

January 29, 2020

Casey Alexander

646.448.3027

[calexander@compasspointllc.com](mailto:calexander@compasspointllc.com)

# Golf Equipment & Entertainment 2020 PGA Merchandise Show Report

Flash Note



PGA™

2020 MERCHANDISE SHOW

We attended the 2020 PGA Merchandise Show last week on Orlando FL. What follows are our observations as they pertain to the golf equipment industry.

## General Golf Industry Impressions.

For years, we have seen the industry leaders glad-speak the industry while the actual on-the-ground industry participants delivered an underlying tone of struggle. In a business that was undergoing a long-term decline in participation, working down from ~30M to ~22M participants, that struggle was not unexpected. But like many industries that have gone through similar periods (US Steel industry, US Auto industry) you inevitably reach a point where if you have survived this long, any spark of growth almost immediately offers improved economics and a significantly improved outlook. The first year of improved US golf rounds played in 3 years seems to be offering the US golf industry that spark.

US golf rounds played are going to increase 1%-2% YoY when December rounds played are reported. The year is finishing strong with August-November all producing YoY rounds played gains. And with Pellucid/Edgehill Consulting offering a prediction of a 4% improvement in weather in 2020, there is ample reason for an improved outlook, and consequently our empirical observation is that 'on-the-ground' industry participants are feeling fairly bullish for the first time in years.

## Exhibit 1. Changes in Consumer Attitudes Since 2010



Source: Sports & Leisure Research Group Presentation 1-22-20, Compass Point Research.

As it relates specifically to the equipment business, we have settled into the 'Core Four' of Callaway Golf (ELY – Buy, \$26.00 PT), Acushnet (GOLF – Sell, \$24.25 PT), PING and TaylorMade. For the second straight year TaylorMade chose not to exhibit at the PGA Merchandise Show, and we believe this was a mistake.

Participants seemed to be engaging brands and excited about stories, and most importantly for those that attended, TaylorMade was not a part of the discussion, *and seemingly was not missed*. Amid rumors that the private equity firm that owns TaylorMade is teeing the company up for a sale, and thus saving the expense of the Show seems a reasonable short term path to enhance EBITDA, there is nothing more dangerous in the golf equipment business as losing relevance.

At the Demonstration Day, the booths of ELY, GOLF and PING were so busy that spillover traffic landed in booths such as Puma/Cobra, Srixon and Wilson. TaylorMade is simply allowing secondary and tertiary brands to invade their space. We heard from multiple sources that TaylorMade is also reducing advertising dollars. We have learned through the years that golf equipment is not made to be bought; equipment has to be sold. We are sure our friends at TaylorMade will have an answer for every charge here, but we listen to what those who buy products have to say, and the chatter is not encouraging.

### **AI = All In on Artificial Intelligence**

In the 20+ years of covering the golf equipment space we have seen many changes, both in equipment and society. It seems that in a world dominated by broad-scale technological innovators such as Amazon, Uber and Tesla, that the consumer now expects a high degree of technological differentiation to improve their lives and the products that they buy. Thus, the introduction of artificial intelligence (AI) and machine learning into the design protocol for golf equipment was not only inevitable, but eventually necessary in order to compete for customer investments that require such technological differentiation. And make no mistake about it, golf equipment is an investment in the eyes of an avid golfer.

We came away from the PGA Merchandise Show more convinced than ever that Callaway Golf (ELY – Buy, \$26.00 PT) is on the right track with their AI design protocol, and long term the result will be greater market share that accompanies the first mover advantage in any major product innovation within the golf equipment industry. And what is unique here is that the protocol extends across the entire product line and is not just contained to a driver design or an iron design.

The new protocol offers several questions which are yet unanswered, such as “You hit it, does it work?” While that seems like a compelling question, it begs the reality of the golf equipment business; that golf clubs are meant to be *sold, not bought*. Marketing, and the capital to market *well* creates stories that engage customers, and at the end of the day what works is what the customer *believes works the best*. And in today's society, no one believes any longer that the next great design is coming from a guy in the garage tinkering on his workbench. They believe that technology is sophisticated, and AI is a tool necessary to make successful products.

---

### **Exhibit 2. Callaway Mavrik Driver and Iron.**



*Source: Callaway Golf, Compass Point Research.*

---

Lead time matters in this business. Every breakthrough products, many of which we cataloged in [our most recent Callaway report](#) (Big Bertha, Tight Lies, Solid Core ball, Two-ball putter, etc.) impacted market share positively for years. They were all eventually copied or inferred that they were using that technology and more. But the market always rewarded the first mover with a market share shift that lasted for years. We expect nothing different in this case, including claims that “we use it too” to “we do something similar but better.” But in following the ELY story we believe it is notable that ELY has been working on this for 3 1/2 years *before ever producing the first product!* And that product, Epic Flash, has been a tremendous success. In 2020 ELY is introducing Mavrik which has used the AI design protocol for drivers, fairway woods, utilities and irons.

How unique is it? The AI program taught the ELY designers that the weight had to be unique for each loft within the iron set in order to maximize performance. From a manufacturing and tooling standpoint, this created significant challenges in that there is simply no longer a one-size-fits-all manufacturing process. The face balance and weighting to the 8-iron is entirely unique to that of the 9-iron and this continues to be so throughout the bag.

There is a gold mine of product extensions as the ELY software engineers continue to ‘teach’ the supercomputer how to ‘learn’. The current process is just in its infancy, but the lead time is substantial. Those that do not have the capital and time to put something similar into play may find that their days are eventually numbered. This is consistent with the history of the golf equipment business which regularly loses companies that fall behind the curve in innovation.

**Acushnet: We Like Everything (but the Price).**

We have always liked almost everything about Acushnet Holdings ([GOLF](#) – Sell, \$24.50 PT) outside of the current valuation which we believe is extended well beyond fair value. As much as we admire Acushnet’s products, management and market position, our disciplined framework simply does not allow us to overpay for any company in the golf equipment business.

That being said, we discovered several positive macro notes that should have a beneficial impact on [GOLF](#) in the coming year. We learned from Jon Last, whose survey work at Sports & Leisure Research Group is excellent, that across the equipment space we should expect flat unit volumes and increased average selling prices (ASPs) with the *exception of golf balls* which are expected to have increased unit volume. According to Mr. Last, golfers *always* expect to play more in the coming year than they did in the preceding year, and if that is their expectation then it makes perfect sense that they would project to increase the amount of golf balls that they would buy.

But we match Jon’s research off with that of Pellucid Corp/Edgehill Consulting which projects that 2020 Golf Playable Hours (GPH, a measure of how many hours are available for golfers to play given the constraints of adverse weather) and we learned that after two of the most miserable years in terms of available GPHs, it is their expectation that GPHs will increase by 4% in 2020. They further project that with the increase in available hours available to play, that US rounds played are going to follow accordingly and should increase as well in 2020. Golf balls are consumables, so if rounds played increase, consumption of golf balls should also increase, and as the market share leader in golf balls this dynamic certainly favors [GOLF](#) to a greater extent than most competitors.

Since golf balls are arguably the most important sales category for [GOLF](#), this is all good news. As a member of the ‘Core Four’ of relevant golf equipment companies, we admire the strength of the overall platform at [GOLF](#), we just feel as though the current price has more than recognized the value of the EBITDA stream, and we believe that the downside risk argues reducing positions in [GOLF](#) at current levels.

### Wearing Our Feelings on our Sleeve When it comes to Apparel.

We have never been great fans of the apparel business but given the exposure that ELY has to apparel through Travis Matthew (TM), it was at least worth our while to investigate the apparel business. What we learned is that TM has moved into the top ten within the US golf apparel segment. While Foot Joy (a division of Acushnet), Nike, and Adidas still dominate the golf apparel category, it is safe to say that the YoY growth rate of TM dwarfs the other three.

Since 80% of all golf apparel sales reportedly takes place at on-course shops, it is instructive that TM has a larger market presence than the Callaway Golf apparel brand. The Callaway brand, which is licensed to Perry Ellis, has a big box distribution scheme which means it is not exposed to the most important channel for golf apparel sales. We feel that when the ELY/Perry Ellis distribution deal expires in 2-3 years, that ELY will reassert control of the brand and begin to push it through the on-course channel. In effect, ELY can make a high value acquisition at no cost when the Perry Ellis/Callaway licensing deal expires.

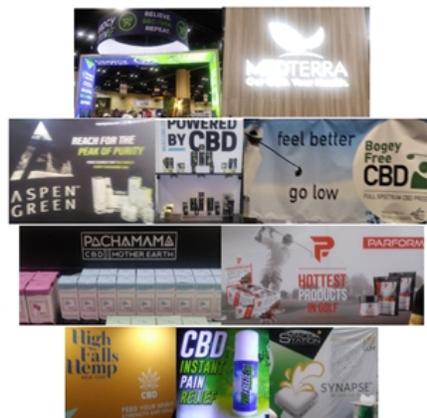
### CBD Goes Mainstream in Golf.

One of the surprises at the PGA Show was the proliferation of companies exhibiting CBD products. While we are not anywhere near as well versed on the subject as our colleague Rommel Dionisio who covers the Cannabis Industry for Compass Point, our long history within the golf industry certainly allows for some cogent observations.

1. Five years ago, the PGA of America would have never allowed companies to exhibit CBD products. Now professional golfers such as Bubba Watson endorse CBD products.
2. The golf industry is not populist by nature. This is a fairly midstream conservative group of people. If CBD has successfully penetrated the golf industry to this extent, it seems inevitable that CBD 'has legs' and is moving into mainstream society very quickly.
3. Based upon our assessment of traffic at the CBD booths, expect to see CBD products in almost every golf shop in the country by 2021.

Why is CBD proliferating within the golf industry to the extent it has? Because golf serves an aging, fanatical population. This aging population has more pain characteristics than most recreational sports exhibit, and CBD plays to the fanatical desire to keep playing while managing the pain. In our view, CBD balms and lotions are akin to 21st Century Ben-Gay. For greater depth on the cannabis market we would point investors to [Rommel Dionisio's initiation report on Charlotte's Web \(CWBHF – Buy, \\$12 PT\)](#).

### Exhibit 3. Various CBD Exhibitors at the 2020 PGA Merchandise Show



Source: 2020 PGA Merchandise Show, Compass Point Research.

**Topgolf NIMBY.**

The debate as to whether Topgolf is acting as a feeder system for 'real' golf continues. On one hand, the idea that you put a golf club into the hands of millions of new potential customers every year simply begs logic to suggest that some of them are more likely to try 'real' golf. Of course, they are. But the Pellucid/Edgehill folks make a decent argument that you don't want to be the golf course that lies within a couple miles of the new Topgolf. That probably doesn't help your business attract those millennials that are ready to try golf.

We learned on our recent non-deal roadshow for ELY in December that surveys suggested that 25% of new golfers were exposed to golf for the first time at a Topgolf location. How many of those would have found their way to 'real' golf without Topgolf? That is impossible to say, but we can argue that those that do go through the Topgolf protocol have likely already progressed past the infant stage as it relates to effectively hitting the ball, and therefore the likelihood that their early experiences on an actual golf course are likely to be more successful, and therefore they are also more likely to stick with it. Given that one of golf's significant challenges is retention of beginners, that can only be a good thing.

**Summary.**

The Pellucid/Edgehill forecast of 4% better weather and increased available hours to play argues for increased US rounds played again in 2020. Further, reports of clean inventory channels suggest that the potential for rounds played growth can leverage into increased sales for equipment manufacturers, even if it comes from increased ASPs against flat unit demand. We perceive the reduced relevance of TaylorMade may offer continued market share opportunities for the remaining three companies from the 'Core Four'; ELY, GOLF and PING. The equipment industry is still a 'Steel Cage Battle Royale' for market share, and until we see sustainable growth in participation, we judge that condition will generally remain. And we believe that the artificial intelligence design protocol employed by ELY is going to impact club and ball designs for years to come and could cause a dynamic shift in long term market share.

**Valuation and Risks:**

**Callaway Golf Valuation:** Our \$26.00 price target assumes an EV/EBITDA multiple of 11.0x on our 2020 EBITDA estimate plus ~\$5.00 per share for ELY's Topgolf 14% stake. **Callaway Golf Risks include but are not limited to:** Revenue, earnings and EBITDA that fail to meet estimates; acquisitions that perform below expectations; foreign currency risk; consumer confidence risk; supply chain risk; regulatory risk coming from rule changes that impact club and ball designs; and intellectual property and patent risk.

**Acushnet Holdings Valuation:** Our \$24.25 price target reflects an EV/EBITDA of 9x on the average of our 2020 EBITDA estimate. **Acushnet Holdings Risks include but are not limited to:** Revenue, earnings and EBITDA that fail to meet estimates; acquisitions that perform below expectations; foreign currency risk; consumer confidence risk; supply chain risk; regulatory risk coming from rule changes that impact club and ball designs; and intellectual property and patent risk.

**Charlotte's Web Valuation:** Given Charlotte's Web's powerful brand equity, its leading market positioning in the fast growing CBD products category, its rapidly growing retail distribution platform, and significant potential upside to estimates when the FDA outlines a regulatory framework for CBD edibles and beverages, we believe shares of CWBHF should trade at an Enterprise Value/2020 Revenue multiple of 8.5x, which generates our price target of \$12. **Charlottes Web Holdings Risks include but are not limited to:** Uncertainty regarding FDA regulation; Deep pocketed competition; Consumer preferences in the nutritional supplement industry; New management team; and Agricultural related risk.

# Important Disclosures

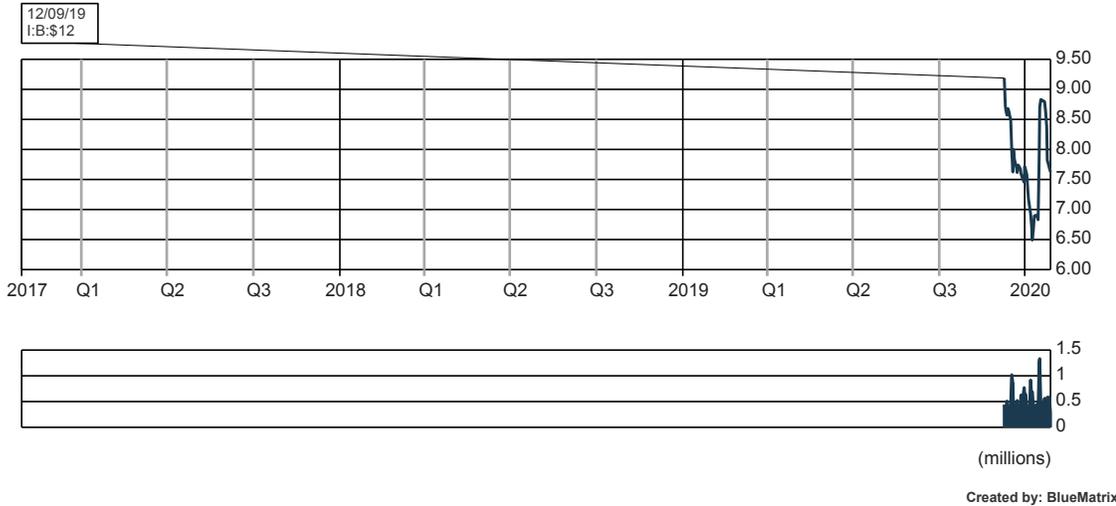
## Analyst Certification

I, Casey Alexander, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities or issues. I further certify that I have not received direct or indirect compensation in exchange for expressing specific recommendations or views in this report.

Coverage Universe			Investment Banking Relationships		
Rating	Number	Percent	Rating	Number	Percent
Buy	83	55	Buy	10	12
Neutral	63	42	Neutral	10	16
Sell	5	3	Sell	0	0
Total	151	100%	Total	20	100%

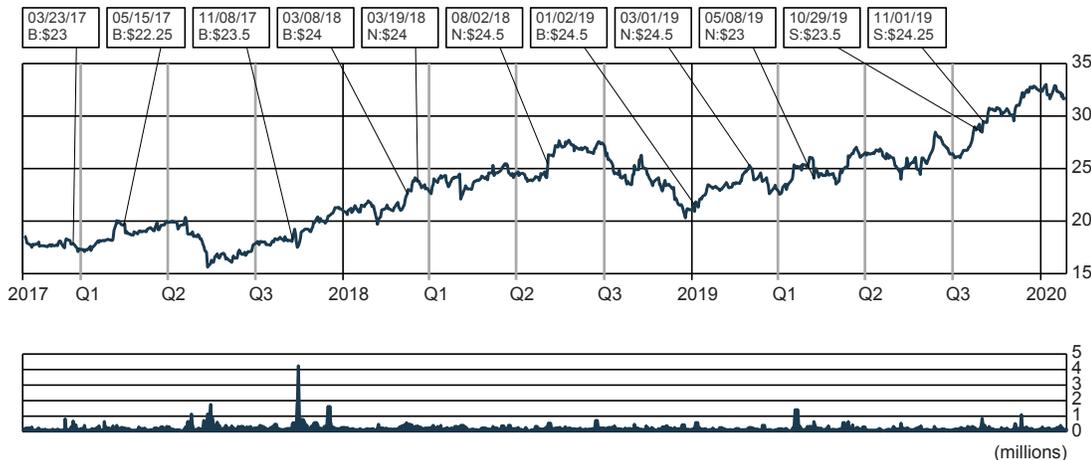
\*Percentage of Investment Banking Clients in Coverage Universe by Rating

### Rating and Price Target History for: Charlotte's Web Holdings (CWBHF) as of 01-27-2020



### Rating and Price Target History for: Callaway Golf Co. (ELY) as of 01-27-2020



**Rating and Price Target History for: Acushnet Inc (GOLF) as of 01-27-2020**

Created by: BlueMatrix

**Ownership and Material Conflicts of Interest****Ratings, Coverage Groups, and Views and Related Definitions**

The information and rating included in this report represent the long-term view as described more fully below. The analyst may have different views regarding short-term trading strategies with respect to the stocks covered by the rating, options on such stocks, and/or other securities or financial instruments issued by the subject company(ies). Our brokers and analysts may make recommendations to their clients that are contrary to the recommendations contained in this research report. Such recommendations or investment decisions are based on the particular investment strategies, risk tolerances, and other investment factors of that particular client or affiliate. From time to time, Compass Point and its respective directors, officers, employees, or members of their immediate families may have a long or short position in the securities or other financial instruments mentioned in this report.

**Stock Ratings System:**

Buy (B): We expect the stock to outperform its peers on a risk adjusted basis over the next 12 months.

Neutral (N): We expect the stock to perform in line with its peers on a risk adjusted basis over the next 12 months.

Sell (S): We expect the stock to underperform its peers on a risk adjusted basis over the next 12 months.

Not Rated (NR): No rating at this time. Rating Suspended (RS): Compass Point Research has suspended the investment rating and price target for this stock, because there is not a sufficient fundamental basis for determining an investment rating or target. The previous investment rating and price Compass Point has suspended coverage of this company. Not Covered (NC): Compass Point does not cover this company. Not Available or Not Applicable (NA): The information is not available for display or is not applicable. Not Meaningful (NM): The information is not meaningful and is therefore excluded.

**Global Disclaimer**

Compass Point Research & Trading, LLC expects to receive or intends to seek compensation for investment banking services from the subject company(ies) in the next 3 months.

The research analyst(s) named in the certification above receives compensation based upon various factors, including, but not limited to, the quality and accuracy of research, client feedback, competitive factors, and overall firm revenues, which include revenues generated by Compass Point Research & Trading, LLC's investment banking activities.

This report is based upon public information that Compass Point Research & Trading, LLC and the research analyst named in the attestation above assume to be correct.

---

Assumptions, opinions, forecasts, and estimates constitute the research analyst's judgment as of the date of this material and are subject to change without notice. The research analyst's judgments may be wrong.

Neither Compass Point Research & Trading, LLC nor its affiliates, nor the research analyst, are responsible for any errors, omissions, or results obtained from the use of this information.

Past performance is not necessarily indicative of future results.

The securities and/or financial instruments mentioned in this research report, and the trading strategies related thereto, may not be suitable for all investors. You must consider your specific investment goals and objectives prior to transacting in any security or financial instrument. Consult with your financial advisor before making any transactions or investments.

© Compass Point Research & Trading, LLC 2020. All rights reserved. Reproduction or quotation in whole or part without permission is forbidden.