Identifying Ratios – Adams and Callaway Golf

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Student Name

Business Finance
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Moderator Name

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The purpose of this paper is to identify the specific ratios related to the financial bases of the Adams Golf and Callaway Golf companies. The two companies will be compared to see if either one is a safer investment. Data for financial ratios come from the balance sheet, the income statement, and the cash flow statement.

Adams Golf was founded 1987 by Barney Adams. Then a golf equipment component supplier and contract manufacturer in West Texas, Barney moved the company to Dallas in the 1990s to concentrate on custom fitting and new product development. Through Barney's experience of custom-fitting golfers and witnessing the response of numerous club designs and materials, he developed the revolutionary Tight Lies fairway wood. With its low profile, low center of gravity and upside-down head design, Tight Lies created a phenomenon in the golf industry. Through the years it has received rave reviews and unprecedented loyalty (Adams Golf, 2006).

Adams Golf designs, markets, and distributes a range of exceptional brands including innovative drivers and fairway woods such as Redline and Ovation, as well as the #1 hybrid irons in golf, the IDEA Irons. All of the equipment at Adams Golf is designed and tested using a variety of sophisticated, state-of-the-art tools, such as CAD rendering, advanced mass property analysis and equipment durability testing (Adams Golf, 2006).

The Company was incorporated in 1987 and re-domesticated in Delaware in 1990. The Company completed an internal reorganization in 1997 and now conducts its operations through several direct and indirect wholly-owned subsidiaries, agencies and distributorships (Adams Golf Company’s 2005 Annual Report). Adams Golf targets a more diverse customer base in that the costs of clubs are not as high as the more expensive and more exclusive Callaway golf clubs. This allows amateurs to obtain good quality clubs, at a lower price.

Ely Callaway, a successful vineyard owner from California, founded Callaway Hickory Stick USA in the early 1980’s after seeing a golf club with a shaft made out of hickory with steel inserted in the middle. Callaway bought a half interest in Hickory Stick USA and renamed the company. He applied a successful formula he had used with his vineyard: hire the smartest people and think big. Richard C. Helmstetter was lured away from his successful company designing billiard cues in Japan to become the Chief Club Designer, and Callaway Hickory Stick USA began carving a niche as a small manufacturer of unique high-performance golf equipment. "Mr. C," as employees affectionately came to call him, bought out his partners and renamed the company Callaway Golf—relocating it from Cathedral City, California to a sleepy seaside town called Carlsbad, just north of San Diego (Callaway Golf, 2006).

In the '90s, Ely Callaway and his company changed the golf industry in ways no one could have anticipated. Richard Helmstetter and his R&D department found a way to create a stainless steel driver that had a larger and more forgiving head than any previous design. Mr. Callaway dubbed the club "Big Bertha" after a World War I German cannon famous for long-distance capabilities. He ordered an unprecedented 300,000 club heads from the casting house and financed part of the cost with his own money. The success of the Big Bertha and its progeny made Callaway Golf the No. 1 golf club company in the world and Mr. C became an icon by making the game more enjoyable for the average golfer (Callaway Golf, 2006).

Callaway Golf Company (the “Company” or “Callaway Golf”) was incorporated in California in 1982 and reincorporated in Delaware on July 1, 1999. In 1997, the Company acquired substantially all of the assets of Odyssey Sports, Inc., which manufactured and marketed the Odyssey brand of putters and wedges. In 1998, the Company began a reorganization of its international operations by acquiring the distribution rights in certain key international markets. As a result, during 1998 through 2001, the Company acquired distribution rights and substantially all of the assets from its distributors in Japan, France, Belgium, Norway, Denmark, Germany, Japan, Ireland, Spain, Canada, Korea and Australia. In 2000, the Company entered the golf ball business with the release of its first golf ball product. In 2003, the Company acquired through a court-approved sale substantially all of the golf-related assets of the TFGC Estate Inc. which included golf ball manufacturing facilities, the Top-Flite and Ben Hogan brands, and all golf-related patents and trademarks (the “Top-Flite Acquisition”). Beginning in 2001, the Company and its participating retailers partnered with FrogTrader, Inc. to develop the Trade In! Trade Up! program. In 2004, Callaway acquired all of the issued and outstanding shares of stock of FrogTrader (which subsequently changed its name to Callaway Golf Interactive, Inc.). The Company acquired FrogTrader to stimulate purchases of new clubs by growing its Trade In! Trade Up! program and to enable the Company to better manage the distribution of pre-owned golf clubs and the Callaway Golf brand. The Company currently has the following wholly-owned operating subsidiaries: Callaway Golf Sales Company, The Top-Flite Golf Company, Callaway Golf Interactive, Inc., Callaway Golf Europe Ltd., Callaway Golf K.K., Callaway Golf Korea Ltd., Callaway Golf Canada Ltd. and Callaway Golf South Pacific PTY Ltd.

Callaway Golf, together with its subsidiaries, designs, manufactures and sells high quality golf clubs (drivers, fairway woods, hybrids, irons, wedges and putters) and golf balls. The Company also sells golf accessories such as footwear, golf bags, golf gloves, golf headwear, golf towels and golf umbrellas. The Company generally sells its products to golf retailers (including pro shops at golf courses as well as off-course retailers), sporting goods retailers and mass merchants, directly and through its wholly-owned subsidiaries, and to third party distributors.

The Company also sells pre-owned golf products through its website, www.callawaygolfpreowned.com. The Company's products are sold in the United States and in over 100 countries around the world. The Company's products are designed for the enjoyment of both amateur and professional golfers. Golfers generally purchase the Company's products on the basis of performance, ease of use and appearance. In addition, the Company licenses its trademarks and service marks in exchange for a royalty fee to third parties for use on products such as golf apparel, footwear, watches, travel gear and eyewear. The Company's business is seasonal and as a result approximately two-thirds of its sales occur during the first half of its fiscal year (Callaway Golf Company's 2005 Annual Report).

Both companies have obtained great success in the same market because of product design and innovation. In determining which company would be a better investment this paper will now look at the different financial ratios investors use to decide if they want to invest in a company or not.

There are several ratios to consider. To start with, there are the liquidity ratios which consist of the current ratio and the liquidity ratio. These ratios measure the ability to meet short-term financial obligations (Lasher, W., 2005). Compared side by side Callaway is the better of the two on these liability ratios. Callaway is 3.12 and Adams is 3.5.

"Asset management ratios address the fundamental efficiency with which a company is run. They help an analyst understand the firm's basic competitiveness." (Lasher, W., 2005). Callaway has a shorter Average collection period than Adams which shows that they are collecting money sooner than Adams. Callaway also has a better inventory turnover rate than Adams. Callaway seems to be managing their inventory better. Adams has a higher fixed asset ratio of 25.1 to Callaway's 7.8, but Callaway's total asset turnover is better than Adams'.

Callaway's debt percentage is about 40% and this causes them to have a much, much higher TIE and cash coverage. The profitability of Callaway to Adams has Callaway coming away the winner, but I believe some of my calculations are wrong because Adams had a 0.1% ROE, ROA, and ROS.

Adams Golf has a lower stock trading price at $1.46 compared to Callaway's $12.70. This causes Callaway's P/E ratio to be higher as is the market to book value.

As these ratios show, Callaway is the better investment of the two companies. Is Callaway a great investment? This is a hard question to answer, but I will venture out and say that it is a pretty good investment. Adams Golf on the other hand doesn't look so good, but my calculation could be wrong. Of the two, Callaway comes away the winner.

References

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	Adams	Callaway
Liquidity		
Current Ratio	3.50	3.12
Quick Ratio	2.10	1.41
Asset Management		
Avg. Collection Period	90.4	35.4
Inventory Turnover	1.9	2.4
Fixed Asset Turnover	25.10	7.80
Total Asset Turnover	1.30	2.28
Debt		
Debt Ratio	28.7%	40.0%
Debt : Equity	37.1	0.0
Times Interest Earned	24.80	181.80
Cash Coverage	25.20	198.60
Fixed Charge Coverage	--	--
Profitability		
Return on Sales	0.1%	13.0%
Return on Assets	0.1%	3.0%
Return on Equity	0.1%	2.0%
Market Value		
Stock Price	$1.46	$12.70
Price / Earning Ratio	0.29	2.56
Market to Book	0.876	7.62

CALLAWAY GOLF COMPANY

CONSOLIDATED BALANCE SHEETS
(In thousands, except share and per share data)

	December 31, 2005	December 31, 2004
ASSETS		
Current assets:		
Cash and cash equivalents	$ 49,481	$ 31,657
Accounts receivable, net	98,082	105,153
Inventories, net	241,577	181,230
Deferred taxes	38,192	32,959
Income taxes receivable	2,026	28,697
Other current assets	9,232	14,036
Total current assets	438,590	393,732
Property, plant and equipment, net	127,739	135,865
Intangible assets, net	146,123	149,168
Goodwill	29,068	30,468
Deferred taxes	6,516	9,837
Other assets	16,462	16,667
	$ 764,498	$ 735,737
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	$ 102,134	$ 75,501
Accrued employee compensation and benefits	24,783	20,215
Accrued warranty expense	13,267	12,043
Bank line of credit	—	13,000
Capital leases, current portion	21	39
Total current liabilities	140,205	120,798
Long-term liabilities:		
Deferred compensation	8,323	8,674
Energy derivative valuation account	19,922	19,922
Capital leases, net of current portion	—	26
Commitments and contingencies (Note 13)		
Shareholders' equity:		
Preferred Stock, $.01 par value, 3,000,000 shares authorized, none issued and outstanding at December 31, 2005 and 2004	—	—
Common Stock, $.01 par value, 240,000,000 shares authorized, 84,950,694 shares and 84,785,694 shares issued at December 31, 2005 and 2004, respectively	850	848
Additional paid-in capital	393,676	387,950
Unearned compensation	(9,014)	(12,562)
Retained earnings	430,996	437,269
Accumulated other comprehensive income	3,377	11,081
Less: Grantor Stock Trust held at market value, 5,954,747 shares and 7,176,678 shares at December 31, 2005 and 2004, respectively	(82,414)	(96,885)
Less: Common Stock held in treasury, at cost, 8,500,811 shares and 8,497,667 shares at December 31, 2005 and 2004, respectively	(141,423)	(141,384)
Total shareholders' equity	596,048	586,317
	$ 764,498	$ 735,737

CALLAWAY GOLF COMPANY

CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share data)

	Year Ended December 31,					
	2005		2004		2003	
Net sales	$998,093	100%	$934,564	100%	$814,032	100%
Cost of sales	583,679	58%	575,742	62%	445,417	55%
Gross profit	414,414	42%	358,822	38%	368,615	45%
Selling expenses	290,074	29%	263,089	28%	207,783	26%
General and administrative expenses	80,145	8%	89,878	10%	65,448	8%
Research and development expenses	26,989	3%	30,557	3%	29,529	4%
Total operating expenses	397,208	40%	383,524	41%	302,760	37%
Income (loss) from operations	17,206	2%	(24,702)	(3)%	65,855	8%
Interest and other income (expense), net	(390)		1,934		3,550	
Interest expense	(2,279)		(945)		(1,522)	
Income (loss) before income taxes	14,537	1%	(23,713)	(3)%	67,883	8%
Provision for (benefit from) income taxes	1,253		(13,610)		22,360	
Net income (loss)	$ 13,284	1%	$ (10,103)	(1)%	$ 45,523	6%
Earnings (loss) per common share:						
Basic	$ 0.19		$ (0.15)		$ 0.69	
Diluted	$ 0.19		$ (0.15)		$ 0.68	
Common equivalent shares:						
Basic	68,646		67,721		66,027	
Diluted	69,239		67,721		66,471	

CALLAWAY GOLF COMPANY

CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	Year Ended December 31,		
	2005	2004	2003
Cash flows from operating activities:			
Net income (loss)	$ 13,284	$(10,103)	$ 45,523
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation and amortization	38,260	51,154	44,496
Loss on disposal of long-lived assets	4,031	7,669	24,163
Tax benefit (reversal of benefit) from exercise of stock options	2,408	2,161	(982)
Noncash compensation	6,527	1,741	15
Net noncash foreign currency hedging loss	—	1,811	2,619
Net loss from sale of marketable securities	—	—	98
Deferred taxes	(3,906)	7,707	(8,320)
Changes in assets and liabilities, net of effects from acquisitions:			
Accounts receivable, net	2,296	(1,048)	12,698
Inventories, net	(65,595)	10,299	4,897
Other assets	7,583	1,554	(4,743)
Accounts payable and accrued expenses	32,740	(16,945)	(2,561)
Accrued employee compensation and benefits	5,121	(5,895)	(3,898)
Accrued warranty expense	1,224	(584)	(838)
Income taxes receivable and payable	26,676	(40,711)	4,004
Deferred compensation	(351)	(273)	1,572
Net cash provided by operating activities	70,298	8,537	118,743
Cash flows from investing activities:			
Capital expenditures	(34,259)	(25,986)	(7,810)
Proceeds from sale of capital assets	1,363	431	178
Acquisitions, net of cash acquired	—	(9,204)	(160,321)
Proceeds from sale of marketable securities	—	—	24
Net cash used in investing activities	(32,896)	(34,759)	(167,929)
Cash flows from financing activities:			
Issuance of Common Stock	14,812	20,311	17,994
Acquisition of Treasury Stock	(39)	(6,298)	(4,755)
Proceeds from (payments on) Line of Credit, net	(13,000)	13,000	—
Dividends paid, net	(19,557)	(19,069)	(18,536)
Other financing activities	(44)	—	(8,117)
Net cash (used in) provided by financing activities	(17,828)	7,944	(13,414)
Effect of exchange rate changes on cash and cash equivalents	(1,750)	2,595	1,488
Net increase (decrease) in cash and cash equivalents	17,824	(15,683)	(61,112)
Cash and cash equivalents at beginning of year	31,657	47,340	108,452
Cash and cash equivalents at end of year	$ 49,481	$ 31,657	$ 47,340
Supplemental disclosures (See Note 3 for acquisition-related disclosures):			
Cash paid for interest and fees	$ (2,096)	$ (1,384)	$ (835)
Cash paid for income taxes			

ADAMS GOLF, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(in thousands, except share and per share amounts)

ASSETS

	December 31,	
	2005	**2004**
Current assets:		
Cash and cash equivalents	$ 10,747	$ 16,367
receivables, net	14,171	9,317
Inventories, net	16,151	11,558
Prepaid expenses	754	234
Other current assets	27	138
Total current assets	41,850	37,614
Property and equipment, net	630	720
Other assets	1,622	44
	$ 44,102	$ 38,378

LIABILITIES AND STOCKHOLDERS' EQUITY

	2005	2004
Current liabilities:		
Accounts payable	$ 4,691	$ 3,876
Accrued expenses	7,284	7,584
Total current liabilities	11,975	11,460
Non-current liabilities	--	480
Total liabilities	11,975	11,940
Stockholders' equity:		
Preferred stock, $0.01 par value; authorized 5,000,000 shares; none issued	--	--
Common stock, $.001 par value; authorized 50,000,000 shares; 23,471,653 and 23,257,653 shares issued and 22,814,153 and 22,600,153 shares outstanding in 2005 and 2004, respectively	23	23
Additional paid-in capital	92,069	90,261
Deferred compensation	(2,570)	(2,298)
Accumulated other comprehensive income (loss)	888	(25)
Accumulated deficit	(55,147)	(58,387)
Treasury stock, 657,500 common shares, at cost	(3,136)	(3,136)
Total stockholders' equity	32,127	26,438
Commitments and contingencies		
	$ 44,102	$ 38,378

ADAMS GOLF, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share amounts)

	Years Ended December 31,		
	2005	**2004**	**2003**
Net sales	$ 56,424	$ 56,762	$ 50,879
Cost of goods sold	30,309	28,580	27,259
Gross profit	26,115	28,182	23,620
Operating expenses:			
Research and development expenses	2,285	1,847	1,721
Selling and marketing expenses	16,571	16,061	14,027
General and administrative expenses	7,063	7,174	5,994
Reversal of settlement expenses (benefit)	(1,771)	--	--
Reversal of restructuring expense (benefit)	(78)	--	(259)
Total operating expenses	24,070	25,082	21,483
Operating income	2,045	3,100	2,137
Other income (expense):			
Interest income	236	81	9
Interest expense	(6)	(13)	(51)
Other	1,052	76	25
Income before income taxes	3,327	3,244	2,120
Income tax expense	87	166	117
Net income	$ 3,240	$ 3,078	$ 2,003
Income per common share :			
Basic	$ 0.14	$ 0.14	$ 0.09
Diluted	$ 0.12	$ 0.12	$ 0.08

ADAMS GOLF, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Years Ended December 31,		
	2005	**2004**	**2003**

Cash flows from operating activities:			
Net income	$ 3,240	$ 3,078	$ 2,003
stments to reconcile net income to net cash provided by (used in) operating activities:			
eciation and amortization of property and equipment and intangible assets	447	562	1,503
rtization of deferred compensation	1,496	793	452
sion for doubtful accounts	557	1,224	443
ges in assets and liabilities:			
de receivables	(5,411)	(108)	(2,342)
entories	(4,593)	(3,500)	1,069
paid expenses	(519)	223	477
ome tax receivable	--	--	18
ıer current assets	110	(131)	127
ıer assets	(1,579)	--	98
counts payable	815	2,683	260
crued expenses	(303)	1,569	660
ıer non-current liabilities	(449)	(79)	(173)
let cash provided by (used in) operating activities	(6,189)	6,314	4,595
ws from investing activities:			
se of equipment	(338)	(347)	(308)
let cash used in investing activities	(338)	(347)	(308)
ı flows from financing activities:			
al payments under capital lease obligation	(43)	(59)	(35)
se of stock options	39	8	--
nancing costs	(2)	(15)	(24)
let cash used in financing activities	(6)	(66)	(59)
f exchange rate changes on cash and cash equivalents	913	331	296
ase (decrease) in cash and cash equivalents	(5,620)	6,232	4,524
l cash equivalents at beginning of the year	16,367	10,135	5,611
l cash equivalents at end of the year	$ 10,747	$ 16,367	$ 10,135
ental disclosure of cash flow information:			
t paid	$ 6	$ 13	$ 51
taxes paid	$ 88	$ 129	$ 114
ıpplemental disclosure of non-cash investing and financing activities - equipment financed with capital lease	$ 15	$ --	$ 152