

***GILFORD SECURITIES GOLF INDUSTRY RESEARCH***

**2009 PGA Merchandise Show Report  
January 28-31 2009  
Orange County Convention Center**



We attended the PGA Merchandise Show and came away with the following observations. We hope you find them illuminating, but we also hope you find the discourse entertaining. We welcome any and all feedback. We KNOW we will hear the feedback when you disagree. It goes with the territory.

**Match Play: The Economy vs. The Golf Equipment Economy**

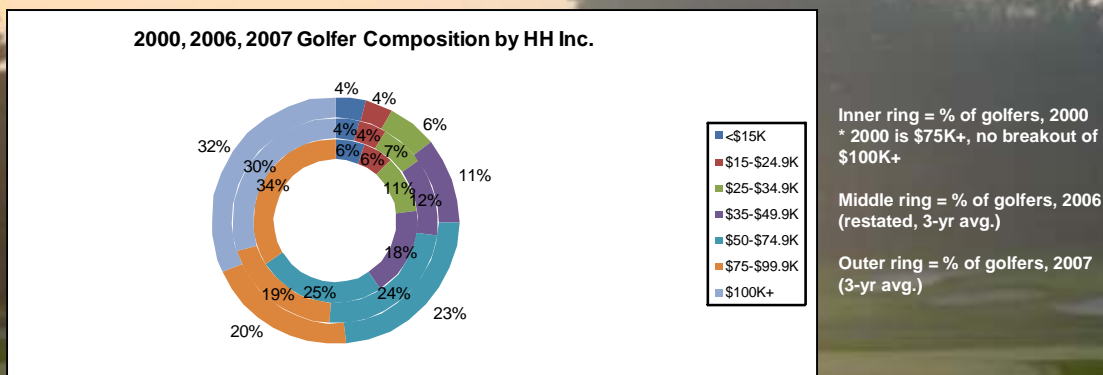
**1. The Positive Aspects**

Clearly the discussions that concerns everyone related to any aspect of the golf equipment industry are **“When will the economy improve enough to stabilize the golf equipment industry, and how badly will we and the equipment industry be affected in the meantime?”** After interviewing dozens of people inside and outside the business and listening to their views, we will take a shot at answering both issues, however unwise that may seem.

We start this discourse by noting the fact that the real issue domestically truly revolves around the core 8-9 million ‘involved’ golfers, as they are the ones that buy the largest share of golf equipment.

It is this core golfer that has been deferring purchases during the last year that has resulted in equipment sales that look to be down -5% to -6% when 2008 is finally tallied up.<sup>1</sup> This core golfer will be a ‘first mover’ when the economy does recover, as the core golfer starts from a better economic position than the average U.S. consumer. This fact has been established by surveys conducted by Pellucid, as delivered in the Pellucid State of the Golf Industry presentation at the 2009 PGA Merchandise Show.

## Golf’s Demographic Profile/Breadth of Appeal Continues to Migrate Upward



- 2007 update shows \$50K+ % of total golfers now at 75%
  - Up from 59% in 2000 (some attributable to inflation)
  - Up from 73% in 2006
- Good if you’re the PGA TOUR selling impressions, not so good if you’re trying to be a diverse, general interest growth sport

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When the economy does recover, this core golfer will feel it first, and will likely feel better than the average consumer. This is good news for the industry, that there will not be a lag effect.

Also, the fact that the core golfer has been deferring purchases means that when the core golfer does start to feel better, the core golfer is likely to start buying very quickly. Why? Because the core ‘involved’ golfer also has a higher need to be ‘technologically proficient’ in the composition of equipment in their bag. The longer they defer purchases the more likely they are to feel technologically left behind, and the more likely they are to rapidly attempt to catch up.

<sup>1</sup> In our 2008 report we stated that “A weak economy rarely has much negative impact on overall golf spending, just as a strong economy rarely has a positive effect on overall golf spending.” Down -5% to -6% suggests that there is an impact, although not a great as many other aspects of the consumer discretionary retail economy.

These factors are the good news for the equipment industry. **The core golfers come from a better economic position and will recover faster than the average consumer**, and when they do they are **likely to exhibit pent up demand for equipment** very quickly. The bad news is that in our opinion the equipment industry is not likely to feel this in a major way until 2010, even if the economy starts to recover sooner than that.

## 2. The Problem of Timing

The biggest issue is the problem of the timing of the recovery, and the self-fulfilled prophecy facing the equipment industry at this juncture. We can make a case (and we might even be right) that the U.S Economy will begin to exhibit signs of recovery as early as the middle of the second quarter. The root of the equipment industry's morose attitude is the dismal consumer confidence that is evident in the U.S (and Global) economy. The lack of consumer confidence and the failure of business confidence that has resulted in a significant rise in unemployment has been almost directly tied to the horrendous news emanating from the banking and financial system.

In fact, the final straw, so to speak, has been the utterly dismal 4<sup>th</sup> quarter earnings reports from the banking system, and the shuddering response from the stock markets globally in response to those reports. Don't get us wrong, these reports have been horrendous, but we believe some of it is an illusion. What about other industries, you say? Well yes, retailing has been abysmal, but that suffers from the same consumer confidence disease that golf does. Autos? Heck, they were in trouble long before the global economy was. In the end, they all stem from dislocation in the global financial system. So what's the illusion?

The illusion is the 4<sup>th</sup> quarter earnings reports themselves. You see, in the banking community, everyone was aware that the second half of the TARP money was still out there waiting to be distributed. The TARP money is 5% cost of capital versus 10%-13% cost of capital from the private markets. If you are the CEO of a top 100 bank, it is irresponsible *not* to get your fair share of the TARP money, if only to assure that you remain competitive and well capitalized. So how do you assure your fair share of the pie? Well, 4<sup>th</sup> quarter results have to be audited anyway, and everyone has screamed for transparency and adequate marking of positions. So satisfy the auditors that you are taking a conservative whack at the books and mark every position down to liquidation value. Not the first bid, but the bid to the bid behind the bid required to liquidate every position. You also go through every capital position, and you write down the value of the doorknobs. You write down the value of the keyboards. Everything, Everywhere. Write it down. Satisfy the auditors and the world that you are serious about adequate marks and financial transparency. The result is that your earnings will be so bad that you will certainly get your fair share of the TARP money. And capital will no longer be an issue.

Now we recognize that the manner and structure of how the TARP money is going to be distributed has changed. But we note that at the time that these decisions about marks and write-downs were taking place, the structure was as we have presented it. So the construction of the argument still stands.

If this whole argument sounds conspiratorial, well it is. But our conversations have led us to conclude that this is a real possibility. How will we know? In late April, as banks start reporting their 1<sup>st</sup> quarter results, we will hear quotes from earnings conference calls such as "It's starting to feel a little bit better, a little more stable". ***When that happens, consumer confidence will have bottomed, and likely residential real estate values as well.*** Unemployment will continue to rise, because it always lags the bottom of the cycle.

By the second quarter reports we will again hear “You know, it continues to feel a little bit better out there, a little more stable” Consumer confidence will continue to creep up. By Q3 the refrain will be “It’s not normal yet, it’s still challenging, but we are getting closer”. ***By the middle of the 4<sup>th</sup> quarter, our guess is that you will see 3-5 major institutions repaying the TARP money so they can pay the senior executives their bonuses.*** And that, as they say, will be that.

### **3. Early Enough for Christmas, Not Early Enough for Golf**

Even though we have established that the core golfer is a first economic mover, and we have established a case for consumer confidence to start to lift as early as the mid-second quarter, this is too late for golf. The industry has convinced itself that 2009 is a down 10% years for sure. Since something close to 65% of all sales occurs in the first half of the year, the seeds of recovery being sown in late April or early May are just too late to capitalize on. Because the industry has set the bar so low, the retail distribution channel has cut way back on the open-to-buy lines in fear of getting caught with any inventory. In fact, the distribution channel is so serious about inventory control that they are packing up any dated merchandise and returning it to manufacturers rather than working it through the channel.

The equipment manufacturers are likewise keeping inventory in the channel as lean as possible. This is true not only because they fear a back up of inventory in the channel, but they also fear the credit worthiness of several key distribution points in the channel. No one wants to get caught with too much inventory at a significant distributor and have that distributor fail on them. That type of hit can be deadly in an off year such as this. This is especially problematic for the secondary and tertiary equipment manufacturers, as they are much more highly dependent upon the off course specialty retail distribution channel and get a much higher percentage of total sales from fewer customers. The failure of any one of those customers could be enough to put a secondary or tertiary equipment manufacturer out of business as well.

For those retailers that are ‘Christmas-oriented’ this timeline could be the story that saves 2009. But for golf, it could be very hard to chase this timeline. They may have to wait for 2010. But hopefully, it is encouraging to sense there is a scenario out there that offers some light at the end of the tunnel.

### **Surviving 2009: The Recipe for Success or Planning for Disaster**

We have studied this industry for a long time now. Have listened to the plans of almost every company for 2009, and we think we can distinguish what is likely to result in survival and future success, and what is likely to result in complete disaster. We can safely say that the industry participants fall into two camps:

1. Introduce new and innovative product, manage inventories, rationalize ad spend into advertising channels where eyeballs are growing, and aggressively take share from competitors that are pulling back from the market. And for lower tier manufacturers, open as many avenues of distribution as possible to protect against the failure of any on customer. Diversify your sales base.
2. Hunker down, keep new product introductions to a minimum, cut ad spend to almost nothing, cut expenses to less than nothing, and pray you can ride out the economic weakness.

Our experience has been that camp #2 is a recipe for ultimate failure, as it enforces a loss of sales momentum, and even worse a loss of market share, that risks the loss of brand importance in the retail distribution channel. Retailers are sales organizations in their own right, and they require that brands support their efforts through effective marketing programs that keep brand names in the forefront of the consumer purchasing plan.

Those brands that choose to pull back from the market lose their relevancy as a purchase option, not only in the mind of the end user, but in the mind of the intermediary sales organization, the retailer. **The retailer, be it specialty off course or green grass, will gravitate to what is selling today, and they will continue to support those brands that give them a perceptual advantage in the minds of the consumer, and that means gravitating towards those brands that market effectively. We cannot emphasize this point strongly enough.**

What qualifies as effective marketing today is **an approach that stresses technological innovation, but with a value message implicit in the purchase decision.** The data points below come from consumer surveys that were provided to us by the Sports & Leisure Research Group of White Plains, NY and delivered in conjunction with the Pellucid State of the Golf Industry presentation at the 2009 PGA Merchandise Show:

**IMPLICATIONS FOR GOLF:  
THE NEW FRUGALITY MEANS VALUE -- NOT CHEAP... BUT  
WE'RE NOT ALL RUSHING TO THE DOLLAR STORE!**

- A value message trumps “cheap prices” to preserve brand equity
- Quality at fair pricing
- Service as a differentiator
- EVERYONE wants a “deal”
- The snob appeal approach falls flat with affluent men
- Don't want to be like Mike! Want to beat him to a pulp!

**Those who choose the path of camp #2 will by their own budgeting and planning process, concede to the competition whatever sales momentum that they may have once had.** The loss of this sales momentum will be very difficult if not impossible to regain, as once the relevancy is lost to the retail distribution channel, it becomes lost to the end user. Once it is lost to the end user, it becomes almost impossible to recapture the open to buy dollars from the retail distribution channel. The natural tendency of retailers is to continue to turn the inventories that are already turning, rather than to try to regenerate turns from a supplier that has been lost (for whatever reason). Salespeople sell tomorrow what they successfully sold today. They are the ultimate creatures of habit.

Those who choose path #1 will change the message. We would characterize the last decade as the Tiffany's and Coach decade. That decade is dead. Technological innovation with a value proposition will be the new mantra. **What's fascinating based upon the study is that it doesn't necessarily imply a change in prices, but a change in the message.** Product positioning and recognition of the change in consumer behavior is what will win the day.

Callaway has already embraced some aspect of the message. Rocco Mediate is playing the Callaway Diablo driver on the PGA Tour. A PGA Tour player using a driver that is not the most expensive driver that Callaway sells would have been unthinkable a couple years ago. Now it delivers the message that Callaway offers a high degree of technological innovation at every price point in their driver arsenal. Notably, Callaway's Tour staff has also been outfitted with Callaway Diablo tour bags. This is a commitment to marketing to the value orientation of their customers. And in this effort is the implicit message that **Callaway is making a concerted effort to take share in the \$299 driver category which is likely to be the most important category for 2009.**

Undoubtedly the companies with a global footprint have an advantage in this endeavor. They have multiple products at multiple price points and can adapt advertising to take advantage of existing price points with a value orientation. But they have their own problems with the disadvantage of current foreign currency exchange rates which are weighing heavily on current results. But we would urge those companies to ignore the foreign currency issues, not try to hedge them, and just drive the business for all it's worth. The one thing we know about foreign currency relationships is that they are bound to change, and the direction of their change is in inverse proportion to the direction and size of any hedging that the industry participants try to do.

Path #2 is particularly deadly for the secondary and tertiary participants.<sup>2</sup> We would urge those companies to change the marketing message towards the value orientation and market the heck out of it. Take share from those fools willing to give ground, even at the expense of current profitability. These companies must do anything and everything to maintain their relevance to the retail distribution channel at this time. They simply *have to be there when the business turns*. **The success stories of the next cycle will be written in the market share reports of this downturn. That much is guaranteed.**

### **Biggest Loser of the Cycle – The Country Club**

Golf's symbol of the Tiffany/Coach era is membership in a country club. It is hard to argue the point that as a purely economic construction, private membership versus public golf is a pretty poor deal.

A chart published in the Met Golfer suggests that the number of private clubs is approximately the same as it was in The Great Depression. The difference is clear that at that time in history, those wishing to enjoy a premium golf experience had almost no choice but to be a member of a private club. As late as the 1950's, private clubs encompassed almost three quarters of that which could be described as a premium golf experience. Because of the vast number of public daily fee courses constructed in the 1980's through the early 2000's, that ratio has swung hard in the opposite direction. **An avid golfer who plays 30 rounds per year at a daily fee facility can enjoy a premium golf experience without the cost of private membership for about \$3000 per year. Very few private facilities can match this cost.** The competition for the consumer golfing dollar has become more price sensitive as a result.

We all know that there are more reasons to evaluate private membership beyond cost, but in economic times such as these, cost becomes a much higher priority in the consumer calculation. Many private facilities are going to find that they need to make several structural long term changes to their economic model or risk insolvency.

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<sup>2</sup> In the 2008 report we noted that "The general economic softness will surely result in the demise of some lower tier competitors, because when they get wounded, acquiring the capital to survive in this environment becomes even more difficult." This statement continues to ring true.

Some of these changes may include: **1. Ala Carte Memberships** – Weekday, Weekend only, and Full Membership categories with ala carte pricing for each. **2. Opening certain facilities to the public** – Almost every club known to man has lost money in the dining room, yet they offer a premium dining experience. Open the dining room for business lunches, etc. and reduce the dependency on members to fund the food operation. Also limited availability of a driving range during non-peak hours could defray certain costs. This could also give exposure to the facility for potential new members. **3. Membership Referral Fees** – Members may complain about reduced initiation fees for new members, but they could reduce their own sunk cost if they could earn a referral fee for the successful introduction of new members.

We have high hopes for the potential success of the **“Get Ready for Golf in 5 Days”** initiative from the Golf 20/20 summit. But I also recognize that the first and best beneficiary of any success from this program will also be the public facility, not the private club. **Adults who are new to the game almost universally begin their experience at public facilities.** It takes a few years for any of those new entrants to matriculate to private club membership.

So the private clubs hopefully will **benefit** from the effort, but it will take a few years for that benefit to manifest itself in terms of initiation fees and incremental revenues to the private facilities.

This is Darwinism at its best. The top 200 clubs in the U.S. are going to fine – forever. For the rest, adapt, evolve, or face potential extinction as a private facility.

### **The Gilford Securities Unofficial Golf Equipment Review – 2009**

**Disclaimer – These are our opinions. And only ours. We reserve the right to be wrong. We are fully aware that many will disagree and many will become downright angry at some of these opinions, but we would suggest that we have been far more right than we have been wrong in the past. Read ‘em and weep.**

#### **1. Drivers**

Since we have gone to such lengths to establish the argument that customers will be seeking a value this year, clearly our best marks have to go to the value side of the equation, the \$299 driver category. One prominent yet unnamed industry leader recently said to us “Mr. Consumer you can buy this wonderful (anonymous) driver for \$299 or you can buy this really, really wonderful (anonymous) driver for \$499. These aren't cars one with satellite radio, leather seats etc... they are drivers and they both do the same thing either one is inferior or the \$499 is a rip off”. We don't necessarily concur with that assessment, but in the post-Tiffany/Coach decade we think it entirely possible that the consumer will.

**Birdies** – The **Callaway Diablo** offers at least the appearance of significant technology baked into the design with the unique trapezoidal sort of head shape. Also the fact that Callaway is making an effort for their \$299 driver to be played on tour (Rocco Mediate) and seen on tour (tour bags are Callaway Diablo bags) offers ample evidence that they get the fact that the consumer is focused on value, and they are pushing the value message. That doesn't mean they have sacrificed higher priced offerings, but they often did so with the hope that customers would simply find the value stuff if they felt priced out of the market. Now value has moved to the forefront. And the club hits the ball great.



The **Adams Speedline** offers an aerodynamic streamlined head that is designed to enhance club head speed and increase distance off the tee. The head from the setup position looks very traditional, but the feel off the club face is excellent and the ball goes. At \$299, those looking for a traditional-shaped head may find the Speedline fills the bill if Adams can successfully market to the aerodynamic advantage.



**Pars** – Someone will buy drivers for more than \$299. And when they do, the **TaylorMade R9** is going to be high on the list. With variable weight technology coupled with adjustable lie and directional angles built into the design, this is the true high end adaptation of adjustable drivers. If price weren't such a huge consideration this year the R9 would certainly have earned a birdie.

The **Nike SQ Dymo with the STR8 Fit adjustable hosel** is also a marvel in adjustability, but that wasn't what impressed us most about the club. In the past, the Nike square was unusually loud, and in our opinion not particularly long. The new square head with the STR8 Fit hosel adaptation is significantly quieter, and to our eye substantially longer. Again, in a different year this would have earned a birdie.

The fascinating aspect of the Nike and the TaylorMade drivers is the speed that the market adjusted to what the consumer really wants. Last year with the introduction of the adjustable drivers, we discussed the three phases of adjustable driver development that we saw coming. Phase one was the clubs that were introduced last year. To remind you of how we saw phase two and three, here is how we described it in last years report:

**“Phase two, late this year or early next year, will be the onset of price compression. As new technologies proliferate and competition heats up, prices come down to levels where more traditional buyers can begin to get involved, thus branching out the technology further. Finally, in three to five years we will hit what we predict will be phase three. The phase will incorporate the single head, single shaft sale with adjustable, interchangeable technology imbedded in the head and the shaft.”**

Amazingly, the developers skipped right over phase two and went straight to phase three in one year.

The **Cobra S9-1 F Speed Driver** delivered a piercing ball flight and better feel than most Cobra drivers we have tried. The attractive cosmetics give the customer enough eye appeal to imagine that technology is definitely a part of the story. At \$299, this driver should be competitive.

The **Cleveland Launcher** offered excellent feel and distance and an attractive price, but in such a traditional shape the club is not offering enough technological innovation to earn a birdie.

**Bogey** – The **Cleveland Hibore XLS Monster** is just too much to look at, and too much to swing. The head of the club is ponderous in relation to the shaft, and it requires a significant effort to reroute the club head back to the ball once you reach the top of the swing. Instead of the ball-and-chain feeling, the Monster was more like a ball-an-anvil, requiring a cast from the top that made it difficult to control.

## 2. Fairway Woods

We might as well just rename this category the 3-Wood category. When we look into other players bags, it's the rare bag that even carries a 5-wood any longer. This is a direct result of the growth in the hybrid category. In this category we saw nothing that particularly grabbed our interest in any way.

## 3. Hybrids

This has become one of the most important categories out there. The performance and versatility of these clubs has allowed them to replace many irons and shorter fairway woods in players' bags. And the equipment companies as a group are getting better all the time making better hybrids. We have also seen the shaft manufacturers put a real emphasis on building shafts specifically designed for hybrid clubs.

We found that the better hybrid clubs all had one thing in common, a leading edge that was well out in front of the shaft. This resulted in an increased ability to get the ball airborne and a shot pattern that had less curve, in either direction.

**Eagle** – The **Tour Edge Bazooka QLS Hybrid** was simply the most outstanding single club that we hit at the Show. At set up, the club gave the impression that it was going to be easy to hit solid, and man it was. The ball flight had a terrific piercing trajectory, but when it reached its intended distance the ball simply fell out of the sky. The leading edge made lining the club up to the target a breeze, and the ball consistently went off on the intended line. This club was simply enjoyable to hit and inspired a huge amount of confidence.



**Birdies – Adams Golf** has made the hybrid category their strength. According to the Darrell Survey, Idea Hybrids ranked as the #1 Hybrids on the PGA Tour, Champions Tour, and Nationwide Tour combined 2006, 2007 & 2008. This is a remarkable achievement. The reason is their hybrids are great, plain and simple. To single out one of their hybrids would be a waste of time. They're all great.



The **Callaway Diablo Hybrid** was also a very strong contender. It's easy to hit with the leading edge well out in front of the shaft. In fact, the Callaway Ft hybrid from a couple years ago was the first hybrid to get the leading edge well out in front of the shaft, and now many have incorporated this into their design. But as we are leaning to the value side of the equation, the Diablo wins our favor in 2009.



**Pars** – There were just a large group of hybrids that are more than adequate. The **Cleveland Launcher Hybrid**, the **TaylorMade Burner Rescue** and the **TaylorMade Rescue TP**, the **Ping G10** and **Ping Rapture Hybrids** are all worth a try.

**Bogey** – The **Titleist 909H** hybrid was notable from the standpoint that it addressed the leading edge was much more in line with the shaft. This gave the appearance of being more difficult to get airborne, and seemed less forgiving on off center hits.

#### 4. Irons

There are two issues that we would like to discuss concerning the iron category for 2009. First of all, **our expectation is that irons will be the weakest club category for 2009**, simply because this is the single highest ticket item. A set of irons will almost certainly run at least \$599 and often significantly more, especially when graphite shafts come into play. Frankly we have never understood the \$200 disparity in the cost of a set of irons with a steel shaft versus a set with graphite shafts. The difference per shaft at the manufacturing level is about \$4 per shaft, so let's call it \$32 over the cost of a set. One way to boost iron sales in 2009 may be to reduce the difference on a set of graphite shafted irons and gain better market share.

The second issue is what we call **"The Myth of the Players Iron versus The Game Improvement Iron"**. For some time now, we have been told that better players want to play, for lack of a better description, muscle-back, butter-knife, forged blade irons. The reason behind this is because of the psycho-kinetic benefits of 'feel' and 'workability'. To that we say 'rubbish'.

Implicit in the myth is that somehow, when you hit a game improvement perimeter weighted iron on the sweet spot, that somehow it might not perform as well as a 'players iron'. Years of experience has taught me that a game improvement iron hit on the sweet spot performs just as well, if not for everyone, then for everyone outside of a tour player.

What we can say is that game improvement perimeter weighted irons perform demonstrably better when you miss the sweet spot, which every player *including tour players* do.

This leaves the concept of 'workability' as the redeeming factor for the players club. Yet in 35 years of tournament golf we have never known a player that intentionally wanted to work the ball more than 4-5 yards in one direction or another from a decent lie in the fairway. This can easily be done with either type of club. Therefore, the remaining issue of 'workability' must be contained to trouble shots of some kind. There is no question that perimeter weighted iron have superior playing characteristics when it comes to getting the ball out of the rough. The lower center of gravity acts more in the manner of a hybrid or fairway wood ripping through the heavier grass.

So it must mean that the players club is superior when trying to swoop it out of the trees. Guess what, we have experience there as well. Anyone who says that a perimeter weighted club cannot be turned hard on a shot out of the trees just hasn't tried it.

No, the players club is a mere marketing category at this point in time. The preponderance of perimeter weighted iron on tour is ample evidence of that. In fact, perimeter weighted forged irons satisfy the liar in all of us: A players club with game improvement features. How novel.

**Birdies** – The **Titleist AP1** irons had a great look at address. In fact, the appearance at address reminded us of our old Callaway X-14's. Which is interesting, because our X-14's at address reminded us of our old Ping Eye2's, which may have been the best iron ever made. In any case, the look of the top line was so comfortable that hitting the AP1's just seemed natural, and the ball flight was perfect.



In an ultra-game improvement iron, the **Tour Edge Bazooka QLS** irons are fantastic. For the higher handicapper who really needs help getting the ball airborne, it just doesn't get any easier than these irons, with an ultra-low center of gravity and a solid feel.

**Pars** – There are those who would say that the new **TaylorMade Burner** irons are breaking new ground. Some might say that the deep undercut notch is an admission that the Callaway X-series has had it right all along. We could care less what either say. We just like the way it looks and feels.

We were not exactly blown away by the **Callaway X-22's**, but we were favorably impressed with the **X-22 Tour** version. Somehow there was little new about the X-22's when it came to actually hitting the ball, but the X-22 Tour edition seemed cleaner and just as forgiving. The problem is the X-22 Tour's cost \$100 more, and the consumer isn't in the mood to pay up for anything.

We are going to offer a par to the structure of a set, rather than just to a name. Aside from a real core competency in hybrids, **Adams Golf** has come to dominate the Hybrid-iron set to an extent we had not thought possible. The Adams Hybrid iron sets collectively hold a huge share in the specialty off course channel.

**Bogies** – Everyone who charges \$200 more for graphite shafted irons versus steel shafted irons get a bogey on our book. All of you need to rethink how you get to market this year. Immediately.

If the incremental cost is \$32, then they need to charge \$64 more wholesale to maintain a 50% gross margin. Retailer margins run about 30%, so that should add an additional \$20. Therefore we see no reason why a graphite iron set should carry a premium price more than \$100 over steel shafted irons. C'mon guys, lets get with it.

## 5. Wedges

We have said for years now that we find very little to distinguish on well made wedge from another. With CAD/CAM techniques pervasive in the manufacturing community and the inputs to make an acceptable wedge well known, there is simply no reason to make a bad one. And frankly, no one does.

The change in the rules as it relates to grooves should make 2009 a banner year for wedge sales, as amateurs will still be allowed to use wedges that are registered as 2009 product beyond the January 1<sup>st</sup>, 2010 cut off date. Therefore we can see amateurs stocking up on grandfathered wedges. In fact, there will almost certainly be a serious run on wedges late in the year.

As we said, amateurs will still be allowed to use wedges that are registered as 2009 product beyond the January 1<sup>st</sup>, 2010 cut off date, but those same wedges will be illegal for PGA tour events and the U.S. Open. In our opinion, this means that **in 2010 we have officially bifurcated the rules!** The cat is out of the bag. We have advocated bifurcating the rules for many years now as a way to help grow the game by increasing the fun quotient for the average golfer. (add section from previous PGA report)

**Birdies** – Our contention is that wedges have become so good that a good player could play with **Titleist Vokey** wedges in April, **Nike SV Tour** wedges in May, **TaylorMade Z TP** wedges in June, **Callaway X-Tour** wedges in July, **Cleveland CG14** wedges in August, **Ping Tour-W** wedges in September, etc., and the players game would not suffer on bit. They're all great.

**Bogey** – Each great golf brand usually becomes a great brand by growing out of a particular core competency. Callaway grew from titanium drivers. TaylorMade from metal woods. Ping from putters. Titleist from golf balls. The list goes on. When that core competency comes under attack from competition, the response is often the same, try to blizzard the landscape with product to try to protect your turf. It rarely works well.

This is exactly what we see from **Cleveland Golf** in the wedge category. The wedge category was the core competency that Cleveland Grew from. Bt as we have expressed, there is little to differentiate one wedge from another in terms of the playing characteristics. The Cleveland response? From the Cleveland website we see three versions of the CG14 wedge, three versions of the CG12 wedge, and two versions of the 588 wedges. A major internet website also offers two versions of the 900 series wedges. Now with the preponderance of acceptable product out there, there is just no way that the distribution channel can carry 8-10 different style of wedges from one company. Therefore, the retailer is forced to decide for the end customer what wedge the end customer is most likely to buy. This is just a very difficult, if impossible task, and it causes the retailer to begin to default to other brands that offer a much simpler menu.

## 6. Putters

The putter category is another area where we see the consumer making a clear preference for technological innovation coupled with a value-oriented message. Clearly we believe that those brands priced under \$200 will have a much better chance of thriving in this environment, as long as they have a marketable technological story to marry with the value pricing structure.

**Birdie** – In the last year **Rife Putters** emerged as a brand that is taking market share and growing the top line in spite of the difficult environment. Rife packs a technology story, with specialized roll-groove putter face, two bar alignment technology, lie alignment fitting and adjustable weight-speed technology.

This all comes at a price less than \$200, and has found acceptance among touring pros despite the fact that Rife does not pay-for-play. Rife has become the number one putter on the Champions Tour. The key for Rife is to keep the momentum going and continue to build the brand, and some day they can branch out into other aspects of the club equipment business.



We also should point out that the **TaylorMade Spider** and the new **TaylorMade Itsy Bitsy Spider** has finally landed TaylorMade some much needed market share success in the putter business. Once again, we are talking about identifiable technology (high MOI) and an affordable price (less than \$200).



**Par** – The Odyssey White Hot XG 2-Ball F7 putter retails for less than \$200, and is packed with a combination of multiple technologies that Odyssey has employed in the past.

**Bogey** – We saw the recent announcement of the **Tour Edge Exotics** putter line that will initially retail for \$299. We say initially, because we don't expect that price point to last for long. We see very little chance of Tour Edge making much headway with this line in the putter market at this price point. Who would buy a Tour Edge for the price of a Scotty Cameron?

## 7. Golf Balls

This is a fascinating year for golf balls as we are likely to hear further developments in the saga of the golf ball patent case between Callaway and Acushnet. In a report on Callaway Golf we have opined on what we think a successful final judgment could be worth, but at this time we will not try to predict what the final outcome will be. What we have learned in studying the case and talking to various experts, is that patent law is very arcane and unpredictable. So we won't predict. We'll just observe.

**Birdie** – The introduction of the **Bridgestone Tour B330-RX** ball, the ball with tour performance geared towards amateur swing speeds, seems to have hit a nerve with the golf consumer. One competing executive told us that it's a good ball. Another told us that the ball was just short. We played it, and it *wasn't* short and it *was* good. The introduction came in a vacuum of new products, and it came at a time where technological innovation in a golf ball was welcome because golf balls are consumables. And consumables are the stronger part of the market.



We also should recognize that TaylorMade has finally hit the market with a golf ball that seems to have resonated with their tour staff and with the public with the introduction of the **TaylorMade TP Red** and **TP Black**. We also found the concept of allowing customers to put their own personal number on the ball to be innovative and smart.



**Par** – We have a new iteration of the **Titleist Pro-V1** series. Whether this ball is the direct result of the patent case or not, we hit it and found that it is very unlikely that anyone could tell the difference between the old ball and the new ball. Given the huge market share that the ball enjoys, we would count this as a good thing. What was necessary was to repeat the Coke/Coke Classic fiasco.

## 8. Shafts

**Birdie** – We have heard the feedback from the tour on the **Aldila Voodoo** shaft has been very strong. The shaft has an innovative coil under the outer skin of the shaft that reduces the amount of deformation of the shaft and therefore returns more snap to the club. Aldila has made a camouflaged VooDoo specifically for Boo Weekly.



**Par** – We are going to give a par to a business model rather than a shaft. Over the last decade, **True Temper** has basically monopolized the steel shaft business. Competitors have been eliminated, equipment has been mothballed or decommissioned, and in tough economic times it is a great equalizer to have a large segment of the business captured.

## 9. Custom Fitting

This is a new category, but we have tried many now, and we have found our favorites.

**Birdie** – The **Bridgestone Golf Challenge**, which involves using your own ball on a golf monitor, then having the custom fitter tell you what Bridgestone ball you will hit better, then trying that ball on the golf monitor, is just a great idea. Of course, it helps when the Bridgestone ball results in superior performance, which might not be guaranteed, but anything that gets the customer engaged is a positive for the brand.

The **Rife Custom Fitting Putter Studio** was the most extensive we have seen just for putters. We are sure others will say theirs is better, but we found this experience to be the best. It might have had something to do with draining about nine 15 footers in a row with the putter that the solution said should work best for us. Remember, it's all about performance enhancing solutions that do not require steroids.

**Par** – The **TaylorMade Performance Lab** was about as comprehensive through the bag as it gets, with swing analysis coupled with technical fitting solutions that found us wanting to walk out with a bag of clubs. The one area where it fell off a little was the putting module, where in stroke testing you don't use a real golf ball, but a sort of Styrofoam substitute. It's like asking if my practice stroke and my real stroke are the same. They're not. But from driver to wedge this is the best.

**The Blue Ribbon** – We only handed out one Eagle, and that went to the Tour Edge Bazooka QLS Hybrid. We urge you to seek it out and try it. If you can't hit this club, quit the game.

**The Red Ribbon** – The Callaway Diablo Driver. To see a major equipment company make a tour commitment to a \$299 driver is a remarkable sea-change, and one that recognizes that consumer buying attitudes have changed.

**The Yellow Ribbon** -- The Bridgestone Tour B330-RX golf ball. Any ball from outside the top four brands that can grab a decent market share in the hyper-competitive golf ball category is worthy of a colored ribbon.

**The Black Ribbon** (The worst idea) – In an amazing feat, Tour Edge gets the blue and the black. The introduction of the Exotics putter for \$299 seems to us the most ludicrous idea of the year. See ya' on the sale rack!

We hope you enjoyed this year's report. We look forward to updating you with our views in the future.

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**ANALYST CERTIFICATION**


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I, Casey Alexander, certify that all the views expressed in this research report accurately reflect my personal views of the subject company (ies). I also certify that I have not and will not receive compensation with respect to the issuance of this report.

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**REQUIRED DISCLOSURES**


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In the normal course of business, Gilford Securities seeks to perform investment banking and other services for various companies and to receive compensation in connection with such services. As such, Gilford Securities intends to seek compensation for investment banking services from the subject companies in the next 3 months.

**Callaway Golf is rated a Buy. No other company mentioned here is currently rated by Gilford Securities, Inc.**

**The author is also the portfolio manager of a hedge fund. The fund has a long position in Callaway Golf.**

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**ANALYST STOCK RATINGS**


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**Buy** The stock should outperform its industry or peer group by 20% or greater within a 12-18 month time frame.

**Sell** The stock is expected to under-perform its industry or peer group by 20% or greater within a 12-18 month time frame, or where fundamentals of a company have deteriorated significantly and the stock is expected to materially depreciate.

**Hold** The stock does not have enough upside or downside potential to rate a Buy or Sell. The stock is either fairly valued or has too much uncertainty to have a Buy or Sell rating.

**Distribution of Gilford Rating (As of 12-22-08)**

Category	Coverage	IB Services*
Buy	75.0%	16.7%
Hold	20.83%	0%
Sell	4.17%	0%

\* Percentage of companies within this category for whom Gilford has provided investment banking (IB) Services within the last 12 months.

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