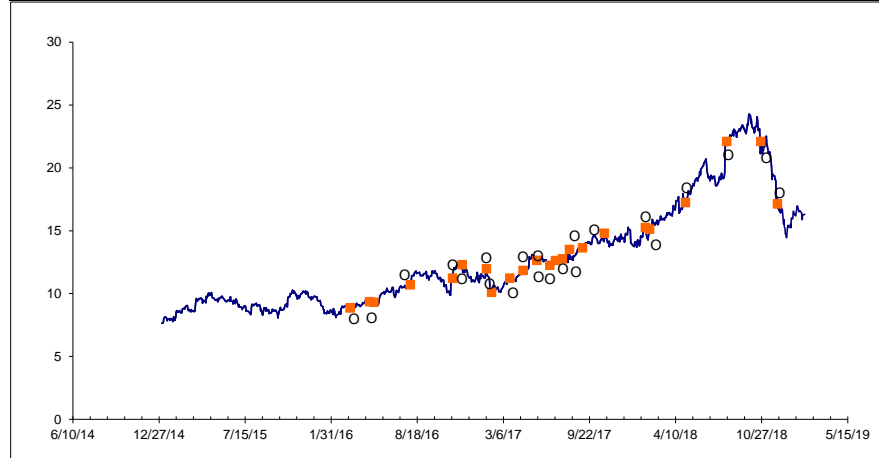
Sources: Company data and Imperial Capital, LLC.

Risk Factors

- **Consumer:** any weakness in sentiment or consumer spending would negatively impact ELY.
- **Jack Wolfskin:** any challenges integrating JW would negatively impact ELY.
- **FX:** ELY is hedged for 2019, but would be negatively impacted if the Euro or Yen weakened.

Price Chart and Ratings History

Figure 5. Callaway Golf Company—Price Chart and Ratings History



Description	Price	IC Rating	Report Date
Common Stock	\$17.13	Outperform	12/3/18
Common Stock	\$22.09	Outperform	10/25/18
Common Stock	\$22.09	Outperform	8/7/18
Common Stock	\$17.24	Outperform	5/3/18
Common Stock	\$15.12	Outperform	2/9/18
Common Stock	\$15.26	Outperform	1/30/18
Common Stock	\$14.79	Outperform	10/27/17
Common Stock	\$13.64	Outperform	9/6/17
Common Stock	\$13.50	Outperform	8/7/17
Common Stock	\$12.75	Outperform	7/21/17
Common Stock	\$12.62	Outperform	7/5/17
Common Stock	\$12.25	Outperform	6/22/17
Common Stock	\$12.65	Outperform	5/23/17
Common Stock	\$11.84	Outperform	4/21/17
Common Stock	\$11.23	Outperform	3/21/17
Common Stock	\$10.10	Outperform	2/7/17
Common Stock	\$11.97	Outperform	1/26/17
Common Stock	\$12.29	Outperform	11/30/16
Common Stock	\$11.23	Outperform	11/8/16
Common Stock	\$10.69	Outperform	8/2/16
Common Stock	\$9.31	Outperform	5/9/16
Common Stock	\$9.35	Outperform	4/29/16
Common Stock	\$8.85	Outperform	3/15/16

Sources: Bloomberg and Imperial Capital, LLC.

Companies under coverage: **George Kelly, CFA:** Acushnet Holdings (GOLF), Brunswick Corporation (BC), Callaway Golf Company (ELY), Drive Shack (DS), Freshpet (FRPT), Haymaker Acquisition Corp (HYAC), Johnson Outdoors (JOUT), Lindblad Expeditions (LIND), MINDBODY (MB), National Beverage (FIZZ), Nautilus (NLS), Planet Fitness (PLNT), Primo Water (PRMW), Town Sports International Holdings (CLUB), YogaWorks (YOGA).

Important Disclosures, Certifications and Other Information

Ratings Distribution and Definitions

Equity Ratings Definitions (as of 7/1/09)		
Outperform	65.29%	Outperform: TRR expected to exceed basket by at least 10%
In-Line	29.75%	In-Line: TRR expected to be in-line with basket
Underperform	4.96%	Underperform: TRR expected to underperform basket by at least 10%
This Equity Ratings Distribution reflects the percentage distribution for rated equity securities for the twelve month period 1/1/18 through 12/31/18. Rating definitions are expressed as the total rate of return (TRR) relative to the expected performance of a basket of like securities over a 12-month period. Within the twelve month period ended 12/31/18, IC has provided investment banking services to 12.66% of companies with equity rated an Outperform, 0.00% of companies with equity rated an Underperform, and 11.11% of companies with equity rated an In-Line. As of 12/31/18.		
Fixed Income Ratings Definitions and Equity Ratings Definitions (prior to 7/1/09)		
Buy: TRR expected to exceed basket by at least 10%		
Hold: TRR expected to be in-line with basket		
Sell: TRR expected to underperform basket by at least 10%		
Rating definitions are expressed as the total rate of return (TRR) relative to the expected performance of a basket of like securities over a 12-month period. Please refer to our publication dated 7/1/09 for details associated with the transition of our Equity Ratings to the current definitions.		

For a discussion of the valuation methods used to determine our price target, if any, please see page(s) 1. See page 4 for the risks that may impede achievement of such price target, and page 4 for our ratings history and price chart.

Analyst Certification: Each research analyst whose name appears in bold on the front page certifies that: (1) the views expressed in this report reflect the analyst's personal views about the subject securities or issuers; and (2) none of the analyst's compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed herein. The analyst(s) responsible for the preparation of this report receive(s) compensation primarily based upon individual performance (e.g., productivity and quality of work) and the overall financial performance of Imperial Capital, LLC, including overall revenues from investment banking activities.

COMPANY	DISCLOSURE
Callaway Golf Company	None

¹ As of the date hereof, the analyst or other Imperial Capital, LLC (IC) or Imperial Capital Asset Management, LLC (ICAM) employee who assisted in the drafting of this report (or a member of his/her household) has a financial interest in the securities of this entity.

² IC makes a market in the debt securities of this entity.

³ IC makes a market in the equity securities of this entity.

⁴ As of 12/31/18, IC or its affiliates beneficially own 1% or more of any class of common equity securities of this entity.

⁵ IC has managed or co-managed a public offering or Rule 144A offering of securities for this entity during the past 12 months.

⁶ IC has received compensation for investment banking services from this entity during the past 12 months.

⁷ IC expects to receive or intends to seek compensation for investment banking services from this entity within the next three months.

⁸ IC or its affiliates has received compensation for products or services other than investment banking services from this entity during the past 12 months.

⁹ IC had a [investment banking services] [non-investment banking securities-related services] [non-securities services] client relationship with this entity during the past 12 months.

¹⁰ As of the date hereof, the analyst or other IC or ICAM employee who assisted in the drafting of this report (or a member of his/her household) serves as an officer, director or advisory board member of this entity.

¹¹ IC had (and/or currently has) a financial advisory relationship with certain creditors or equity holders with respect to the entity during the past 12 months.

Compendium Disclosure: Securities of issuers in this report, in addition to the subject issuer, may be rated by IC or its affiliate. Please see disclosures, price charts, and ratings histories for those issuers in our previously-published research reports, available by contacting your account executive at 1-800-929-2299, or on IC's Web site at www.imperialcapital.com.

*Disclosure items appropriate to each entity, if any, are indicated.

The table above discloses IC's or its affiliate's ownership, if any, of securities mentioned herein. While this report is in circulation, IC or its affiliates may, from time to time, make purchases or sales for their own accounts of securities of any entity. The table above also discloses, as of the date hereof, whether or not IC makes a market in any of the securities mentioned herein. IC's market making may constitute, in the case of equity securities and certain debt securities, standing ready to make purchases or sales of securities on a regular or continuous basis or quoting markets in debt securities. Notwithstanding IC's market making activities as of the date hereof, while this report is in circulation IC may begin or discontinue such market making activity for any entity.

This report was jointly prepared pursuant to an intercompany agreement with IC's affiliate, Imperial Capital Asset Management, LLC (ICAM), a SEC registered investment advisor. The analyst who prepared this report is an associated person of ICAM. From time to time, ICAM may accept payments from customers for generic investment advice contained in this report. None of the analyst's compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed herein. This report is for information purposes only. Under no circumstances is it to be used or considered as an offer to sell, or a solicitation of an offer to buy any security. While the information contained in this report has been obtained from sources believed to be reliable, we do not represent or guarantee that the report is accurate or complete, and it should not be relied upon as such. Any references or citations to, or excerpts from, third-party information or data sources (including, but not limited to, Bloomberg, Capital IQ and IBISWorld) do not and are not intended to provide financial or investment advice and are not to be relied upon by anyone as providing financial or investment advice. Based on public information available to us, prices and opinions expressed in this report reflect judgments as of the date hereof and are subject to change without notice. The securities covered by or mentioned in this report involve substantial risk and should generally be purchased only by investors able to accept such risk. **This research report and the securities mentioned herein, some of which may not be registered under the Securities Act of 1933, are intended only for Qualified Institutional Buyers (QIBs), as defined under Rule 144A.** Any opinions expressed assume that this type of investment is suitable for the investor. This report may be the last or only report covering the issuer(s), industries sectors and/or securities discussed. Decisions to cease coverage are based on a variety of factors. IC and ICAM's research coverage is opportunistic in nature and analysts generally are not assigned continuing-coverage responsibilities for any issuer, industry, sector or security. As a result, coverage of such issues is frequently characterized by either isolated reports or long periods between reports. IC's and ICAM's views of a security, issuer, industry or sector may change without the issuance of a new report. If you would like to know whether IC's and ICAM's views have changed, please call us at (310) 246-3700.

Imperial Capital, LLC is a member of FINRA (www.finra.org) and SIPC (www.sipc.org)

© Copyright 2019 Imperial Capital, LLC and Imperial Capital Asset Management, LLC