TOPGOLF CALLAWAY BRANDS

TOPGOLF CALLAWAY BRANDS CORP.
FIRST QUARTER 2023 EARNINGS CALL PREPARED REMARKS

Lauren Scott, Director of Investor Relations

Thank you, operator and good afternoon, everyone. Welcome to Topgolf Callaway Brands' first quarter 2023 earnings conference call. I'm Lauren Scott, the Company's Director of Investor Relations. Joining me as speakers on today's call are Chip Brewer, our President and Chief Executive Officer, and Brian Lynch, our Chief Financial Officer and Chief Legal Officer.

Earlier today, the Company issued a press release announcing its first quarter 2023 financial results. In addition, there is a presentation that accompanies today's prepared remarks and may make it easier for you to follow the call. This earnings presentation, as well as the earnings press release, are both available on the Company's Investor Relations website under the "Financial Results" tab.

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

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

Chip Brewer, President and Chief Executive Officer

Thank you, Lauren. Good afternoon to everyone on our call and thank you for joining us today.

Our business is off to a strong start, with first quarter revenue and adjusted EBITDA coming in ahead of our expectations. The outperformance was driven largely by continued operational momentum at the Topgolf venues as well as a strong launch of our Paradym family of clubs. Looking forward, there is certainly some macro-economic uncertainty around the world. However, across all of our business segments, our core consumers remain engaged. And, we continue to believe our portfolio of brands is positioned to drive further growth in both revenue and profitability. We believe we are uniquely positioned to do this by meeting our consumers in a diverse set of environments that they are highly passionate about; be that on course, off course or in their active lifestyle. This certainly includes leveraging the synergies inherent in our leadership position in both on and off course golf; what we like to call Modern Golf. Turning to Topgolf specifically, and I believe this is perhaps the key point investors should take away from today's call, the team's various initiatives combined with their brand momentum have both made us increasingly confident in our ability to drive long term SVS growth, and we are now pleased to be able to communicate even higher venue profitability expectations. This increased confidence and updated expectations, have obvious and significant positive implications for the long-term value of our company.

Shifting to our segment overview, I will first start with Topgolf's results. The Topgolf venues business had another great quarter, outperforming our expectations for both revenue and profitability. Owned venues delivered 11% same venue sales growth over Q1 last year, driven by continued brand momentum, increased digital access through PIE (our inventory management system), and our new marketing initiatives. Adjusted EBITDA exceeded expectations due to continued improvement in operational efficiencies. We will speak more on this operational efficiency improvement in a moment. From a development perspective, we opened one venue during Q1; in Charleston, South Carolina, and it opened very strongly. We remain on track to open 11 new owned and operated venues in 2023, with one scheduled to open in Q2 and the balance coming in the second half of the year. And, Toptracer also had a successful quarter with over 1,550 bays installed compared to approximately 1,160 last year.

For the full year, same venues sales is now forecast to be up mid-to-high single digits, a little lower than we thought when we spoke with you in February, due to corporate events trending lower starting late in Q1. Our corporate business was strong to start the quarter and is still expected to be at approximately 2019 levels for the full year; however, with the March banking crises, and what we believe is a trend towards many companies further reducing corporate spend, we viewed it as prudent to lower our balance of year corporate sales expectations vs our original budget. We view this revision as a reflection of near-term volatility, not a long-term concern over the viability of our corporate sales channel. And, importantly, our walk-in and small events business, which is the consumer-driven portion and accounts for 80% of venue revenue, has remained robust. Like our underlying operating efficiencies, our walk in and small event business will benefit from the continued rollout of PIE, marketing and other key initiatives through the balance of this year and next. As a result, we remain confident in our Topgolf earnings forecast for this year and have increased confidence in our ability to continue to deliver sustained same venue sales growth throughout business cycles, something we recognize we must prove to the markets and we hope that our six consecutive quarters of delivered SVS growth is starting to do.

Digging a little deeper into the digital access and marketing improvements at the venues, I want to highlight some of the early success metrics. Starting with Topgolf's "Come Play Around" marketing campaign, our goal was to increase awareness primarily in markets where we have existing venues, but also more broadly given our growing national footprint. We are happy to report that awareness in-market has increased to 48%, up from 41% a year ago and 38% as recently as Dec 2021. PIE, our digital inventory management system, is also showing very promising results. As of the end of March, we had implemented PIE in 36 venues across the US, with the expectation of being in all US venues by the end of 2023. Venues with PIE in place, have seen increased bay utilization, same venue sales growth and profitability. With the help of PIE, the team grew the digital penetration of our venue business by a couple of points again last quarter, ending at just over 30%. The opportunity to further drive awareness and our digital runway are clear priorities for the Topgolf team; the results are paying off, and there's significant runway ahead to grow top and bottom line through these efforts.

I'll now turn to venue unit economics. To further underscore the progress we have made, as well as our confidence in the Topgolf venue business going forward, we are now updating the target venue unit economics and return metrics. As you will see in today's investor presentation, we are now targeting:

- 35% 4-wall Adjusted EBITDAR margins, up from 32% previously,
- a 2-and-a-half-year payback period, down from just over 3 years,
- and a 20% return on gross investment, up from approximately 17.5%.
- With these changes, we also increased our cash-on-cash return projection from 40-50% to 50-60%.

In my opinion, the updated Adjusted EBITDAR margin target is the big headline this quarter. It shows an approximate 10% improvement in the venue four wall profitability vs. the targets we published in early 2021 and nearly a 21% improvement versus actual results prior to our merger. This new target reflects the progress we have made on a lot of fronts including further improving our pricing and digital reservation strategies, bay inventory and labor management, COGS and of course our confidence in driving long term same venue sales growth. These are sustainable, long-term changes that will benefit our long-term outlook.

If you have been following our story, you know we strongly believe that our top capital allocation priority is investing in the profitable growth of our business; and that the largest portion of this is the investments we make in our venues. Given these newly disclosed targets, we have even more conviction that this investment strategy will generate outstanding shareholder returns.

Moving to the golf equipment segment, I am very proud of the performance of our new Paradym line of clubs. The entire line is doing extremely well and delivering rave reviews from consumers. We launched Paradym in late February and in the very next month the Callaway brand jumped to the # 1 US brand position in the driver, fairway wood and iron categories according to Datatech. The Paradym driver in particular continues to outperform both on Tour and in the market, with 8 wins on the PGA Tour YTD and finishing the month of March as the #1 selling driver model in the US.

From a brand perspective, Jon Rahm's historic success at the Masters was an incredible and highly visible moment for our business, with over 12 million viewers, making it the most-watched golf telecast in 5 years. We congratulate Jon and are thrilled to be partnering with him on what is a terrific run of great play.

On the women's side of the game, Rose Zhang has also had a phenomenal season so far, recently winning the Augusta National Women's Amateur tournament and setting the record for the most weeks as the number 1 ranked women's amateur. We are excited and honored to be a part of her already very promising career in golf.

Looking at the overall market for golf and the health of the game, all major indicators continue to be solid. Rounds played through March in the US were roughly flat year over year but remain significantly up vs. 2019 levels and also up versus even last year on a weather-adjusted playable hour basis. And, overall interest in the sport, as indicated by the Masters ratings, remains very high.

Turning to equipment sales specifically, the market started the year a little behind our initial expectations of flat to slightly down for the full year but we view this as totally understandable given the economic climate and how many entry-level sets were purchased over the last few years. Fortunately, our product performance is at or slightly ahead of our expectations. We see these factors essentially balancing each other out. Overall, we feel good about the health of our core golf consumer, and, despite macro-economic uncertainty, we don't see meaningful risk given both our brand heat and how passionate the consumer is about both us and golf in general. As previously mentioned, based on past data, golf has not been particularly sensitive to mild recessions.

And, for those out there that have been looking for a post-COVID reversion in golf participation, I think that we would all have to agree that there is no sign of one in the current data, as the game continues to be top of mind for what appears to be a sustainably larger audience with resulting play levels remaining elevated. And, as we look into the future, we have to keep in mind the positive long-term impact of the new structural growth now embedded in the modern golf ecosystem where our new venues alone should add 3 to 4 million new off course golf participants each year.

Turning now to our Active Lifestyle segment. This business met our high expectations in Q1 and is forecast to do so for the full year. We are seeing continued strong E-commerce sales growth from both TravisMathew and Jack Wolfskin. TravisMathew continued to successfully expand its Women's launch during Q1 and also recently introduced active apparel. Despite more challenging market conditions this year, this brand is on track for another strong year of both bottom and top line growth. For Jack Wolfksin, performance in China outperformed expectations during the quarter and continues to trend positively. Our business in Europe was challenged by difficult business conditions and high customer inventories but still delivered a nice quarter of growth. Overall, we are pleased with the brand's direction, the quality of the products and, despite uncertainty on market conditions in Europe for the balance of this year, we remain confident in the long-term outlook.

Lastly, turning to financial items. In addition to the success of the business segments over the quarter, I want to commend our finance team on the completion of our debt refinancing. The new capital structure provides increased flexibility and a lower long-term cost of capital. It also simplifies and strengthens our capital structure while maintaining modest net leverage and increasing our liquidity by over $300 million. I'm no financial expert, but I'm certain the combination of less financial risk, increased flexibility and a lower cost of capital has to be a good thing.

In conclusion, we remain confident that the Modern Golf ecosystem will grow again this year and we remain excited about the direction of our business. In the near term, we are increasingly confident in our ability to hit our 2023 expectations including transitioning to positive free cash flow this year and then further EBITDA as well as EPS growth going forward. With this increased confidence in 2023 and the higher venue economic expectations announced today, our confidence in delivering on, or exceeding, our previously announced long-term economic targets has, of course, also increased.

And now I'll turn the call to Brian to provide more detail on our financials and outlook.

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

Thank you, Chip, and good afternoon, everyone.

As Chip mentioned, 2023 is off to a strong start and we are very pleased with our first quarter results. Demand remains healthy, inventories are receding, and our debt refinancing was very successful, putting us in a good liquidity position with funded net debt levels at approximately 2.3x. And even more importantly, the long-term profitability of, and the corresponding shareholder value creation opportunity related to, the Topgolf business is turning out to be even more successful than we expected.

Turning now to our results. Our first quarter results include net revenue of $1.167 billion dollars, a year-over-year increase of 12%, or 15% on a constant currency basis, led by 11% same venue sales growth at Topgolf and a 28% increase in Active Lifestyle revenue. We achieved this sales growth despite a $29 million negative impact from changes in foreign currency exchange rates and an $80 to $100 million fill-in at retail in the golf equipment business that occurred during the first half of 2022.

In the first quarter, non-GAAP operating income was $91 million, increasing over 2% on a constant currency basis, or down 14% currency impacted. We are pleased with this performance given the tough year-over-year comparison for the Golf Equipment business as we anniversary the post-covid retail channel fill in during the first half of 2022 and the investments in labor and marketing we made in the Topgolf business which I will touch on further in a minute.

Net Income decreased $37.7 million on a non-GAAP basis, which is ahead of plan. This decrease includes an $18.6 million increase in interest expense related to higher interest rates and increased interest related to new Topgolf venues and $17.3 million of negative foreign currency translation, as well as a $7.2 million decrease in other income, net hedge gains.

Lastly, Q1 Adjusted EBITDA was $157 million, up 3% on a constant currency basis, or down 7% currency impacted. This result was ahead of the guidance we provided with Q4 earnings, with the outperformance largely attributable to the successful Paradym launch, improved supply, and increased venue profitability at Topgolf.

Now turning to our segment performance. In Q1 2023, Topgolf contributed $404 million in revenue, a year-over-year increase of 25%, or 26% on a constant currency basis, driven by both strong same venue sales growth and better than expected performance in the non-comp, newly opened venues.

Topgolf's segment operating income decreased $3.7 million or 132 basis points of operating margin due to the planned increase in expenses we discussed last quarter, including marketing expenses related to Topgolf's new marketing awareness campaign and the full impact of the investments in labor in the second half of 2022. Combined, these investments added over 300 bps of headwind in the quarter. The underlying profitability of this business remains strong. Without the impact of these targeted investments on the seasonally low first quarter, operating margin would have increased nicely. Adjusted EBITDA for Topgolf was $48 million, up approximately $6 million compared to Q1 2022 and our guidance due to outperformance in the venue business.

Golf Equipment generated $444 million in revenue, down 5% over Q1 2022, or just over 1% on a constant currency basis. This was a better-than-planned result given the retail channel fill-in I previously mentioned. Segment operating income decreased 19% to $82 million vs Q1 2022, primarily due to foreign exchange rate impacts. Constant currency gross margin also grew, up 140 basis points in the quarter with pricing and decreased freight expenses more than offsetting other inflationary pressures.

Lastly, our Active Lifestyle segment revenue for the quarter was $320 million, up 28%, or 32% on a constant currency basis year-over-year. Segment operating income increased 40% to $37 million. This increase was led by strong performance of the TravisMathew and Jack Wolfskin brands and favorable freight costs, which more than offset unfavorable foreign exchange rate impacts and inflation.

As we turn to the balance sheet, I'd like to highlight the debt refinancing we completed in March. Overall, the transactions added over $300 million of additional liquidity, reduced our cost of debt, and extended the maturities of our credit facilities, thereby simplifying and strengthening our capital structure. While we will have some increased debt and interest expense in the short-term related to the upsizing of the term loan, the additional liquidity gives us flexibility on how to finance Topgolf venues and therefore over the long-term the amount of incremental debt and interest expense should be the same or lower than if we had not upsized the term loan.

More specifically, we entered into a new $1.25 billion 7-year senior secured term loan B. A large portion of the proceeds were used to refinance both the Callaway and Topgolf term loan B, and the Topgolf revolving credit facility, all of which have been paid off and no longer exist. We used the balance of the proceeds to pay down our ABL facility. We also upsized and extended the existing Topgolf Callaway Brands $400 million ABL with a new 5-year $525 million senior secured ABL revolving credit facility.

For the debt we replaced as part of the refinance, the payback was under two years and generated go-forward cash interest savings of over $12 million per year. Those savings are being offset by the additional liquidity we added causing interest expense to be higher in 2023 than what we assumed for guidance in our Q4 earnings call.

Moving to the balance sheet, as of March 31, 2023, available liquidity, which is comprised of cash-on-hand and availability under our credit facilities, was $626 million dollars compared to $576 million dollars at March 31, 2022 and $415 million at December 31, 2022.

At quarter-end, we had total net debt of $2.210 billion dollars, excluding the convertible debt of approximately $258 million, compared to $1.457 billion at the end of Q1 2022. This increase relates primarily to incremental new venue financing and replenishment of working capital for the non-Topgolf business.

Our Net Debt leverage, which excludes the convertible note, was a better-than-expected 4.1x at March 31, 2023 compared to 3.0x at March 31, 2022. The year-over-year increase was due to the new venue development and increases in working capital. We expect the net debt leverage ratio will increase slightly in Q2 and then decrease in the second half as the business generates free cash flow.

Consolidated Net Accounts Receivable was $455 million dollars as of March 31, 2023, compared to $413 million dollars at the end of Q1 2022. Non-Topgolf days sales outstanding were approximately flat year over year.

Our inventory balance increased to $930 million dollars at the end of the first quarter of 2023 compared to $552 million at March 31, 2022, but down from our December 31, 2022 balance of $959 million. We are still on track to be at more normal levels of inventory by the end of the year. The strong start to the Golf Equipment segment and continued momentum of the Active Lifestyle segment gives us increased confidence in this. The quality of the inventory is good as older inventory was generally cleaned up during the pandemic.

Capital Expenditures for the first quarter were $70 million dollars, net of venue financing reimbursements. This includes $51 million dollars related to Topgolf. For full year 2023, we expect total company capex of $270 million, including $190 million from Topgolf, which is net of venue financing reimbursements.

Now turning to our balance of the year outlook. We are increasing the midpoint of our full year 2023 revenue guidance resulting in a new range of $4.42 billion to $4.47 billion, and increasing the midpoint of our Adjusted EBITDA guidance resulting in a new range of $625 million to $640 million. We are also increasing the Topgolf Adjusted EBITDA outlook to $315 million to $325 million to reflect the increased profitability at the venues even with a slight decrease in same venue sales expectations.

For the second quarter 2023, we estimate revenue to be within the range of $1.175 billion and $1.195 billion, up from Q2 2022's reported $1.1 billion. We expect Topgolf segment revenue to be within the range of $475 - $485 million, with same venue sales growth of flat to up 4% and continued strong performance at the non-comp, new venues. As a reminder, Q2 2022 was a strong quarter for Topgolf given the pent-up demand amid Omicron-related shutdowns in Q1 last year.

We estimate Q2 Adjusted EBITDA to be within the range of $195 - $205 million, slightly down from Q2 2022, which assumes a Q2 Adjusted EBITDA for the Topgolf segment to be within the range of $87 - $93 million, up slightly compared to last year. Like the first quarter, second quarter year over year comparisons will be impacted by the 2022 retail channel fill-in in the golf equipment segment and the investments in Topgolf labor and marketing expenses I mentioned earlier. The skewed year over year comparisons should moderate in the second half.

Overall, we feel good about our business. While we are cognizant of the macroeconomic uncertainty around the world, the fundamentals of our business remain strong. Topgolf venue development and same venue sales growth remain robust; we are not seeing a reversion in golf; our Active Lifestyle business was up significantly for the first quarter; and Topgolf and the total company are on track to be free cash flow positive well ahead of our forecasts at the time of the merger. Finally, and most importantly, we are well on our way to achieving the increased venue profitability targets Chip mentioned earlier. Achieving these new targets should result in a higher enterprise valuation over the long-term.

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

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