CALLAWAY GOLF CO
Form 10-Q
November 05, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q
ý Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended September 30, 2015
OR
o 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

Callaway Golf Company
(Exact name of registrant as specified in its charter)

Delaware	95-3797580
(State or other jurisdiction of incorporation or organization)	(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)

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 ý No o
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted 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 and post such files). Yes ý No o
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Large accelerated filer o	Accelerated filer ý
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No ý
As of September 30, 2015, the number of shares outstanding of the Registrant’s common stock outstanding was 89,923,121.

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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," "on track," 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, the reversal of the deferred tax valuation allowance in future periods, future income tax expense, the future impact of new accounting standards and the continued success of the Company's turnaround plan and the Company's recovery, as well as improved financial results during 2015. 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;
- delays, difficulties, changed strategies, or increased costs in implementing the Company’s turnaround plans;
- 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;
- 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;
- the ability of the Company to manage international business risks;
- future changes in foreign currency exchange rates and the degree of effectiveness of the Company’s hedging programs;
- 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.

For details concerning these and other risks and uncertainties, see Part I, Item IA, “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 Commission from time to time. 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.

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Callaway Golf Company Trademarks: The following marks and phrases, among others, are trademarks of Callaway Golf Company: Apex-Apex Tour-APW-Aqua Dry-Arm Lock-Backstryke-Big Bertha-Big Bertha Alpha-Big T-Black Series-Callaway-Callaway Golf- Callaway Media Productions-Callaway Supersoft-C Grind-Chev-Chev 18-Chevron Device-Chrome Soft-Comfort Tech-CXR-D.A.R.T.-Dawn Patrol-Divine-Eagle-Engage-ERC-FTiZ-FT Optiforce-Fast Tech Mantle-FT Performance-FT Tour-Fusion-Fusion RX-Gems-Gravity Core-Great Big Bertha-Heavenwood-Hex Aerodynamics-Hex Chrome-Hex Solaire-HX-Hyper Lite-Hyper Speed Face-IMIX-Innovate or Die design-Ion X-Jailbird-Kings of Distance-Legacy-Longer From Everywhere-Mack Daddy-MarXman-MD3 Milled-MetalX-Number One Putter in Golf-Odyssey-Odyssey Works-OptiFit-Opti Flex-Opti Grip-Opti Shield-Opti Therm-ORG 14-ORG 15-ProType-·R·-Rossie-R Moto-S2H2-Sabertooth-SoftFast-Solaire-Speed Regime-Speed Step-SR1-SR2-SR3-Steelhead-Strata-Strata Jet-Stronomic-Superhot-Tank-Tank Cruiser-Teron-Tech Series-TiHot-Tour Authentic -Trade In! Trade Up!-Trionomer Cover-Tru Bore-udesign-Uptown-Versa-Warbird-Weather Series-Wedgeducation-W Grind-White Hot-White Hot Tour-White Hot Pro-White Hot Pro Havok-White Ice-World's Friendliest-X-12-X-14-X-16-X-18-X-20- X-22-X-24-X Act-X Hot-X Hot Pro-X² Hot-XR design-X Series-XSPANN-Xtra Traction Technology-XTT-Xtra Width Technology-2-Ball-3 Deep.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)

CALLAWAY GOLF COMPANY

CONSOLIDATED CONDENSED BALANCE SHEETS

(Unaudited)

(In thousands)

	September 30, 2015	December 31, 2014
ASSETS		
Current assets:		
Cash and cash equivalents	$ 41,592	$ 37,635
Accounts receivable, net	153,040	109,848
Inventories	184,845	207,229
Deferred taxes, net	5,260	5,081
Income taxes receivable	1,286	928
Other current assets	19,455	23,312
Total current assets	405,478	384,033
Property, plant and equipment, net	53,810	58,093
Intangible assets, net	88,795	88,833
Goodwill	26,868	27,821
Deferred taxes, net	2,232	2,346
Investment in golf-related ventures (Note 6)	52,376	50,677
Other assets	9,031	13,008
Total assets	$ 638,590	$ 624,811
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	$ 117,080	$ 123,251
Accrued employee compensation and benefits	29,630	37,386
Asset-based credit facilities	—	15,235
Accrued warranty expense	6,015	5,607
Income tax liability	3,097	2,623
Deferred taxes, net	25	26
Total current liabilities	155,847	184,128
Long-term liabilities:		
Income tax payable	3,426	3,867
Deferred taxes, net	35,389	35,043
Convertible notes, net (Note 2)	26,701	108,574
Long-term incentive compensation and other	1,093	1,665
Commitments and contingencies (Note 9)		
Shareholders' equity:		
Preferred stock, $0.01 par value, 3,000,000 shares authorized, none issued and outstanding at September 30, 2015 and December 31, 2014	—	—
Common stock, $0.01 par value, 240,000,000 shares authorized, 89,927,375 and 78,373,598 shares issued at September 30, 2015 and December 31, 2014, respectively	899	784
Additional paid-in capital	292,909	210,057
Retained earnings	132,437	89,932
Accumulated other comprehensive loss	(10,073)	(796)
Less: Common stock held in treasury, at cost, 4,254 and 779,681 shares at September 30, 2015 and December 31, 2014, respectively	(38)	(8,443)

Total shareholders’ equity	416,134	291,534
Total liabilities and shareholders’ equity	$ 638,590	$ 624,811

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Net sales	$175,780	$168,572	$690,463	$752,339
Cost of sales	98,178	103,265	383,898	431,329
Gross profit	77,602	65,307	306,565	321,010
Operating expenses:				
Selling expense	52,390	46,871	178,675	184,786
General and administrative expense	15,772	12,918	47,407	43,459
Research and development expense	8,673	8,144	24,192	22,903
Total operating expenses	76,835	67,933	250,274	251,148
Income (loss) from operations	767	(2,626)	56,291	69,862
Interest income	25	43	372	368
Interest expense	(3,545)	(2,080)	(7,849)	(7,665)
Other income (expense), net	683	3,833	1,208	(1,367)
Income (loss) before income taxes	(2,070)	(830)	50,022	61,198
Income tax provision	1,547	304	5,002	3,651
Net income (loss)	$(3,617)	$(1,134)	$45,020	$57,547
Earnings (loss) per common share:				
Basic	$(0.04)	$(0.01)	$0.56	$0.74
Diluted	$(0.04)	$(0.01)	$0.53	$0.66
Weighted-average common shares outstanding:				
Basic	83,875	77,646	80,030	77,551
Diluted	83,875	77,646	94,614	93,384
Dividends declared per common share	$0.01	$0.01	$0.03	$0.03

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Net income (loss)	$(3,617)	$(1,134)	$45,020	$57,547
Other comprehensive income (loss):				
Change in fair value of derivative instruments	(1,174)	—	869	—
Foreign currency translation adjustments	(5,861)	(9,495)	(10,146)	(4,808)
Comprehensive income (loss)	$(10,652)	$(10,629)	$35,743	$52,739

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

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

	Nine Months Ended September 30, 2015	2014
Cash flows from operating activities:		
Net income	$45,020	$57,547
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	13,350	16,379
Deferred taxes	(184)	(179)
Share-based compensation	5,535	3,979
Gain on disposal of long-lived assets and deferred gain amortization	(772)	(1,097)
Discount amortization on convertible notes	515	551
Change in assets and liabilities:		
Accounts receivable, net	(48,099)	(52,218)
Inventories	19,417	75,380
Other assets	5,609	(150)
Accounts payable and accrued expenses	(4,845)	(50,620)
Accrued employee compensation and benefits	(7,264)	(2,195)
Accrued warranty expense	408	(524)
Income taxes receivable/payable	42	(4,936)
Other liabilities	(342)	(3,575)
Net cash provided by operating activities	28,390	38,342
Cash flows from investing activities:		
Capital expenditures	(8,513)	(8,803)
Proceeds from sales of property and equipment	2	458
Investment in golf-related ventures	—	(4,712)
Net cash used in investing activities	(8,511)	(13,057)
Cash flows from financing activities:		
Repayment of asset-based credit facilities, net	(15,235)	(25,660)
Exercise of stock options	5,330	2,222
Dividends paid	(2,454)	(2,330)
Acquisition of treasury stock	(1,942)	(1,006)
Credit facility amendment costs	—	(608)
Equity issuance costs	—	(7)
Net cash used in financing activities	(14,301)	(27,389)
Effect of exchange rate changes on cash and cash equivalents	(1,621)	(1,227)
Net increase (decrease) in cash and cash equivalents	3,957	(3,331)
Cash and cash equivalents at beginning of period	37,635	36,793
Cash and cash equivalents at end of period	$41,592	$33,462
Supplemental disclosures:		
Cash paid for income taxes, net	$4,858	$8,349
Cash paid for interest and fees	$6,339	$7,824
Noncash investing and financing activities:		
Conversion of convertible notes to common stock, net of discount (Note 2)	$82,388	$—
Issuance of treasury stock and common stock for compensatory stock awards released from restriction	$3,763	$87

Acquisition of treasury stock for minimum statutory withholding taxes	$—	$(7)
Accrued capital expenditures at period-end	$1,603	$268

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

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

	Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock		Total
	Shares	Amount				Shares	Amount	
Balance at December 31, 2014	78,374	$784	$210,057	$89,932	$(796)	(780)	$(8,443)	$291,534
Conversion of convertible notes to common stock, net of discount (Note 2)	11,331	113	82,275	—	—	—	—	82,388
Acquisition of treasury stock	—	—	—	—	—	(215)	(1,942)	(1,942)
Exercise of stock options	111	1	(1,202)	—	—	666	6,531	5,330
Compensatory awards released from restriction	110	1	(3,763)	—	—	320	3,762	—
Share-based compensation	—	—	5,535	—	—	—	—	5,535
Stock dividends	1	—	7	(61)	—	5	54	—
Cash dividends	—	—	—	(2,454)	—	—	—	(2,454)
Equity adjustment from foreign currency translation	—	—	—	—	(10,146)	—	—	(10,146)
Change in fair value of derivative instruments	—	—	—	—	869	—	—	869
Net income	—	—	—	45,020	—	—	—	45,020
Balance at September 30, 2015	89,927	$899	$292,909	$132,437	$(10,073)	(4)	$(38)	$416,134

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

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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 (“SEC”). 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, 2014 filed with the SEC. 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 assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ materially from those estimates and assumptions.

Recent Accounting Standards

In July 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2015-11, "Inventory (Topic 330): Simplifying the Measurement of Inventory." Topic 330, Inventory, currently requires an entity to measure inventory at the lower of cost or market. Market could be replacement cost, net realizable value, or net realizable value less an approximately normal profit margin. The amendments do not apply to inventory that is measured using last-in, first-out (LIFO) or the retail inventory method. The amendments apply to all other inventory, which includes inventory that is measured using first-in, first-out (FIFO) or average cost. An entity should measure in scope inventory at the lower of cost and net realizable value. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. Subsequent measurement is unchanged for inventory measured using LIFO or the retail inventory method. The amendments in this update more closely align the measurement of inventory in GAAP with the measurement of inventory in International Financial Reporting Standards. For public business entities, the amendments are effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. The amendments should be applied prospectively with earlier application permitted as of the beginning of an interim or annual reporting period. The Company is currently evaluating the impact this ASU will have on its consolidated condensed financial statements.

In April 2015, the FASB has issued ASU No. 2015-05, "Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40): Customer’s Accounting for Fees Paid in a Cloud Computing Arrangement." Existing GAAP does not include explicit guidance about a customer’s accounting for fees paid in a cloud computing arrangement. Examples of cloud computing arrangements include: (a) software as a service; (b) platform as a service; (c) infrastructure as a service; and (d) other similar hosting arrangements. The amendments provide guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. The amendments do not change the accounting for a customer’s accounting for service contracts. As a result of the amendments, all software licenses within the scope of Subtopic 350-40 will be accounted for consistent with other licenses of intangible assets. For public business entities, the amendments will be effective for annual periods, including interim periods within those annual periods, beginning after December 15, 2015. Early adoption is permitted. The Company is currently evaluating the impact this ASU will have on its consolidated condensed financial statements.

In April 2015, the FASB issued ASU No. 2015-03, "Interest—Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs." The amendments in this ASU require that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The guidance in ASU 2015-03 (see paragraph 835-30-45-1A) does not address presentation or subsequent measurement of debt issuance costs related to line-of-credit arrangements. Given the absence of authoritative guidance within ASU 2015-03 for debt issuance costs related to line-of-credit arrangements, the SEC staff stated that they would not object to an entity deferring

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and presenting debt issuance costs as an asset and subsequently amortizing the deferred debt issuance costs ratably over the term of the line-of-credit arrangement, regardless of whether there are any outstanding borrowings on the line-of-credit arrangement.The recognition and measurement guidance for debt issuance costs are not affected by the amendments in this ASU. The amendments for this ASU are effective for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. Early adoption of the amendments is permitted for financial statements that have not been previously issued. The Company does not expect that the adoption of this amendment will have a material impact on the Company’s consolidated condensed financial statements and disclosures.

In August 2014, the FASB issued ASU No. 2014-15, "Presentation of Financial Statements—Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity’s Ability to Continue as a Going Concern." This ASU is intended to define management’s responsibility to evaluate whether there is substantial doubt about an organization’s ability to continue as a going concern and to provide related footnote disclosures, and it provides guidance to an organization’s management, with principles and definitions that are intended to reduce diversity in the timing and content of disclosures that are commonly provided by organizations today in the financial statement footnotes. Until the issuance of this ASU, U.S. GAAP lacked guidance about management’s responsibility to evaluate whether there is substantial doubt about the organization’s ability to continue as a going concern or to provide related footnote disclosures. The amendments are effective for annual periods ending after December 15, 2016, and interim periods within annual periods beginning after December 15, 2016. Early application is permitted for annual or interim reporting periods for which the financial statements have not previously been issued. The Company does not expect that the adoption of this amendment will have a material impact in the foreseeable future on the Company’s consolidated condensed financial statements and disclosures.

In June 2014, the FASB issued ASU No. 2014-12, "Compensation—Stock Compensation (Topic 718): Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period." This ASU requires that a performance target that affects vesting and that could be achieved after the requisite service period, be treated as a performance condition. The performance target should not be reflected in estimating the grant-date fair value of the award. Compensation cost should be recognized in the period in which it becomes probable that the performance target will be achieved and should represent the compensation cost attributable to the period(s) for which the requisite service has already been rendered. If the performance target becomes probable of being achieved before the end of the requisite service period, the remaining unrecognized compensation cost should be recognized prospectively over the remaining requisite service period. The total amount of compensation cost recognized during and after the requisite service period should reflect the number of awards that are expected to vest and should be adjusted to reflect those awards that ultimately vest. The requisite service period ends when the employee can cease rendering service and still be eligible to vest in the award if the performance target is achieved. This ASU is effective for annual periods and interim periods within those annual periods beginning after December 15, 2015. Earlier adoption is permitted. The adoption of this ASU will not have a material impact on the Company's consolidated condensed financial statements.

In May 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers: (Topic 606)." This ASU affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards (e.g., insurance contracts or lease contracts). This ASU will supersede the revenue recognition requirements in Topic 605, "Revenue Recognition," and most industry-specific guidance. In addition, the existing requirements for the recognition of a gain or loss on the transfer of nonfinancial assets that are not in a contract with a customer (e.g., assets within the scope of Topic 360, "Property, Plant, and Equipment," and intangible assets within the scope of Topic 350, "Intangibles-Goodwill and Other") are amended to be consistent with the guidance on recognition and measurement (including the constraint on revenue) in this ASU. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The amendments in this ASU are effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. Early adoption is not permitted. The Company is currently evaluating the impact this ASU will have on its consolidated condensed financial statements.

Note 2. 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 September 30, 2015, the Company had no borrowings outstanding under either facility, $1,117,000 in outstanding letters of credit, and $41,592,000 in cash and cash equivalents. The combined maximum amount that could have been outstanding under both facilities on September 30, 2015, after letters of credit was $106,187,000, resulting in total available liquidity including cash on hand of $147,779,000 compared to the maximum amount that could have been outstanding under both facilities on September 30, 2014, of $72,188,000 and total available liquidity including cash on hand of $105,650,000.

Primary Asset-Based Revolving Credit Facility

The Company's primary credit facility is a Loan and Security Agreement with Bank of America N.A. (as amended, the “ABL Facility”), which provides a senior secured asset-based revolving credit facility of up to $230,000,000, comprised of a $160,000,000 U.S. 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), inventory and accounts receivable of the Company’s subsidiaries in the United States, Canada and the United Kingdom.

As of September 30, 2015, the Company had no borrowings outstanding under the ABL Facility and $1,117,000 in outstanding letters of credit. The maximum amount of additional indebtedness (as defined by the ABL Facility) that could have been outstanding on September 30, 2015, after outstanding borrowings and letters of credit was approximately $89,503,000. The maximum availability under the ABL Facility fluctuates with the general seasonality of the business and increases and decreases with changes in the Company’s inventory and accounts receivable balances. The maximum availability is at its highest during the first half of the year when the Company’s inventory and accounts receivable balances are higher and is lower during the second half of the year when the Company's inventory levels decrease and its accounts receivable decrease as a result of cash collections. Average outstanding borrowings during the nine months ended September 30, 2015 were $49,049,000, and average amounts available under the ABL Facility during the first nine months of 2015, after outstanding borrowings and letters of credit, was approximately $85,623,000. Amounts borrowed under the ABL Facility may be repaid and borrowed as needed. The entire outstanding principal amount (if any) is due and payable at the earlier of (i) the date that is six months prior to the maturity of the Company’s 3.75% Convertible Senior Notes maturing on August 15, 2019 or (ii) June 23, 2019, if a qualifying refinancing of the Company’s 3.75% Convertible Senior Notes due 2019 has occurred at least six months prior to their maturity.

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 meeting certain restrictions on the amount of additional indebtedness and requirements to maintain a certain fixed charge coverage ratio under certain circumstances. As of September 30, 2015, 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 $23,000,000. The Company’s borrowing base availability was above $23,000,000 during the nine months ended September 30, 2015, and the Company was in compliance with the fixed charge coverage ratio as of September 30, 2015. Had the Company not been in compliance with the fixed charge coverage ratio as of September 30, 2015, the Company's maximum amount of additional indebtedness that could have been outstanding on September 30, 2015 would have been reduced by $23,000,000.

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 U.K. and the U.S. borrowing bases, as adjusted. The applicable margin for any month will be reduced by 0.25% if the Company’s availability ratio is greater than or equal to 67% and the Company’s “leverage ratio” (as defined below) is less than 4.0 to 1.0 as of the last day of the month for which financial statements have been delivered, so long as no default or event of default exists. The Company’s “leverage ratio” is the ratio of the amount of debt for borrowed money to the twelve-month trailing EBITDA (as defined in the ABL Facility), each determined on a consolidated basis. At September 30, 2015, the Company’s trailing 12 months average interest rate applicable to its outstanding loans under the ABL Facility, including the fees described below, was 4.36%.

In addition, the ABL Facility provides for monthly fees ranging from 0.25% to 0.375% of the unused portion of the ABL Facility, depending on the prior month’s average daily balance of revolver loans and stated amount of letters of credit relative to lenders' commitments.

The fees incurred in connection with the origination and amendment of the ABL Facility totaled $4,956,000, which are amortized into interest expense over the term of the ABL Facility agreement. Unamortized fees at September 30, 2015 and December 31, 2014 totaled $1,903,000 and $2,233,000, respectively, of which $507,000 and $496,000 were included in other current assets, respectively, and $1,396,000 and $1,737,000 were included in other assets, respectively, in the accompanying consolidated condensed balance sheets.

Japan ABL Facility

In January 2015, the Company entered into a separate asset-based loan and guarantee agreement (the "Japan ABL Facility") between its subsidiary in Japan and The Bank of Tokyo-Mitsubishi UFG, Ltd and The Development Bank of Japan. The Company can borrow up to 2 billion Yen (or U.S. $16,684,000, using the exchange rate in effect as of September 30, 2015) over a one-year term, and the amounts outstanding are secured by certain assets, including eligible inventory.The Japan ABL Facility is subject to an effective interest rate of 1.48% and includes certain restrictions including covenants related to certain pledged assets and financial performance metrics. As of September 30, 2015, the Company was in compliance with these covenants. There were no borrowings outstanding under this facility at September 30, 2015, and the maximum amount that could have been outstanding at September 30, 2015 was $16,684,000. The Company intends to renew the Japan ABL Facility when the one-year term expires.

Convertible Senior Notes

In August 2012, the Company issued $112,500,000 of 3.75% Convertible Senior Notes (the “convertible notes”). The convertible notes are convertible, at the option of the note holder, at any time on or prior to the close of business on the business day immediately preceding August 15, 2019, into shares of common stock at an initial conversion rate of 133.3333 shares per $1,000 principal amount of convertible notes, which was initially equal to an aggregate of 15,000,000 shares of common stock at a conversion price of approximately $7.50 per share, subject to customary anti-dilution adjustments. The Company incurred transactional fees of $3,537,000 in connection with the issuance of the convertible notes, which are amortized into interest expense over the term of the convertible notes.

In August 2015, the Company exchanged $84,983,000 in aggregate principal amount of the convertible notes for 11,331,064 shares of common stock, plus cash payments to the note holders representing an exchange inducement and accrued and unpaid interest through the closing date of the exchange transactions. In connection with the exchange, the Company recorded $2,595,000 of the outstanding discount as of September 30, 2015 to shareholders' equity. Upon completion of the exchange transactions, $27,517,000 in aggregate principal amount of the convertible notes remains outstanding, and such amount is convertible into an aggregate of 3,668,936 shares of common stock at a conversion price of approximately $7.50 per share, subject to anti-dilution adjustments. The Company pays interest of 3.75% per year on the principal amount of the convertible notes, payable semiannually in arrears on February 15 and August 15 of each year. The remaining convertible notes mature on August 15, 2019.

In connection with the exchange in August 2015, the Company accelerated the amortization of transaction fees, which resulted in charges of $1,559,000 in the third quarter of 2015. Unamortized transaction fees as of September 30, 2015 and December 31, 2014 were $494,000 and $2,358,000, respectively, of which $126,000 and $505,000 were included in other current assets as of September 30, 2015 and December 31, 2014, respectively, and $368,000 and $1,853,000 were included in other long-term assets as of September 30, 2015 and December 31, 2014, respectively, in the accompanying consolidated condensed balance sheets.

The net carrying amount of the convertible notes as of September 30, 2015 and December 31, 2014 was $26,701,000 and $108,574,000, respectively, and the unamortized discount as of September 30, 2015 was $816,000. Total interest and amortization expense recognized for the three and nine months ended September 30, 2015 was $767,000 and $3,273,000, respectively, and $1,241,000 and $3,715,000 for the three and nine months ended September 30, 2014, respectively.

Upon the occurrence of a change of control of the Company or a termination of trading of the common stock of the Company, note holders will have the option to require the Company to repurchase for cash all or any portion of such note holder’s convertible notes at a price equal to 100% of the principal amount of the repurchased convertible notes, plus accrued and unpaid interest thereon to the repurchase date. In addition, upon the occurrence of certain change of control events of the Company, the Company will pay a premium on the convertible notes converted in connection with such change of control events by increasing the conversion rate on such convertible notes.

The convertible notes contain certain covenants including payment of principal and interest, certain repurchase obligations, obligations of the Company to convert the convertible notes, and other customary covenants as set forth in the Indenture. The Company was in compliance with these covenants as of September 30, 2015.

The convertible notes can be redeemed for cash in whole or in part at the option of the Company at a redemption price equal to 100% of the principal amount of the convertible notes to be redeemed, plus accrued and unpaid interest thereon to the redemption

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date. On October 15, 2015, the Company issued a notice of redemption for the remaining $27,517,000 in aggregate principal amount of the convertible notes outstanding pursuant to the terms of the indenture that governs the convertible notes. The redemption is scheduled to occur on November 16, 2015. The holders of the convertible notes have the right to convert their notes, subject to certain terms, conditions and covenants specified in the convertible notes and the indenture that governs the convertible notes, at any time prior to the close of business on the business day immediately preceding the redemption date at a current conversion rate equivalent to 133.3333 shares of common stock per $1,000 in principal amount of convertible notes. In the event that note holders do not exercise the option to convert the convertible notes into shares of common stock, the Company would be expected to redeem the notes for cash.

Note 3. Earnings (Loss) 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 reflects the potential dilution that could occur if convertible securities, or other contracts to issue common stock, were exercised or converted into common stock. Dilutive securities are included in the calculation of diluted earnings per common share using the treasury stock method and the if-converted method in accordance with Accounting Standards Codification ("ASC) Topic 260, “Earnings per Share.” Dilutive securities include the common stock equivalents of convertible notes, options granted pursuant to the Company’s stock option plans and outstanding restricted stock units and performance share units granted to employees and non-employee directors (see Note 10).

Weighted-average diluted common shares outstanding is the same as weighted-average basic common shares outstanding in periods when a net loss is reported or in periods when diluted earnings per share is higher than basic earnings per share.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Earnings (loss) per common share—basic				
Net income (loss)	$(3,617)	$(1,134)	$45,020	$57,547
Weighted-average common shares outstanding—basic	83,875	77,646	80,030	77,551
Basic earnings per common share	$(0.04)	$(0.01)	$0.56	$0.74
Earnings (loss) per common share—diluted				
Net income (loss)	$(3,617)	$(1,134)	$45,020	$57,547
Add: Interest on convertible debt	—	—	5,329	3,715
Net income including assumed conversions	$(3,617)	$(1,134)	$50,349	$61,262
Weighted-average common shares outstanding—basic	83,875	77,646	80,030	77,551
Convertible notes weighted-average shares outstanding	—	—	13,217	15,000
Options and restricted stock	—	—	1,367	833
Weighted-average common shares outstanding—diluted	83,875	77,646	94,614	93,384
Dilutive earnings (loss) per common share	$(0.04)	$(0.01)	$0.53	$0.66

For the three months ended September 30, 2015 and 2014, securities outstanding totaling approximately 11,676,000 and 16,753,000 shares, respectively (including stock options and common shares underlying convertible senior notes of 9,711,000 and 15,000,000 shares, respectively) were excluded from the earnings per share calculation as their effect would be antidilutive. For the nine months ended September 30, 2015 and 2014, securities outstanding totaling approximately 579,000 and 2,717,000 shares underlying stock options, respectively, were excluded as their effect would be antidilutive.

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Note 4. Inventories

Inventories are summarized below (in thousands):

	September 30, 2015	December 31, 2014
Inventories:		
Raw materials	$ 48,836	$ 47,661
Work-in-process	714	519
Finished goods	135,295	159,049
	$ 184,845	$ 207,229

Note 5. Goodwill and Intangible Assets

Goodwill at September 30, 2015 and December 31, 2014 was $26,868,000 and $27,821,000, respectively. The decrease in goodwill during the nine months ended September 30, 2015 of $953,000 was due to foreign currency fluctuations. Gross goodwill before cumulative impairments at September 30, 2015 and December 31, 2014 was $28,617,000 and $29,570,000, respectively.

The Company's goodwill and acquired intangible assets with indefinite lives are not amortized, but are subject to an annual impairment test. The Company performs an impairment analysis on its goodwill and intangible assets at least annually and whenever events or changes in circumstances indicate that the carrying value of such assets may not be fully recoverable. Acquired intangible assets with definite lives are amortized over their estimated useful lives and are tested for impairment only when impairment indicators are present.

The following sets forth the intangible assets by major asset class (dollars in thousands):

	Useful Life (Years)	September 30, 2015			December 31, 2014		
		Gross	Accumulated Amortization	Net Book Value	Gross	Accumulated Amortization	Net Book Value
Non-Amortizing:							
Trade name, trademark and trade dress and other	NA	$88,590	$ —	$88,590	$88,590	$ —	$88,590
Amortizing:							
Patents	2-16	31,581	31,376	205	31,581	31,338	243
Developed technology and other	1-9	7,961	7,961	—	7,961	7,961	—
Total intangible assets		$128,132	$ 39,337	$88,795	$128,132	$ 39,299	$88,833

Aggregate amortization expense on intangible assets was approximately $38,000 and $54,000 for the nine months ended September 30, 2015 and 2014, respectively.

Amortization expense related to intangible assets at September 30, 2015 in each of the next five fiscal years and beyond is expected to be incurred as follows (in thousands):

Remainder of 2015	$13
2016	51
2017	51
2018	51
2019	39
	$205

Note 6. Investments

Investment in TopGolf International, Inc.

The Company owns preferred shares of TopGolf International, Inc. ("TopGolf"), the owner and operator of TopGolf entertainment centers. In connection with this investment, the Company has a preferred partner agreement with TopGolf in which

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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 the TopGolf retail stores, access to consumer information obtained by TopGolf, and other rights incidental to those listed above.

In December 2014, the Company remitted funds to subscribe for $1,699,000 in preferred shares of TopGolf. In January 2015, the subscription was accepted and the Company acquired the $1,699,000 in preferred shares. As of September 30, 2015, the Company's total investment in preferred shares of TopGolf was $52,376,000. The Company's total ownership interest in TopGolf, including the Company's voting rights in the preferred shares of TopGolf, remains at less than 20% of the outstanding equity securities of TopGolf. In addition, as of September 30, 2015, the Company did not have the ability to significantly influence the operating and financing activities and policies of TopGolf, and accordingly, the Company's investment in TopGolf is accounted for at cost in accordance with ASC Topic 325, "Investments—Other." The fair value of the Company's investment in TopGolf was not estimated as of September 30, 2015 as it was not practicable to do so. However, there were no events or changes in circumstances that would have had a significant adverse effect on the fair value of this investment.

Note 7. Product Warranty

The Company has a stated two-year warranty policy for its golf clubs. 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 following table provides a reconciliation of the activity related to the Company's reserve for accrued warranty expense (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Beginning balance	$6,447	$7,396	$5,607	$6,406
Provision	1,052	(15)	4,321	3,895
Claims paid/costs incurred	(1,484)	(1,499)	(3,913)	(4,419)
Ending balance	$6,015	$5,882	$6,015	$5,882

Note 8. Income Taxes

The Company calculates its interim income tax provision in accordance with ASC 270, "Interim Reporting," and ASC 740 "Accounting for Income Taxes" (together, "ASC 740"). At the end of each interim period, the Company estimates the annual effective tax rate for foreign operations and applies that rate to its ordinary foreign quarterly earnings. For the Company's U.S. operations, the Company uses the discrete method to calculate the U.S. interim tax expense as the annual effective rate was not considered a reliable estimate of year-to-date income tax expense. Under the discrete method, the Company determines its U.S. tax expense based upon actual results as if the interim period were an annual period. The Company's full U.S. valuation allowance position and the seasonality of the Company's business create results with significant variations in the customary relationship between income tax expense and pre-tax income for the interim periods. As a result, the Company believes that using the discrete method is more appropriate than the annual effective tax rate method to calculate the income tax provision related to its U.S. operations.

The realization of deferred tax assets, including loss and credit carry forwards, is subject to the Company generating sufficient taxable income during the periods in which the temporary differences become realizable. Due to the Company's net operating losses in the United States from 2009 to 2013, the Company recorded a valuation allowance against its U.S. deferred tax assets. As a result, at each quarter end, as the U.S. deferred tax assets are adjusted upwards or downwards, the associated valuation allowance and income tax expense is adjusted. If sufficient positive evidence arises in the future, such as a sustained return to profitability in the U.S. business, the valuation allowance could be reversed as appropriate, decreasing income tax expense in the period of the reversal.

The provision for income taxes is primarily comprised of taxes related to the Company's foreign operations. The income tax provision for the three months ended September 30, 2015 and 2014 was $1,547,000 and $304,000, respectively. The increase in the income tax provision was primarily due to the release of certain unrecognized tax benefits due to the lapse of statutes of

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limitation in various jurisdictions in the third quarter of 2014. The income tax provision for the nine months ended September 30, 2015 and 2014 was $5,002,000 and $3,651,000, respectively. The increase in the income tax provision was primarily due to the release of certain unrecognized tax benefits due to the lapse of statutes of limitation in various jurisdictions in the third quarter of 2014.

At September 30, 2015, the gross liability for income taxes associated with uncertain tax positions was $6,546,000. The liability for uncertain tax positions, if recognized, could be reduced by $1,376,000 of offsetting tax benefits associated with the correlative effects of potential transfer pricing adjustments as well as $4,200,000 of deferred taxes. The net amount of $970,000, would favorably affect the Company’s consolidated condensed financial statements and effective income tax rate. The unrecognized tax benefit liabilities are expected to decrease by approximately $354,000 during the next 12 months. The gross liability for uncertain tax positions increased by $160,000 and decreased by $13,000 for the three and nine months ended September 30, 2015, respectively. The increase and decrease were primarily due to changes in positions taken in the current year, and to changes in foreign currency translation, respectively.

The Company recognizes interest and penalties related to income tax matters in income tax expense. For the three months ended September 30, 2015 and 2014, the Company's provision for income taxes includes an expense of $35,000 and a benefit of $31,000, respectively, related to the recognition and reversal of interest and penalties, respectively. For the nine months ended September 30, 2015 and 2014, the Company's provision for income taxes includes an expense of $1,000 and a benefit of $55,000, respectively, also related to the recognition and reversal of interest and penalties. As of September 30, 2015 and December 31, 2014, the gross amount of accrued interest and penalties included in income taxes payable in the accompanying consolidated condensed balance sheets was $1,063,000 and $1,062,000, respectively.

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

Tax Jurisdiction	Years No Longer Subject to Audit
U.S. federal	2010 and prior
California (United States)	2008 and prior
Canada	2009 and prior
Japan	2008 and prior
South Korea	2009 and prior
United Kingdom	2010 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 that period. The Company continues to monitor changes in ownership. If such a cumulative change did occur in any three year period and the Company were limited in the amount of losses it could use to offset taxable income, the Company's results of operations and cash flows would be adversely impacted.

Note 9. 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

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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 upon 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 range of monetary loss, amounts covered by insurance or the financial impact that will result from such matters. Management believes that the final resolution of the current matters pending against the Company, individually and in the aggregate, will not have a material adverse effect upon the Company’s consolidated financial position. The Company’s results of operations or cash flows, however, could be materially affected in any particular period by the unfavorable resolution of one or more of these contingencies.

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, 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. As of September 30, 2015, 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 under these agreements is $58,396,000 over the next four years. 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. Future minimum purchase commitments as of September 30, 2015, are as follows (in thousands):

Remainder of 2015	$20,216
2016	26,811
2017	10,722
2018	497
Thereafter	150
	$58,396

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 $1,117,000 as of September 30, 2015.

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 material payments under the commitments and guarantees described above will have a material effect on the Company’s

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financial condition. The fair value of indemnities, commitments and guarantees that the Company issued during the nine months ended September 30, 2015 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 for convenience or by the officer for substantial cause. In addition, in order to assure that the officers would continue to provide independent leadership consistent with the Company’s best interest, 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 monetary payments and health benefits, upon the termination of employment following a change in control.

Note 10. Share-Based Employee Compensation

As of September 30, 2015, 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, 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 nine months ended September 30, 2015 and 2014 for share-based compensation, including expense for stock options, restricted stock units, phantom stock units, cash settled stock appreciation rights and performance share units.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
	(In thousands)			
Cost of sales	$120	$(55)	$563	$71
Operating expenses	1,350	(436)	7,574	2,519
Total cost of share-based compensation included in income, before income tax	$1,470	$(491)	$8,137	$2,590

Stock Options

Stock options granted under the 2004 Incentive Plan are valued using the Black-Scholes option-pricing model on the date of grant. The model uses various assumptions, including a risk-free interest rate, the estimated term of the options, the estimated stock price volatility, and the estimated dividend yield. Compensation expense for stock options is recognized over the vesting period and is reduced by an estimate for forfeitures, which is based on the Company’s historical forfeitures of unvested options and awards.

There were no stock options granted during the nine months ended September 30, 2015 or 2014. Total compensation expense recognized for stock options during the three and nine months ended September 30, 2015 was $320,000 and $1,064,000, respectively, and $358,000 and $1,081,000 during the three and nine months ended September 30, 2014, respectively. At September 30, 2015, the total amount of unamortized expense related to stock options was $525,000, which will be recognized over a weighted-average period of 0.5 years.

Restricted Stock Units

Restricted stock units granted under the 2004 Incentive Plan and 2013 Directors Plan are valued at the Company’s closing stock price on the date of grant and generally vest within a one to three year period. Compensation expense for restricted stock units is recognized over the vesting period and is reduced by an estimate for forfeitures. During the three months ended September 30, 2015 and 2014, the Company granted 8,000 and 13,000 shares underlying restricted stock units, respectively, at a weighted average grant-date fair value of $9.10 and $7.61, respectively. During the nine months ended September 30, 2015 and 2014, the Company granted 556,000 and 384,000 shares underlying restricted stock units, respectively, at a weighted average grant-date fair value of $8.30 and $8.18 per share, respectively.

Total compensation expense, net of estimated forfeitures, recognized for restricted stock units during the three months ended September 30, 2015 and 2014 was $865,000 and $770,000, respectively, and $2,626,000 and $2,121,000, during the nine months ended September 30, 2015 and 2014, respectively. At September 30, 2015, the Company had $5,470,000 of total unamortized compensation expense related to non-vested restricted stock units under the Company’s share-based payment plans. That cost is expected to be recognized over a weighted-average period of 1.5 years.

Performance Share Units

Performance share units granted under the 2004 Incentive Plan are stock-based awards in which the number of shares ultimately received depends on the Company's performance against specified metrics over a one 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 50% to 150% of the participant's target award. Performance share units are initially valued at the Company's closing stock price on the date of grant. Compensation expense, net of estimated forfeitures, is recognized over the vesting period and will vary based on remeasurements 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 units cliff-vest in full at the end of a three year period.

The Company granted 509,000 and 453,000 shares underlying performance units during the nine months ended September 30, 2015 and 2014, respectively, at a weighted average grant-date fair value of $7.96 and $8.20 per share, respectively. The Company did not grant any performance share units during the three months ended September 30, 2015 or 2014.

During the three months ended September 30, 2015 and 2014, the Company recognized total compensation expense, net of estimated forfeitures, of $790,000 and $310,000, respectively, for performance share units. During the nine months ended September 30, 2015 and 2014, the Company recognized total compensation expense, net of estimated forfeitures, of $1,846,000 and $777,000, respectively, for performance share units. At September 30, 2015, unamortized compensation expense related to these awards was $6,632,000, which is expected to be recognized over a weighted-average period of 1.9 years.

Phantom Stock Units

Phantom stock units granted under the 2004 Incentive Plan are a form of share-based awards that are indexed to the Company’s stock and are settled in cash. Because phantom stock units are settled in cash, compensation expense recognized over the vesting period will vary based on changes in fair value. Fair value is remeasured at the end of each interim reporting period based on the closing price of the Company’s common stock. All of the previously granted phantom stock units were fully vested as of September 30, 2015.

There were no phantom stock units granted during the nine months September 30, 2015 or 2014 and the Company did not recognize expense for the three months ended September 30, 2015. The Company reversed $57,000 of compensation expense related to previously granted phantom stock units during the three months ended September 30, 2014, and recognized $390,000 and $374,000 of compensation expense related to previously granted phantom stock units during the nine months ended September 30, 2015 and 2014, respectively. Accrued compensation expense for these awards was $1,898,000 at December 31, 2014, which was recorded in accrued employee compensation and benefits in the accompanying consolidated condensed balance sheets. There were no outstanding phantom stock units as of September 30, 2015.

Stock Appreciation Rights

Cash settled stock appreciation rights ("SARs") granted under the 2004 Incentive Plan are valued using the Black-Scholes option-pricing model on the date of grant. SARs are subsequently remeasured at each interim reporting period based on a revised Black-Scholes value until they are exercised. SARs generally vest over a three year period. There were no SARs granted during the nine months ended September 30, 2015 or 2014. The Company reversed $505,000 and $1,872,000 of compensation expense related to previously granted SARs during the three months ended September 30, 2015 and 2014, respectively. The Company recognized $2,211,000 and reversed $1,763,000 of compensation expense related to previously granted SARs during the nine months ended September 30, 2015 and 2014, respectively. Accrued compensation expense for these awards was $2,001,000 and $3,990,000 at September 30, 2015 and December 31, 2014, respectively, which was recorded in accrued employee compensation and benefits in the accompanying consolidated condensed balance sheets.

Note 11. 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

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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 exchange contracts (see Note 12) that are measured at fair value on a recurring basis by the above pricing levels at September 30, 2015 and December 31, 2014 (in thousands):

	Fair Value	Level 1	Level 2	Level 3
September 30, 2015				
Foreign currency derivative instruments—asset position	$252	$—	$252	$—
Foreign currency derivative instruments—liability position	(71)	—	(71)	—
	$181	$—	$181	$—
December 31, 2014				
Foreign currency derivative instruments—asset position	$40	$—	$40	$—
Foreign currency derivative instruments—liability position	(246)	—	(246)	—
	$(206)	$—	$(206)	$—

The fair value of the Company's foreign currency exchange 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 exchange contracts designated as cash flow hedges are recorded in other comprehensive income, and in other income (expense) for non-designated foreign currency exchange contracts (see Note 12) .
Disclosures about the Fair Value of Financial Instruments
The carrying values of cash and cash equivalents at September 30, 2015 and December 31, 2014 are reasonable estimates of fair value due to the short-term nature of these balances and are therefore classified as Level 1. The table below illustrates information about fair value relating to the Company's financial assets and liabilities that are recognized in the accompanying consolidated balance sheets as of September 30, 2015 and December 31, 2014, as well as the fair value of contingent contracts that represent financial instruments (in thousands).

	September 30, 2015		December 31, 2014	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Convertible notes[(1)]	$27,517	$30,636	$108,574	$126,222
ABL Facility[(2)]	$—	$—	$15,235	$15,235
Standby letters of credit[(3)]	$1,117	$1,117	$1,142	$1,142

(1) The carrying value of the convertible notes at September 30, 2015 and December 31, 2014, is net of the unamortized discount of $816,000 and $3,926,000, respectively (see Note 2). The fair value of the convertible notes was determined based on secondary quoted market prices, and as such is classified within Level 2 of the fair value hierarchy.
(2) The carrying value of amounts outstanding under the Company's ABL Facility approximate its fair value as the amounts outstanding are due within one year or less. The fair value of this debt is categorized within Level 2 of the fair value hierarchy.
(3) 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. There were no amounts drawn from these letters of credit as of September 30, 2015 and December 31, 2014. The fair value of this

contingent obligation is categorized within Level 2 of the fair value hierarchy.

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Nonrecurring Fair Value Measurements

The Company measures certain assets at fair value on a nonrecurring basis at least annually or when certain indicators are present. These assets include long-lived assets, goodwill and non-amortizing intangible assets that are written down to fair value when they are held for sale or determined to be impaired. During the nine months ended September 30, 2015 and 2014, the Company did not have any significant assets or liabilities that were measured at fair value on a nonrecurring basis in periods subsequent to initial recognition.

Note 12. 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.

The Company accounts for its foreign currency forward contracts in accordance with ASC Topic 815, “Derivatives and Hedging” (“ASC 815”). ASC 815 requires the recognition of all derivatives 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 hedges are recorded as a component of other comprehensive income and released into earnings as a component of cost of goods sold 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 other income (expense).

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 foreign currency forward contracts as well as the location of the asset and/or liability on the consolidated condensed balance sheets at September 30, 2015 and December 31, 2014 (in thousands):

	Asset Derivatives			
	September 30, 2015		December 31, 2014	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives designated as cash flow hedging instruments:				
Foreign currency forward contracts	Other current assets	$659	Other current assets	$—
Derivatives not designated as hedging instruments:				
Foreign currency forward contracts	Other current assets	$252	Other current assets	$40

	Liability Derivatives			
	September 30, 2015		December 31, 2014	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives designated as cash flow hedging instruments:				
Foreign currency forward contracts	Accounts payable and accrued expenses	$96	Accounts payable and accrued expenses	$—

Derivatives not designated as hedging instruments:				
Foreign currency forward contracts	Accounts payable and accrued expenses	$71	Accounts payable and accrued expenses	$246

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Cash Flow Hedging Instruments

In January 2015, the Company entered into foreign currency forward contracts designated as qualifying cash flow hedges to help mitigate the Company's foreign currency exposure on intercompany sales of inventory to its foreign subsidiaries. These contracts generally mature within 12 months from their inception. At September 30, 2015, the notional amount of the Company's foreign currency forward contracts designated as cash flow hedge instruments was approximately $43,155,000. The Company did not enter into cash flow hedging contracts in 2014. 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 hypothetical derivative 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 if (i) 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 11).

As of September 30, 2015, the Company recorded a net gain of $1,999,000 in other comprehensive income (loss) related to its hedging activities. This gain will be relieved and recognized in cost of goods sold as the physical transactions being hedged occur. The Company recognized net gains of $1,018,000 and $1,130,000 in cost of goods sold for the three and nine months ended September 30, 2015, respectively, and $62,000 and $683,000 in other income (expense) for the three and nine months ended September 30, 2015, respectively, as a result of hedge ineffectiveness. In addition, in both the three and nine months ended September 30, 2015, the Company recognized net gains of $528,000 in other income (expense) related to cash flow hedges that did not meet the accounting requirements during the nine months ended September 30, 2015 due to ineffectiveness. Based on the current valuation, the Company expects to reclassify net gains of $869,000 from accumulated other comprehensive income (loss) into net earnings during the next 12 months.

The following tables summarize the net effect of all cash flow hedges on the consolidated condensed financial statements for the three and nine months ended September 30, 2015 (in thousands):

	Gain (Loss) Recognized in Other Comprehensive Income (Loss) (Effective Portion)			
	Three Months Ended September 30,		Nine Months Ended September 30,	
Derivatives designated as cash flow hedging instruments	2015	2014	2015	2014
Foreign currency forward contracts	$(156)	$—	$1,999	$—

	Gain Reclassified from Other Comprehensive Income (Loss) into Earnings (Effective Portion)			
	Three Months Ended September 30,		Nine Months Ended September 30,	
Derivatives designated as cash flow hedging instruments	2015	2014	2015	2014
Foreign currency forward contracts	$1,018	$—	$1,130	$—

	Gain Recognized in Other Income (Expense) (Ineffective Portion)			
	Three Months Ended September 30,		Nine Months Ended September 30,	

Derivatives designated as cash flow hedging instruments	2015	2014	2015	2014
Foreign currency forward contracts	$590	$—	$1,211	$—

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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 nine months ended September 30, 2015. Amounts shown do not include any tax effect due to the valuation allowance on the Company's deferred taxes in the United States (Note 8). Amounts are in thousands.

Beginning balance, December 31, 2014	$(796)
Change in fair value of derivative instruments	2,059
Amounts reclassified from accumulated other comprehensive loss to other income (expense) due to hedge instrument ineffectiveness	(203)
Foreign currency translation adjustments	(6,978)
Ending balance, March 31, 2015	$(5,918)
Change in fair value of derivative instruments	717
Amounts reclassified from accumulated other comprehensive loss to cost of goods sold	(112)
Amounts reclassified from accumulated other comprehensive loss to other income (expense) due to hedge instrument ineffectiveness	(418)
Foreign currency translation adjustments	2,693
Ending balance, June 30, 2015	$(3,038)
Change in fair value of derivative instruments	(94)
Amounts reclassified from accumulated other comprehensive loss to cost of goods sold	(1,018)
Amounts reclassified from accumulated other comprehensive loss to other income (expense) due to hedge instrument ineffectiveness	(62)
Foreign currency translation adjustments	(5,861)
Ending balance, September 30, 2015	$(10,073)

Foreign Currency Forward Contracts Not Designated as Hedging Instruments

The Company uses foreign currency forward contracts that are not designated as qualified 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 September 30, 2015 and December 31, 2014, the notional amounts of the Company's foreign currency forward contracts not designated as hedging instruments used to help mitigate the exposures discussed above were approximately $63,583,000 and $62,866,000, respectively. The increase in foreign currency forward contracts reflects the general timing of when the Company enters into these contracts. The Company estimates the fair value of these foreign currency forward contracts based on pricing models using current market rates, and the Company records these contracts on the balance sheet at fair value with changes in fair value recorded in earnings in other income (expense). These contracts are classified under Level 2 of the fair value hierarchy (see Note 11).

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 nine months ended September 30, 2015 and 2014, respectively (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 September 30,		Nine Months Ended September 30,	
		2015	2014	2015	2014
Foreign currency forward contracts	Other income (expense), net	$637	$8,766	$978	$7,238

In addition, for the three and nine months ended September 30, 2015, the Company recognized net foreign currency losses related to transactions with its foreign subsidiaries of $527,000 and $1,254,000, respectively. For the three and nine months ended September 30, 2014, the Company recognized net foreign currency losses of $5,030,000 and $2,662,000, respectively, related to transactions with the Company's foreign subsidiaries.

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Note 13. Segment Information

The Company has two operating segments that are organized on the basis of products, namely the golf clubs segment and golf balls segment. The golf clubs segment consists of Callaway Golf woods, hybrids, irons and wedges and Odyssey putters. This segment also includes golf apparel and footwear, golf bags, golf gloves, travel gear, headwear and other golf-related accessories, in addition to royalties from licensing of the Company's trademarks and service marks and sales of pre-owned golf clubs. The golf balls segment consists of Callaway Golf balls. There are no significant intersegment transactions.

The table below contains information utilized by management to evaluate its operating segments for the interim periods presented (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014[1]
Net sales:				
Golf Clubs	$146,522	$143,353	$577,294	$635,821
Golf Balls	29,258	25,219	113,169	116,518
	$175,780	$168,572	$690,463	$752,339
Income (loss) before income taxes:				
Golf Clubs	$6,564	$3,760	$69,555	$77,922
Golf Balls	3,511	543	17,559	17,350
Reconciling items[1]	(12,145)	(5,133		