

GOLFSMITH INTERNATIONAL HOLDINGS INC

Form 10-Q

October 27, 2010

[Table of Contents](#)

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended October 2, 2010

OR

.. **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from to

Commission file number 000-52041

GOLFSMITH INTERNATIONAL HOLDINGS, INC.

(Exact Name of Registrant as Specified in Its Charter)

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Delaware
(State or Other Jurisdiction of
Incorporation or Organization)

16-1634847
(I.R.S. Employer
Identification No.)

11000 N. IH-35, Austin, Texas
(Address of Principal Executive Offices)

78753 3195
(zip code)

Registrant's Telephone Number, Including Area Code: (512) 837-8810

Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report: Not Applicable

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 No

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 No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer
Non-accelerated filer Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class of Common Stock
\$.001 par value

Outstanding at October 27, 2010
15,803,035 Shares

Table of Contents

GOLFSMITH INTERNATIONAL HOLDINGS, INC.

QUARTERLY REPORT ON FORM 10-Q

FOR THE QUARTER ENDED OCTOBER 2, 2010

TABLE OF CONTENTS

| | Page |
|--|-------------|
| <u>Part I. Financial Information</u> | |
| <u>Item 1. Financial Statements</u> | |
| <u>Condensed Consolidated Balance Sheets at October 2, 2010 (unaudited), October 3, 2009 (unaudited) and January 2, 2010</u> | 3 |
| <u>Unaudited Condensed Consolidated Statements of Operations for the three- and nine-month periods ended October 2, 2010 and October 3, 2009</u> | 4 |
| <u>Unaudited Condensed Consolidated Statements of Cash Flows for the three- and nine-month periods ended October 2, 2010 and October 3, 2009</u> | 5 |
| <u>Notes to Unaudited Condensed Consolidated Financial Statements</u> | 6 |
| <u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 11 |
| <u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u> | 17 |
| <u>Item 4. Controls and Procedures</u> | 17 |
| <u>Part II. Other Information</u> | |
| <u>Item 1. Legal Proceedings</u> | 18 |
| <u>Item 1A. Risk Factors</u> | 18 |
| <u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u> | 18 |
| <u>Item 3. Defaults Upon Senior Securities</u> | 18 |
| <u>Item 4. [Reserved]</u> | 18 |
| <u>Item 5. Other Information</u> | 18 |
| <u>Item 6. Exhibits</u> | 18 |
| <u>Signatures</u> | 19 |

Table of Contents**PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****Golfsmith International Holdings, Inc.****Condensed Consolidated Balance Sheets**

| | October 2, 2010 (unaudited) | October 3, 2009 (unaudited) | January 2, 2010 |
|---|-----------------------------------|-----------------------------------|-----------------------|
| ASSETS | | | |
| Current assets: | | | |
| Cash | \$ 767,632 | \$ 3,703,161 | \$ 696,198 |
| Receivables, net of allowances of \$217,131, \$230,763 and \$220,733 at October 2, 2010, October 3, 2009 and January 2, 2010, respectively | 1,998,339 | 1,606,503 | 1,949,411 |
| Inventories | 80,734,274 | 79,062,653 | 77,991,098 |
| Prepaid expenses and other current assets | 5,914,758 | 4,328,150 | 4,737,077 |
| Total current assets | 89,415,003 | 88,700,467 | 85,373,784 |
| Property and equipment, net | 58,126,118 | 56,661,763 | 56,475,787 |
| Intangible assets, net | 25,652,606 | 25,985,630 | 25,945,699 |
| Other long-term assets | 1,735,941 | 1,159,859 | 1,076,592 |
| Total assets | \$ 174,929,668 | \$ 172,507,719 | \$ 168,871,862 |
| LIABILITIES AND STOCKHOLDERS EQUITY | | | |
| Current liabilities: | | | |
| Accounts payable | \$ 33,966,447 | \$ 35,917,806 | \$ 32,371,826 |
| Accrued expenses and other current liabilities | 14,934,597 | 14,233,461 | 19,491,865 |
| Total current liabilities | 48,901,044 | 50,151,267 | 51,863,691 |
| Deferred rent liabilities | 14,625,706 | 15,029,961 | 13,412,548 |
| Long-term debt | 42,636,399 | 33,680,721 | 36,000,000 |
| Total liabilities | 106,163,149 | 98,861,949 | 101,276,239 |
| Stockholders Equity: | | | |
| Common stock \$.001 par value; 25,000,000 shares authorized at October 2, 2010 and 100,000,000 shares authorized at each October 3, 2009 and January 2, 2010; and 15,803,035 shares issued and outstanding at October 2, 2010, 15,777,185 shares issued and outstanding at each October 3, 2009 and January 2, 2010 | 15,804 | 15,778 | 15,778 |
| Preferred stock \$.001 par value; 10,000,000 shares authorized at October 2, 2010, October 3, 2009 and January 2, 2010; no shares issued and outstanding | | | |
| Deferred stock units \$.001 par value; 454,998 shares outstanding at October 2, 2010, 314,998 shares outstanding at each October 3, 2009 and January 2, 2010 | 455 | 315 | 315 |
| Additional paid-in capital | 125,000,730 | 123,845,197 | 124,042,392 |
| Accumulated other comprehensive loss | (163,888) | (205,904) | (153,609) |
| Accumulated deficit | (56,086,582) | (50,009,616) | (56,309,253) |

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| | | | |
|---|-----------------------|-----------------------|-----------------------|
| Total stockholders' equity | 68,766,519 | 73,645,770 | 67,595,623 |
| Total liabilities and stockholders' equity | \$ 174,929,668 | \$ 172,507,719 | \$ 168,871,862 |

See accompanying notes to unaudited condensed consolidated financial statements

Table of Contents**Golfsmith International Holdings, Inc.****Condensed Consolidated Statements of Operations****(Unaudited)**

| | Three Months Ended | | Nine Months Ended | |
|--|--------------------|--------------------|--------------------|--------------------|
| | October 2, 2010 | October 3, 2009 | October 2, 2010 | October 3, 2009 |
| Net revenues | \$ 93,272,151 | \$ 90,586,270 | \$ 278,966,906 | \$ 274,176,044 |
| Cost of products sold | 61,187,785 | 59,534,966 | 182,790,788 | 180,166,834 |
| Gross profit | 32,084,366 | 31,051,304 | 96,176,118 | 94,009,210 |
| Selling, general and administrative | 31,529,010 | 29,490,794 | 93,163,244 | 89,481,609 |
| Store pre-opening / closing expenses | 262,198 | 144,400 | 719,864 | 255,011 |
| Lease termination and impairment charges | 1,349,970 | | 1,349,970 | |
| Total operating expenses | 33,141,178 | 29,635,194 | 95,233,078 | 89,736,620 |
| Operating income (loss) | (1,056,812) | 1,416,110 | 943,040 | 4,272,590 |
| Interest expense | 356,806 | 268,340 | 806,111 | 1,060,203 |
| Other income, net | 40,310 | 3,828 | 64,856 | 50,191 |
| Income (loss) before income taxes | (1,373,308) | 1,151,598 | 201,785 | 3,262,578 |
| Income tax benefit (expense) | 229,430 | (51,967) | 20,886 | (507,556) |
| Net income (loss) | \$ (1,143,878) | \$ 1,099,631 | \$ 222,671 | \$ 2,755,022 |
| Net income (loss) per common share - basic | \$ (0.07) | \$ 0.07 | \$ 0.01 | \$ 0.17 |
| Net income (loss) per common share - diluted | \$ (0.07) | \$ 0.07 | \$ 0.01 | \$ 0.17 |
| Basic weighted average common shares outstanding | 16,254,860 | 16,092,183 | 16,178,853 | 16,062,073 |
| Diluted weighted average common shares outstanding | 16,254,860 | 16,224,824 | 16,889,560 | 16,077,286 |

See accompanying notes to unaudited condensed consolidated financial statements

Table of Contents**Golfsmith International Holdings, Inc.****Condensed Consolidated Statements of Cash Flows****(Unaudited)**

| | Nine Months Ended | |
|---|--------------------|--------------------|
| | October 2, 2010 | October 3, 2009 |
| Operating Activities | | |
| Net income | \$ 222,671 | \$ 2,755,022 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation | 7,456,567 | 7,132,981 |
| Provision for bad debt expense | 205,162 | 204,989 |
| Amortization of intangible assets | 293,093 | 283,267 |
| Amortization of debt issue costs | 114,816 | 123,120 |
| Stock-based compensation | 904,148 | 599,468 |
| Non-cash impairment charges | 371,286 | |
| Change in operating assets and liabilities: | | |
| Accounts receivable | (224,441) | (122,484) |
| Inventories | (3,973,823) | 10,186,005 |
| Prepays and other current assets | (1,316,357) | 2,055,493 |
| Other assets | (384,239) | (231,559) |
| Accounts payable | 2,722,805 | 5,365,094 |
| Accrued expenses and other current liabilities | (4,595,671) | (5,064,896) |
| Deferred rent | 1,635,250 | 2,820,175 |
| Net cash provided by operating activities | 3,431,267 | 26,106,675 |
| Investing Activities | | |
| Purchases of property and equipment | (9,652,926) | (7,020,497) |
| Net cash used in investing activities | (9,652,926) | (7,020,497) |
| Financing Activities | | |
| Principal payments on line of credit | (79,643,275) | (111,186,502) |
| Proceeds from line of credit | 86,279,674 | 93,159,001 |
| Debt issuance costs | (389,926) | |
| Proceeds from exercise of stock options | 54,354 | |
| Net cash provided by (used in) financing activities | 6,300,827 | (18,027,501) |
| Effect of exchange rate changes on cash | (7,734) | (10,525) |
| Change in cash | 71,434 | 1,048,152 |
| Cash, beginning of period | 696,198 | 2,655,009 |
| Cash, end of period | \$ 767,632 | \$ 3,703,161 |
| Supplemental cash flow information: | | |
| Interest payments | \$ 800,043 | \$ 1,396,610 |
| Income tax payments | \$ 314,115 | \$ 327,386 |

See accompanying notes to unaudited condensed consolidated financial statements

Table of Contents

GOLFSMITH HOLDINGS INTERNATIONAL, INC.

NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Nature of Business and Basis of Presentation

Basis of Presentation and Principles of Consolidation

Golfsmith International Holdings, Inc. (the Company) is a multi-channel, specialty retailer of golf and tennis equipment and related apparel and accessories. The Company offers golf and tennis equipment from top national brands as well as its own proprietary brands. In addition, the Company provides clubmaking services, including the sale of individual club components for customers to build clubs, custom fitting and repair services. The Company markets its products through retail stores and through its direct-to-consumer channels, which include its Internet site and catalogs.

The accompanying unaudited condensed consolidated financial statements include the accounts of the Company, its wholly-owned subsidiary Golfsmith International, Inc. (Golfsmith) and Golfsmith's subsidiaries. The Company has no operations other than its investment in Golfsmith. Accordingly, these unaudited condensed consolidated financial statements represent the operations of Golfsmith and its subsidiaries. All inter-company account balances and transactions have been eliminated in consolidation.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. Actual results could differ from those estimates. As information in this report relates to interim financial information, certain footnote disclosures required by GAAP for complete audited financial statements have been condensed or omitted. In the opinion of management, the unaudited condensed consolidated financial statements reflect all adjustments consisting of normal and recurring accruals considered necessary for a fair presentation of the Company's financial position, results of operations and cash flows for the periods presented. Operating results for the three- and nine-month periods ended October 2, 2010, are not necessarily indicative of the results that may be expected for the fiscal year ending January 1, 2011. These unaudited condensed consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements and notes thereto for the year ended January 2, 2010, included in the Company's Annual Report on Form 10-K filed with the SEC on February 25, 2010.

Revenue Subject to Seasonal Variations

The Company's business is seasonal and its sales leading up to and during the warm weather golf season and the December holiday gift-giving season have historically contributed a significantly higher percentage of the Company's annual net revenues and annual net operating income than in other periods in its fiscal year.

Fiscal Year

The Company's fiscal year ends on the Saturday closest to December 31. The three-month periods ended October 2, 2010 and October 3, 2009 both consisted of 13 weeks. The nine-month periods ended October 2, 2010 and October 3, 2009 both consisted of 39 weeks.

Foreign Currency Translation

The financial statements of the Company's international operations are translated into U.S. dollars using period-end exchange rates for assets and liabilities, historical exchange rates for stockholders' equity, and average exchange rates during the period for revenues and expenses. Cumulative translation gains and losses are excluded from results of operations and recorded as a separate component of accumulated other comprehensive income (loss). Gains and losses resulting from the revaluation of long-term intercompany receivable and payable balances are recorded in accumulated other comprehensive income (loss). Gains and losses resulting from transactions denominated in foreign currencies are included in other income (expense) in the condensed consolidated statements of operations and were not material for the periods presented.

Comprehensive Income (Loss)

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Comprehensive income (loss) is computed as net income (loss) plus certain other items that are recorded directly to stockholders' equity. In addition to net income (loss), the components of comprehensive income (loss) also include foreign currency translation adjustments. There were no material changes to comprehensive income (loss) during the three and nine month periods ended October 2, 2010 and October 3, 2009.

Table of Contents

Fair Value of Financial Instruments

The carrying amounts of the Company's cash, accounts receivable and accounts payable approximate fair values due to their short-term nature. The carrying value of the Company's credit facility at October 2, 2010 approximates fair value based on rates available for similar debt available to comparable companies in the marketplace.

Reclassifications

Reclassification from store pre-opening/closing expenses to selling, general and administrative expense in the amount of \$0.3 million and \$0.1 million for the three and nine months ended October 3, 2009, respectively, related to relocation expenses incurred in 2009 for two stores that, after relocation, continued to meet the criteria of a comparable store. Reclassification from cost of products sold to selling, general and administrative expense in the amount of \$0.1 million and \$0.2 million for the three and nine months ended October 3, 2009, respectively, related to club manufacturing research and development expenses which are regarded as selling, general and administrative expense for fiscal 2010. Reclassifications from prepaid expenses and other current assets to accounts payable in the amount of \$2.9 million and \$2.3 million as of October 3, 2009 and as of January 2, 2010, respectively, related to vendor rebates and credits which have been netted against related outstanding balances in accounts payable for each of the periods then ended. The effect of these reclassifications is not material and did not affect the Company's reported net income or cash flows.

Recent Accounting Pronouncements

In December 2009, the FASB issued additional authoritative guidance requiring new disclosures related to fair value measurements. The new guidance requires entities to separately disclose the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and to describe the reasons for the transfers. The guidance also requires entities to present separately information about purchases, sales, issuances, and settlements within Level 3 fair value measurements. The new guidance is effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements within Level 3 fair value measurements. Those disclosures will be effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. The adoption of the guidance did not have an impact on the Company's consolidated results of operations or financial position.

In February 2010, the FASB amended the authoritative guidance it issued in May 2009 on subsequent events. The original guidance required SEC filers to evaluate subsequent events through the date of financial statement issuance and to disclose the date through which subsequent events have been evaluated. The guidance was amended so that SEC filers are no longer required to disclose the date through which subsequent events have been evaluated. The new guidance was effective immediately upon issuance of the amendment which was in February 2010. We do not anticipate that the adoption of the guidance will have an impact on the Company's consolidated results of operations or financial position.

In June 2009, the FASB issued guidance which amends previously issued guidance on variable interest entities. This new guidance prescribes a qualitative model for identifying whether a company has a controlling financial interest in a variable interest entity, or VIE, and eliminates the quantitative model previously prescribed. The new model identifies two primary characteristics of a controlling financial interest: (1) provides a company with the power to direct significant activities of the VIE; and (2) obligates a company to absorb losses of and/or provides rights to receive benefits from the VIE. The new guidance requires a company to reassess on an ongoing basis whether it holds a controlling financial interest in a VIE. A company that holds a controlling financial interest is deemed to be the primary beneficiary of the VIE and is required to consolidate the VIE. This statement is effective for fiscal years beginning after November 15, 2009, and interim periods within those fiscal years. The adoption of the guidance did not have a material impact on the Company's consolidated results of operations or financial position.

In October 2009, the FASB issued guidance on revenue recognition that provides clarification on whether multiple deliverables exist, how the arrangement should be separated, and the consideration allocated. An entity is required to allocate revenue in an arrangement using estimated selling prices of deliverables in the absence of vendor-specific objective evidence or third-party evidence of selling price. These amendments also eliminate the use of the residual method and require an entity to allocate revenue using the relative selling price method. These amendments significantly expand the disclosure requirements for multiple-deliverable revenue arrangements. These provisions are to be applied on a prospective basis for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010, with earlier application permitted. The adoption of the guidance is not expected to have a material impact on the Company's consolidated results of operations or financial position.

Table of Contents**2. Basic and Diluted Net Income (Loss) Per Common Share**

The calculation for basic net income (loss) per share of common stock is based on the weighted average number of shares of common stock outstanding, including outstanding deferred common stock units (DSUs). Diluted net income (loss) per share of common stock is computed based on the weighted average number of shares of common stock outstanding, including outstanding DSUs, adjusted by the number of additional shares that would have been outstanding had the potentially dilutive common shares been issued. Potentially dilutive shares of common stock include outstanding stock options.

The following table sets forth the computation of basic and diluted net income (loss) per common share:

| | Three Months Ended | | Nine Months Ended | |
|---|--------------------|--------------------|--------------------|--------------------|
| | October 2, 2010 | October 3, 2009 | October 2, 2010 | October 3, 2009 |
| Net income (loss) | \$ (1,143,878) | \$ 1,099,631 | \$ 222,671 | \$ 2,755,022 |
| Basic: | | | | |
| Weighted-average shares of common stock outstanding | 15,799,862 | 15,777,185 | 15,787,957 | 15,777,185 |
| Weighted-average shares of deferred common stock units outstanding | 454,998 | 314,998 | 390,896 | 284,888 |
| Shares used in computing basic net income (loss) per common share | 16,254,860 | 16,092,183 | 16,178,853 | 16,062,073 |
| Effect of dilutive securities (1): | | | | |
| Stock options | | 132,641 | 710,707 | 15,213 |
| Shares used in computing diluted net income (loss) per common share | \$ 16,254,860 | \$ 16,224,824 | \$ 16,889,560 | \$ 16,077,286 |
| Basic net income (loss) per common share | \$ (0.07) | \$ 0.07 | \$ 0.01 | \$ 0.17 |
| Diluted net income (loss) per common share | \$ (0.07) | \$ 0.07 | \$ 0.01 | \$ 0.17 |

(1) Potentially dilutive shares of common stock include outstanding stock options. The computation of dilutive shares for the three months ended October 2, 2010 excluded 1,972,900 of outstanding options, because such outstanding options would have been anti-dilutive due to the Company's net loss.

On May 4, 2010, the Company's stockholders approved an amendment to the Company's Second Amended and Restated Certificate of Incorporation to decrease the number of authorized shares of common stock from 100 million to 25 million. This amendment relating to the change in authorized shares was filed with the Delaware Secretary of State on May 5, 2010.

Non-Employee Director Compensation Plan

On May 4, 2010, the Company's Board of Directors approved an amendment to the Non-Employee Director Compensation Plan providing changes in the annual retainer and annual grant of DSU's.

3. Income Taxes

In fiscal 2010 and 2009, the Company's provision for income taxes consists primarily of state and foreign income taxes. Due to the utilization of the deferred tax assets relating to net operating losses, the Company does not anticipate paying U.S. federal income taxes in fiscal 2010.

The Company had \$0.09 million in unrecognized tax benefits as of October 2, 2010. The unrecognized tax benefits relate to the uncertainty regarding deductions taken on tax returns that have not been examined by the applicable tax authorities. Absent further action by the applicable taxing authorities, the Company will recognize these benefits during the three months ended January 1, 2011 due to the closing of open tax year. The tax years 2006 through 2009 remain open to examination by the major taxing jurisdictions to which the Company is subject.

Table of Contents

4. Debt

Credit Facility

On July 9, 2010, the Company's Amended and Restated Credit Agreement (the *Credit Agreement*) originally entered into on June 20, 2006, and as subsequently amended on September 26, 2007, was amended by entering into the Second Amendment to Amended and Restated Credit Agreement (the *Second Amendment*) by and among Golfsmith International, L.P., Golfsmith NU, L.L.C., and Golfsmith USA, L.L.C., as borrowers (the *Borrowers*), the Company and the subsidiaries of the Company identified therein, as credit parties (the *Credit Parties*) and General Electric Capital Corporation, as administrative agent (the *Agent*) and lender. The term of the Credit Agreement has, pursuant to the Second Amendment, among other things, been extended 48 months from the effective date of the Second Amendment and expires on July 9, 2014. The Credit Agreement, as amended, (the *Credit Facility*) consists of a \$90.0 million asset-based revolving credit facility (the *Revolver*), including a \$5.0 million letter of credit sub facility. Borrowings incurred under the Credit Facility will be used for working capital and capital expenditures of the Borrowers and their subsidiaries (the *Loans*).

Interest Rate and Fees. Borrowings outstanding under the Credit Facility currently bear interest per annum, at the Company's election, at a rate equal to either (1) LIBOR plus two and three quarters of a percent (2.75%, the *Applicable Revolver LIBOR Margin*), or (2) the *Base Rate*, which is equal to the highest of (i) the publicly quoted rate as published by *The Wall Street Journal* on corporate loans posted by at least 75% of the nation's 30 largest banks, (ii) the Federal Funds Rate plus 300 basis points per annum, and (iii) the sum of LIBOR plus the excess of the *Applicable Revolver LIBOR Margin* over a quarter of a percent (0.25%, the *Applicable Revolver Index Margin*). Commencing on January 1, 2011, the applicable margins are subject to adjustment (up or down) prospectively on a quarterly basis on the first business day of each fiscal quarter as determined by average daily borrowing availability for the immediately preceding quarter. The fee in respect of the Borrowers non-use of available funds is 0.375% with no utilization-based decrease and is payable monthly. During the three and nine months ended October 2, 2010, the weighted average interest rate on the Company's outstanding borrowings was 3.10% and 2.62%, respectively. The weighted average interest rate on the Company's outstanding borrowings during the three and nine months ended October 3, 2009 was 2.47% and 2.71%, respectively.

Covenants and Events of Default. The Credit Facility contains customary affirmative covenants regarding, among other things, the delivery of financial and other information to the lenders, maintenance of records, compliance with law, maintenance of property and insurance and conduct of the Company's existing business. The Credit Facility also contains certain customary negative covenants that limit the ability of the Credit Parties to, among other things, create liens, make investments, enter into transactions with affiliates, incur debt, acquire or dispose of assets, including merging with another entity, enter into sale-leaseback transactions and make certain restricted payments. The foregoing restrictions are subject to certain customary exceptions for facilities of this type. The Credit Facility includes events of default (and related remedies, including acceleration of the Loans made thereunder) usual for a facility of this type, including payment default, covenant default (including breaches of the covenants described above), cross-default to other indebtedness, material inaccuracy of representations and warranties, bankruptcy and involuntary proceedings, change of control and judgment default. Many of the defaults are subject to certain materiality thresholds and grace periods usual for a facility of this type. As of October 2, 2010, October 3, 2009 and December 31, 2009, the Company was in compliance with all applicable covenants.

Borrowing Capacity. Available amounts under the Credit Facility are calculated against a borrowing base. The borrowing base is limited to (i) 90% of the net amount of Borrowers' eligible accounts, as defined in the Credit Facility, plus (ii) the lesser of (x) 70% of the Borrowers' eligible inventory, as defined in the Credit Facility, or (y) up to 90% of the Borrowers' net orderly liquidation value of eligible inventory, plus (iii) the lesser of 63% of the fair market value of eligible real estate, as defined in the Credit Facility, and minus (iv) any reserves, as defined in the Credit Facility (reserves associated with gift card liability are 25% and customer deposits are 50% of the Borrowers' book value). The Agent has the right to establish, modify or eliminate reserves against eligible inventory and accounts from time to time in its reasonable credit judgment. The Credit Facility stipulates that borrowing availability at any given time cannot be less than \$3.5 million. In addition, when the available amount of the Loans is less than 15% of the borrowing base, the Agent may request that amounts in the Borrowers' accounts be forwarded to a deposit account designated by the Agent.

At October 2, 2010, the Company had \$42.6 million of outstanding borrowings under its Credit Facility and \$18.4 million of borrowing availability after giving effect to all reserves. At October 3, 2009, the Company had \$33.7 million of outstanding borrowings under its Credit Facility and \$22.5 million of borrowing availability after giving effect to all reserves. At January 2, 2010, the Company had \$36.0 million of outstanding borrowings under its Credit Facility and \$17.8 million of borrowing availability after giving effect to all reserves.

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Guarantees and Collateral. Borrowings under the Credit Facility are jointly and severally guaranteed by the Credit Parties, and are secured by a security interest granted in favor of the Administrative Agent, for itself and for the benefit of the lenders, in substantially all of the personal and owned real property of the Credit Parties, including a lien on all of the equity securities of the Borrowers and each of the Borrower's current and future domestic subsidiaries.

Table of Contents

The Company has no operations other than its investment in its wholly-owned subsidiary Golfsmith, and its liability under its Credit Facility. Golfsmith and its domestic subsidiaries comprise all of the Company's assets, liabilities and operations, including its liabilities under its Credit Facility. There are no restrictions in the Credit Facility on the transfer of funds in the ordinary course of business between the Company, Golfsmith and any of Golfsmith's domestic subsidiaries.

5. Intangible Assets

Identifiable intangible assets consisted of the following as of each of the periods presented:

| | October 2, 2010 | October 3, 2009 | January 2, 2010 |
|---|----------------------|----------------------|----------------------|
| Amortizable intangible assets: | | | |
| Customer database - gross carrying amount | \$ 3,454,205 | \$ 3,399,205 | \$ 3,454,205 |
| Customer database - accumulated amortization | (3,031,850) | (2,643,826) | (2,738,757) |
| Total amortizable intangible assets | \$ 422,355 | \$ 755,379 | \$ 715,448 |
| Indefinite-lived intangible assets: | | | |
| Patents | \$ 100,000 | \$ 100,000 | \$ 100,000 |
| Trade names | 11,158,000 | 11,158,000 | 11,158,000 |
| Trademarks | 13,972,251 | 13,972,251 | 13,972,251 |
| Total indefinite-lived intangible assets | \$ 25,230,251 | \$ 25,230,251 | \$ 25,230,251 |
| Intangibles assets, net | \$ 25,652,606 | \$ 25,985,630 | \$ 25,945,699 |

Amortization expense related to the Company's customer database was approximately \$0.1 million in each of the three-month periods ended October 2, 2010 and October 3, 2009, and was approximately \$0.3 million in each of the nine-month periods ended October 2, 2010 and October 3, 2009. Amortization expense is recorded in selling, general and administrative expenses in the unaudited condensed consolidated statements of operations. The Company's customer database is being amortized over the estimated useful life of 9 years.

Future estimated amortization expense related to the Company's customer database is as follows:

| | |
|----------------|-------------------|
| Remaining 2010 | \$ 111,841 |
| 2011 | 310,514 |
| Total | \$ 422,355 |

6. Commitments and Contingencies*Lease Commitments*

The Company leases all but one of its store locations under operating leases that provide for annual payments that, in some cases, increase over the life of the lease. The operating leases expire at various times through June 2022. The aggregate of the minimum annual payments is expensed on a straight-line basis over the term of the related lease without consideration of renewal option periods, rent holidays and escalating rents. In addition, the Company has entered into certain sublease agreements with third parties to sublease retail space previously occupied by the Company. The sublease terms end at various times through June 2019. Rent expense, net of sublease rental income, was \$6.6 million and \$5.5 million for the three-month periods ended October 2, 2010 and October 3, 2009, respectively, and was \$18.1 million and \$16.3 million for the nine-month periods ended October 2, 2010 and October 3, 2009, respectively. Sublease rental income recorded as a reduction to rent expense

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was \$0.3 million and \$0.3 million for the three-month periods ended October 2, 2010 and October 3, 2009, respectively and was \$0.8 million and \$0.9 million for the nine-month periods ended October 2, 2010 and October 3, 2009, respectively.

Table of Contents

The Company previously entered into a guarantee agreement in conjunction with assigning one of its leases to a subtenant. The guarantee provides that the Company will assume responsibility for rental payments in the event the subtenant defaults. The amounts of future rental payments as of October 2, 2010 are \$0.1 million for 2010, \$0.3 million for 2011 and \$0.2 million for 2012. The Company believes the probability of loss on this guarantee is remote, and therefore it has not recorded an accrual related to the guarantee of these payments.

Legal Proceedings

On October 23, 2009, David O. Flynn, on behalf of himself and all others similarly situated, filed a putative class action lawsuit in the California Superior Court in Orange County against the Company asserting violations of applicable wage and hour and unfair competition laws, seeking monetary damages and injunctive relief. The Company plans to vigorously defend all allegations. It is not possible to estimate the amount of loss or range of possible loss, if any, that might result from an adverse resolution of this matter.

The Company is involved in various other legal proceedings arising in the ordinary course of conducting business. The Company believes that the ultimate outcome of such matters, individually or in the aggregate, will not have a material adverse impact on its financial position or results of operations. The Company believes the amounts reserved in its consolidated financial statements are adequate in consideration of the probable and estimable liabilities.

7. Lease termination and impairment charges

During the third quarter of 2010, the Company recorded store closing and lease termination charges in the amount of \$1.3 million, comprised of \$0.3 million in lease termination charges, \$0.4 million in fixed asset impairment charges and \$0.6 million in future rent obligations. The fair value of the future rent obligation and early lease termination charges was determined based on the Company's discounted cash obligation to the landlords of these properties, net of sublease reimbursements. As of October 2, 2010, these obligations are included in accrued expenses and other liabilities on the condensed consolidated balance sheet.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our unaudited condensed consolidated financial statements and related notes included elsewhere in this Quarterly Report on Form 10-Q.

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Statements that are not historical facts, including statements about our beliefs and expectations, are forward-looking statements. Forward-looking statements include statements preceded by, followed by or that include the words may, could, would, should, believe, expect, anticipate, plan, estimate, target, project, intend and similar expressions. These statements include, among others, statements regarding our expected business outlook, anticipated financial and operating results, our business strategy and means to implement the strategy, our objectives, the amount and timing of future store openings, store retrofits and capital expenditures, the likelihood of our success in expanding our business, financing plans, working capital needs and sources of liquidity.

Forward-looking statements are not guarantees of performance. These statements are based on management's beliefs and assumptions, which in turn are based in part on currently available information and in part on management's estimates and projections of future events and conditions. Important assumptions relating to the forward-looking statements include, among others, assumptions regarding demand for our products, the introduction of new product offerings, store opening costs, our ability to lease new sites on a timely basis, expected pricing levels, the timing and cost of planned capital expenditures, competitive conditions and general economic conditions. These assumptions could prove inaccurate. Forward-looking statements also involve risks and uncertainties, which could cause actual results that differ materially from those contained in any forward-looking statement. Many of these factors are beyond our ability to control or predict.

We believe our forward-looking statements are based on reasonable assumptions; however, undue reliance should not be placed on any forward-looking statements, which are based on current expectations. Other than as required by law, we undertake no obligation to publicly update forward-looking statements, whether as a result of new information, future events or otherwise. You are advised, however, to consult any further disclosures we make on related subjects in our Form 10-Q, 8-K and 10-K reports and our other filings with the SEC.

Overview

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We are one of the nation's largest specialty retailers of golf and tennis equipment, apparel, footwear and accessories. We operate as an integrated multi-channel retailer, offering our customers the convenience of shopping in our retail locations across the nation and through our direct-to-consumer channels, which include both our website, www.golfsmith.com, and our direct mail catalogs. As of October 2, 2010, we operated 75 retail stores in 21 states and 31 markets. We were founded in 1967 as a golf clubmaking company offering custom-made clubs, clubmaking components and club repair services. In 1972 we opened our first retail store, in 1975 we

Table of Contents

mailed our first general golf products catalog, and in 1997 we launched our Internet site designed to expand our direct-to-consumer business. We closed two retail stores during the three months ended October 2, 2010 and expect to open a new store in Naples, Florida during the fourth quarter of this year. Subsequent to the end of the quarter, we signed a lease for the opening of an additional retail store in the first quarter of fiscal 2011.

As a specialty retailer, we are affected by changes in consumer confidence and economic conditions that impact our customers. The demand for our products is affected by the financial health of our customers, which may be adversely influenced by macroeconomic factors such as unemployment, fuel and energy costs, weakness in the housing market, declines in securities markets and unavailability of consumer credit. During the current economic downturn, the demand for our products has been adversely impacted, as reflected in our results of operations for the last two years. In response to the lower demand, since fiscal 2008, we have been taking steps to reduce our cost structure and introduce increased operational efficiencies. We believe the reduced cost structure and operational efficiencies implemented thus far have positively impacted operating results despite the negative pressure on top line sales.

In addition to future new store openings, a major part of our strategy continues to be enhancing the non-clubmaking and Internet portions of our direct-to-consumer channel. We also anticipate continuing to develop a number of our existing proprietary brands in the future, as we continue our efforts to grow our proprietary brand revenue.

Fiscal Year

Our fiscal year ends on the Saturday closest to December 31 and consists of either 52 weeks or 53 weeks. Each quarter of each fiscal year generally consists of 13 weeks. The three-month periods ended October 2, 2010 and October 3, 2009 each consisted of 13 weeks. The nine-month periods ended October 2, 2010 and October 3, 2009 each consisted of 39 weeks.

Results of Operations

The following table presents our unaudited condensed consolidated statements of operations and the related percentage of total net revenues for the three and nine month periods ended October 2, 2010 and October 3, 2009:

| | Three Months Ended | | | | Nine Months Ended | | | |
|--|--------------------|--------|--------------------|--------|--------------------|--------|--------------------|--------|
| | October 2, 2010 | | October 3, 2009 | | October 2, 2010 | | October 3, 2009 | |
| Net revenues (1) | \$ 93,272,151 | 100.0% | \$ 90,586,270 | 100.0% | \$ 278,966,906 | 100.0% | \$ 274,176,044 | 100.0% |
| Cost of products sold (2) | 61,187,785 | 65.6% | 59,534,966 | 65.7% | 182,790,788 | 65.5% | 180,166,834 | 65.7% |
| Gross profit | 32,084,366 | 34.4% | 31,051,304 | 34.3% | 96,176,118 | 34.5% | 94,009,210 | 34.3% |
| Selling, general and administrative | 31,529,010 | 33.8% | 29,490,794 | 32.6% | 93,163,244 | 33.4% | 89,481,609 | 32.6% |
| Store pre-opening / closing expenses (3) | 262,198 | 0.3% | 144,400 | 0.2% | 719,864 | 0.3% | 255,011 | 0.1% |
| Lease termination and impairment charges (4) | 1,349,970 | 1.4% | | 0.0% | 1,349,970 | 0.5% | | 0.0% |
| Total operating expenses | 33,141,178 | 35.5% | 29,635,194 | 32.7% | 95,233,078 | 34.1% | 89,736,620 | 32.7% |
| Operating income (loss) | (1,056,812) | -1.1% | 1,416,110 | 1.6% | 943,040 | 0.3% | 4,272,590 | 1.6% |
| Interest expense | 356,806 | -0.4% | 268,340 | -0.3% | 806,111 | -0.3% | 1,060,203 | -0.4% |
| Other income, net | 40,310 | 0.0% | 3,828 | 0.0% | 64,856 | 0.0% | 50,191 | 0.0% |
| Income (loss) before income taxes | (1,373,308) | -1.5% | 1,151,598 | 1.3% | 201,785 | 0.1% | 3,262,578 | 1.2% |
| Income tax benefit (expense) | 229,430 | 0.2% | (51,967) | -0.1% | 20,886 | 0.0% | (507,556) | -0.2% |

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| | | | | | | | | |
|-------------------|----------------|-------|--------------|------|------------|------|--------------|------|
| Net income (loss) | \$ (1,143,878) | -1.2% | \$ 1,099,631 | 1.2% | \$ 222,671 | 0.1% | \$ 2,755,022 | 1.0% |
|-------------------|----------------|-------|--------------|------|------------|------|--------------|------|

Table of Contents

- (1) Revenues consist of merchandise sales, net of expected returns, from our stores and our direct-to-consumer channels, as well as gift card breakage.
- (2) Cost of products sold includes inbound freight, vendor discounts and rebates, as well as cooperative promotional vendor income that do not pertain to incremental direct advertising costs. It also includes salary and facility expenses, such as depreciation associated with our distribution and fulfillment center in Austin, Texas.
- (3) Store pre-opening expenses consist primarily of rent, marketing, payroll and recruiting costs related to the opening of new retail stores that are incurred prior to a new store opening. Store closing expenses include future net lease obligations, to the extent not covered by future subrental income, and payroll expenses and other charges associated with a store that has been closed.
- (4) Lease termination and impairment charges consist of impairment of fixed assets and future rent and operating expenses related to store closures.

The following table presents consolidated net revenues by channel and comparable store sales percentage changes for the three and nine month periods ended October 2, 2010 and October 3, 2009:

| | Three Months Ended | | | | Nine Months Ended | | | |
|--|--------------------|--------------------|----------------|-------------|--------------------|--------------------|----------------|-------------|
| | October 2, 2010 | October 3, 2009 | \$ Change | % Change | October 2, 2010 | October 3, 2009 | \$ Change | % Change |
| Comparable stores (1) | \$ 73,566,946 | \$ 74,829,733 | \$ (1,262,787) | -1.7% | \$ 220,000,554 | \$ 222,332,911 | \$ (2,332,357) | -1.0% |
| Non-comparable stores | 4,265,302 | 785,732 | 3,479,570 | 442.8% | 11,453,812 | 3,349,516 | 8,104,296 | 242.0% |
| Total stores (2) | 77,832,248 | 75,615,465 | 2,216,783 | 2.9% | 231,454,366 | 225,682,427 | 5,771,939 | 2.6% |
| Direct-to-consumer International distributors and other (3) | 13,323,430 | 12,589,784 | 733,646 | 5.8% | 40,690,539 | 41,621,077 | (930,538) | -2.2% |
| | 2,116,473 | 2,381,021 | (264,548) | -11.1% | 6,822,001 | 6,872,540 | (50,539) | -0.7% |
| Net revenues | \$ 93,272,151 | \$ 90,586,270 | \$ 2,685,881 | 3.0% | \$ 278,966,906 | \$ 274,176,044 | \$ 4,790,862 | 1.7% |

- (1) We consider sales by a new store to be comparable commencing in the fourteenth month after the store was opened or acquired. We consider sales by a relocated store to be comparable if the relocated store is expected to serve a comparable customer base and there is not more than a 30-day period during which neither the original store nor the relocated store is closed for business. We consider sales by retail stores with modified layouts to be comparable. We consider sales by stores that are closed to be comparable in the period leading up to closure if they meet the qualifications of a comparable store and do not meet the qualifications to be classified as discontinued operations.
- (2) Included in total stores net revenues is \$4.2 million, \$14.1 million, \$4.2 million and \$13.2 million for the three and nine months ended October 2, 2010 and October 3, 2009, respectively, related to sales transacted online and either picked up by the customer at our stores or shipped to the customer from one of our retail stores.
- (3) Consists of sales made through our international distributors, through our distribution and fulfillment center near London, England and gift card breakage revenue.

Three Months ended October 2, 2010 compared to Three Months ended October 3, 2009

Net Revenues. Net revenues increased 3.0% to \$93.3 million for the three months ended October 2, 2010 from \$90.6 million for the three months ended October 3, 2009. The increase was primarily due to a \$3.5 million increase in revenue from new stores and a \$0.7 million increase in revenue from our direct-to-consumer channel partially offset by a decrease of 1.7% in comparable store sales during the three months ended October 2, 2010 as compared to the three months ended October 3, 2009.

Gross Profit. Consolidated gross profit, as a percentage of net revenues, increased to 34.4% for the three months ended October 2, 2010 from 34.3% for the three months ended October 3, 2009. The increase in gross profit, as a percentage of net revenues, of 0.1%, was due to (1) an increase of 0.4%, as a percentage of net revenues, resulting from improved sales performance of higher margin categories and (2) an increase of 0.2%, as a percentage of net revenues, due to a decrease in shrink expense resulting from improvements in the current year physical inventory results. This increase was partially offset by a decrease of 0.5%, as a percentage of net revenues, in vendor allowances which were shifted to offset direct advertising costs this year.

Table of Contents

Selling, general and administrative expenses. Selling, general and administrative expenses increased 6.9% to \$31.5 million for the three months ended October 2, 2010 from \$29.5 million for the three months ended October 3, 2009. As a percentage of net revenues, selling, general and administrative expense increased to 33.8% for the three months ended October 2, 2010 from 32.6% for the three months ended October 3, 2009. The increase in selling, general and administrative expense in absolute dollars primarily relates to new stores and net advertising expenses. The increase was partially offset by non-recurring litigation settlement costs recorded in the prior year third quarter of \$0.4 million. The increase in selling, general and administrative expense, as a percentage of net revenue, relates to sales decreasing at a faster rate than operating expenses.

Store pre-opening / closing expenses. Store pre-opening / closing expenses for the three months ended October 2, 2010 primarily includes expenses related to the closing of two stores. Store pre-opening / closing expenses in the three months ended October 3, 2009 includes occupancy costs related to our retail store in Irvine, California, which opened in the fourth quarter of fiscal 2009.

Lease termination and impairment charges. Included in the three months ended October 2, 2010 is \$1.3 million in asset impairment and lease termination charges associated with store closures. See Note 7 to our condensed consolidated financial statements.

Interest expense. Interest expense consists primarily of interest expense incurred on borrowings under our Credit Facility. For the three months ended October 2, 2010 and October 3, 2009, interest expense was \$0.4 million and \$0.3 million, respectively.

Other income, net. There were minimal changes in other income (expense), net during the three months ended October 2, 2010 as compared to the three months ended October 3, 2009. Included in other income (expense), net are realized foreign currency exchange rate gains/losses, gains from the sale of assets and other miscellaneous income.

Income tax benefit (expense). During the three-month periods ended October 2, 2010 and October 3, 2009, we recorded an income tax benefit of approximately \$0.2 million and a nominal income tax expense, respectively, on a pre-tax loss and income of approximately \$1.4 million and \$1.2 million, respectively. The income tax expense for the periods differed from the amount which would have been recorded using the U.S. statutory tax rate of 34% due to a change in our valuation allowances. See Note 3 of the notes to Unaudited Condensed Consolidated Financial Statements included in this Form 10-Q for further discussion.

Nine Months Ended October 2, 2010 compared to Nine Months Ended October 3, 2009

Net Revenues. Net revenues increased 1.7% to \$279.0 million for the nine months ended October 2, 2010 compared to \$274.2 million for the nine months ended October 3, 2009. The increase was primarily due to an \$8.1 million increase in new store revenues partially offset by a decrease of \$0.9 million from our direct-to-consumer channel and a \$2.3 million decrease in comparable store revenues during the nine months ended October 2, 2010 as compared to the nine months ended October 3, 2009.

In addition to the conditions discussed above, we believe our sales were impacted by colder and wetter weather conditions in the continental United States in the first quarter of fiscal 2010. Additionally, we believe that golf rounds played in the United States, a leading indicator of golf participation tracked by Golf Datatech L.L.C., affects potential sales of our products. For the eight months ended August 2010 golf rounds played decreased 3.6% as compared to the same period in the prior year.

Our net revenues continue to be negatively impacted by general economic conditions as well as a decrease in consumer confidence. The challenging economic climate is evidenced in our business by a highly competitive retail selling environment and decreasing retail store traffic. We anticipate that these conditions will continue to exist for the foreseeable future. However, in an effort to drive consumer demand, we continued to offer value-based promotions from many of the top manufacturers this year, which positively contributed to our net revenues.

Gross Profit. Consolidated gross profit, as a percentage of net revenues, increased to 34.5% for the nine months ended October 2, 2010 from 34.3% for the nine months ended October 3, 2009. The increase in gross profit, as a percentage of net revenues, of 0.2%, was due to (1) an increase of 0.5%, as a percentage of net revenues, resulting from improved sales performance of higher margin categories and (2) an increase of 0.1%, as a percentage of net revenues, due to a decrease in shrink expense resulting from improvements in the current year physical inventory results. This increase was partially offset by a decrease of 0.4%, as a percentage of net revenues, in vendor allowances which were shifted to offset direct advertising costs this year.

Selling, general and administrative. Selling, general and administrative expense increased 4.1% to \$93.2 million for the nine months ended October 2, 2010 from \$89.5 million for the nine months ended October 3, 2009. As a percentage of net revenues, selling, general and administrative expense increased to 33.4% for the nine months ended October 2, 2010 from 32.6% for the nine months ended October 3, 2009.

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The increase in selling, general and administrative expense in absolute dollars primarily relates to new stores and net advertising expense in the current year. These increases were partially offset by one-time charges in the prior year associated with a litigation settlement and severance for our former Chief Financial Officer.

Table of Contents

Store pre-opening / closing expenses. Store pre-opening / closing expenses increased to \$0.7 million for the nine months ended October 2, 2010 as compared to \$0.3 million for the nine months ended October 3, 2009. The increase in store pre-opening / closing expenses for the nine months ended October 2, 2010 was due to costs related to the closing of two stores and costs incurred for three new store openings. Store pre-opening / closing expenses in the nine months ended October 3, 2009 include occupancy costs related to our retail store in Irvine, California which opened in the fourth quarter of fiscal 2009 and costs related to the closing of one store in June 2009.

Lease termination and impairment charges. Included in the nine months ended October 2, 2010 is \$1.3 million in asset impairment and lease termination charges associated with store closures. See Note 7 to our condensed consolidated financial statements.

Interest expense. Interest expense consists primarily of interest expense incurred on borrowings under our Credit Facility. For the nine months ended October 2, 2010, interest expense decreased by 24.0% to \$0.8 million as compared to \$1.1 million for the nine months ended October 3, 2009.

Other income, net. There were minimal changes in other income (expense), net during the nine months ended October 2, 2010 as compared to the nine months ended October 3, 2009. Included in other income (expense), net are realized foreign currency exchange rate gains/losses, gains from the sale of assets, and other miscellaneous income.

Income tax benefit (expense). During the nine-month periods ended October 2, 2010 and October 3, 2009, we recorded a nominal income tax benefit and income tax expense of \$0.5 million, respectively, on pre-tax income of approximately \$0.2 million and \$3.3 million, respectively. The tax expense for the periods differed from the amount which would have been recorded using the U.S. statutory tax rate of 34% due to a change in our valuation allowances. See Note 3 to our unaudited condensed consolidated financial statement for further discussion of the methods used to compute our tax provision in each fiscal year.

Liquidity and Capital Resources

As of October 2, 2010, our primary sources of liquidity consisted of cash totaling \$0.8 million and \$18.4 million of available borrowings under our Credit Facility which is more fully described in Note 4 of the Notes to Condensed Consolidated Financial

Statements, included in this Quarterly Report on Form 10-Q. As of October 2, 2010, we had outstanding debt obligations under our Credit Facility of \$42.7 million.

Our capital expenditures depend on our ability to generate sufficient cash flows from operations as well as available borrowings under our Credit Facility. Historically, cash flows generated from operations and our borrowing capacity under our Credit Facility have allowed us to meet our cash requirements, including capital expenditures and working capital needs. In addition, future cash outflows related to new store openings, advertising, store retrofits, and other expenditures have been adjusted and may need to be further adjusted accordingly from time to time in the future. For the remainder of fiscal 2010, we anticipate incurring approximately \$1.0 million in capital expenditures, excluding tenant improvement allowances, related primarily to one new store opening and investments in our information technology infrastructure.

If cash generated from operations and available borrowings under our Credit Facility are insufficient to satisfy our liquidity requirements, we may seek to sell additional equity or arrange additional debt financing. If cash from operations and cash available under our Credit Facility are not sufficient to meet our needs, we cannot assure you that we will be able to obtain additional financing in sufficient amounts and/or on acceptable terms in the near future.

Cash Flows

| | Nine Months Ended | |
|---|----------------------------|----------------------------|
| | October 2, 2010 | October 3, 2009 |
| Net cash provided by operating activities | \$ 3,431,267 | \$ 26,106,675 |
| Net cash used in investing activities | (9,652,926) | (7,020,497) |
| Net cash provided by (used in) financing activities | 6,300,827 | (18,027,501) |

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| | | |
|---|-----------|--------------|
| Effect of exchange rate changes on cash | (7,734) | (10,525) |
| Change in cash | \$ 71,434 | \$ 1,048,152 |

Table of Contents

Operating Activities

Our cash flows from operations are seasonal. Operating activities provided \$3.4 million of cash for the nine months ended October 2, 2010 and provided \$26.1 million of cash for the nine months ended October 3, 2009. The decrease in cash provided by operating activities during the nine months ended October 2, 2010, as compared to the nine months ended October 3, 2009 is due to increased inventory stock purchases in the current year quarter as a result of three new store openings as well as the timing of other working capital activities.

Investing Activities

Cash used in investing activities primarily relates to building out new stores, remodeling or relocating existing stores, purchasing information technology as well as capital expenditures for our distribution facilities and corporate headquarters. Investing activities used \$9.7 million of cash for the nine months ended October 2, 2010 and \$7.0 million of cash for the nine months ended October 3, 2009. Cash used during the current year primarily relates to three new store openings, several store remodels and investments in our information technology infrastructure. Cash used during the prior year relates to the build out of two new stores and the relocation of two existing stores.

Financing Activities

Financing activities provided \$6.3 million of cash for the nine months ended October 2, 2010 and used \$18.0 million of cash for the nine months ended October 3, 2009. Cash provided by and used in financing activities primarily relates to net draws and principal payments under our Credit Facility.

Indebtedness

As of October 2, 2010, we had approximately \$42.6 million in aggregate indebtedness outstanding and \$18.4 million in available borrowings under our Credit Facility, after giving effect to all reserves. At October 3, 2009, the Company had \$33.7 million of borrowings outstanding under the Credit Facility and \$22.5 million in available borrowings under our Credit Facility, after giving effect to all reserves. As of January 2, 2010, we had \$36.0 million of outstanding borrowings under our Credit Facility and \$17.8 million of borrowing availability after giving effect to all reserves.

Our Credit Facility contains customary affirmative covenants regarding, among other things, the delivery of financial and other information to the lenders, maintenance of records, compliance with law, maintenance of property and insurance and conduct of our existing business. The Credit Facility also contains certain customary negative covenants that limit the ability of the Credit Parties (as defined in Note 4 of the notes to our Unaudited Condensed Consolidated Financial Statements) to, among other things, create liens, make investments, enter into transactions with affiliates, incur debt, acquire or dispose of assets, including merging with another entity, enter into sale-leaseback transactions, and make certain restricted payments. As of October 2, 2010, we were in compliance with all applicable covenants. See Note 4 of the notes to our Unaudited Condensed Consolidated Financial Statements for further discussion of the terms of our Credit Facility.

Borrowings under our Credit Facility typically increase as working capital requirements increase in anticipation of peak selling periods in late spring and in advance of the December holiday gift-giving season, and then decline following these periods. In the event sales results are less than anticipated and our working capital requirements remain constant, the amount available under our Credit Facility may not be adequate to satisfy our needs. If this were to occur, we may not succeed in obtaining additional financing in sufficient amounts, if at all, and/or on acceptable terms.

Off-Balance Sheet Arrangements

As of October 2, 2010, we did not have any off-balance sheet arrangements.

Critical Accounting Policies and Estimates

Our significant accounting policies are more fully described in Note 1 of our Audited Consolidated Financial Statements in our Annual Report on Form 10-K filed with the SEC on February 25, 2010. Certain of our accounting policies are particularly important to the portrayal of our financial position and results of operations. In applying these critical accounting policies, our management uses its judgment to determine the appropriate assumptions to be used in making certain estimates. Those estimates are based on our historical experience, the terms of existing

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contracts, our observance of trends in the industry, information provided by our customers and information available from other outside sources, as appropriate. These estimates are subject to an inherent degree of uncertainty. We have chosen accounting policies that we believe are appropriate to report accurately and fairly our operating results and financial position, and we apply those accounting policies in a consistent manner. Our critical accounting policies have not changed significantly since the filing of our Annual Report.

Table of Contents

Recent Accounting Pronouncements

In December 2009, the FASB issued additional authoritative guidance requiring new disclosures related to fair value measurements. The new guidance requires entities to separately disclose the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and to describe the reasons for the transfers. The guidance also requires entities to present separately information about purchases, sales, issuances, and settlements within Level 3 fair value measurements. The new guidance is effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements within Level 3 fair value measurements. Those disclosures will be effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. We do not anticipate that the adoption of the guidance will have an impact on the Company's consolidated results of operations or financial position.

In February 2010, the FASB amended the authoritative guidance it issued in May 2009 on subsequent events. The original guidance required SEC filers to evaluate subsequent events through the date of financial statement issuance and to disclose the date through which subsequent events have been evaluated. The guidance was amended so that SEC filers are no longer required to disclose the date through which subsequent events have been evaluated. The new guidance was effective immediately upon issuance of the amendment which was in February 2010. The adoption of the guidance did not have an impact on our consolidated results of operations or financial position.

In June 2009, the FASB issued guidance which amends previously issued guidance on variable interest entities. This new guidance prescribes a qualitative model for identifying whether a company has a controlling financial interest in a variable interest entity, or VIE, and eliminates the quantitative model previously prescribed. The new model identifies two primary characteristics of a controlling financial interest: (1) provides a company with the power to direct significant activities of the VIE; and (2) obligates a company to absorb losses of and/or provides rights to receive benefits from the VIE. The new guidance requires a company to reassess on an ongoing basis whether it holds a controlling financial interest in a VIE. A company that holds a controlling financial interest is deemed to be the primary beneficiary of the VIE and is required to consolidate the VIE. This statement is effective for fiscal years beginning after November 15, 2009, and interim periods within those fiscal years. The adoption of the guidance did not have a material impact on our consolidated results of operations or financial position.

In October 2009, the FASB issued guidance on revenue recognition that provides clarification on whether multiple deliverables exist, how the arrangement should be separated, and the consideration allocated. An entity is required to allocate revenue in an arrangement using estimated selling prices of deliverables in the absence of vendor-specific objective evidence or third-party evidence of selling price. These amendments also eliminate the use of the residual method and require an entity to allocate revenue using the relative selling price method. These amendments significantly expand the disclosure requirements for multiple-deliverable revenue arrangements. These provisions are to be applied on a prospective basis for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010, with earlier application permitted. The adoption of the guidance is not expected to have a material impact on our consolidated results of operations or financial position.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

As a smaller reporting company as defined by Item 10 of Regulation S-K, we are not required to provide the information required by this item.

ITEM 4. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our principal executive officer and principal financial and accounting officer, we conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, as of the end of the period covered by this report. Based upon, and as of the date of this evaluation, the chief executive officer and the chief financial officer concluded that our disclosure controls and procedures were effective such that the information required to be disclosed in our SEC reports (i) is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and (ii) is accumulated and communicated to our management, including our principal executive officer and principal financial and accounting officer, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

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During the quarter ended October 2, 2010, there have been no changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

PART II: OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

On October 23, 2009, David O. Flynn, on behalf of himself and all others similarly situated, filed a putative class action lawsuit in the California Superior Court in Orange County against the Company asserting violations of applicable wage and hour and unfair competition laws, seeking monetary damages and injunctive relief. The Company plans to vigorously defend all allegations. It is not possible to estimate the amount of loss or range of possible loss, if any, that might result from an adverse resolution of this matter.

We are involved in various other legal proceedings arising in the ordinary course of conducting business. We are not aware of any such lawsuits, the ultimate outcome of which, individually or in the aggregate, would have a material adverse impact on our financial position or results of operations.

ITEM 1A. RISK FACTORS

As a smaller reporting company as defined by Item 10 of Regulation S-K, we are not required to provide the information required by this item.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None

ITEM 4. [RESERVED]

None.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

- 31.1 Rule 13a-14(a)/15d-14(a) Certification of Martin E. Hanaka.*
- 31.2 Rule 13a-14(a)/15d-14(a) Certification of Sue E. Gove.*
- 32.1 Certification of Martin E. Hanaka Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.*
- 32.2 Certification of Sue E. Gove Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.*

* Filed herewith.

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

GOLFSMITH INTERNATIONAL HOLDINGS, INC.

By: /s/ Martin E. Hanaka
Martin E. Hanaka
Chairman and Chief Executive Officer
(Principal Executive Officer and Authorized
Signatory)
Date: October 27, 2010

By: /s/ Sue E. Gove
Sue E. Gove
Executive Vice President, Chief Operating Officer
and Chief Financial Officer
(Principal Financial and Accounting Officer and
Authorized Signatory)
Date: October 27, 2010